SECURE Act 2.0 & ERISA Litigation

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Practical and Tactical Actions

- Contemplate necessary operational changes and timeline
- Consult with plan and payroll providers regarding their approaches to various provisions
- Discuss optional provisions with plan committees
- Consider plan design elements for incorporation
- Develop communications for various audiences
- Reconsider Roth savings strategies

SECURE 2.0

What we should be discussing with our clients… Right now!

Catch-up Contributions

MANDATORY – 2024 and Later

Does the Plan allow for Roth contributions?

Add Roth before 12/31/2023

OTHERWISE

Participants earning > $145K during 2023
can't make catch up contributions in 2024.

Roth Employer Contributions

- Optional – 2023 and later
- Vested Employer contributions can be Roth
- Applies to 401(k), 403(b) and government 457(b)
- Employee responsible for taxes
- Probably does not increase FICA or Medicare wages
- Probably reported on Form 1099R
- Probably not counted as compensation for plan purposes

Long-term Part-time Employees

MANDATORY – 2024 and later

LTPT become eligible to defer beginning in 2024

3 consecutive years (after 12/31/2020) with 500 – 999 hours

Match Student Loan Repayments

Optional – 2024 and later

Employee must annually certify payment made on loan

- Employer may rely on certification

Applies to "Qualified Student Loan Payment"

- Incurred on behalf of employee (not employee's children)
- Can't exceed Section 402(g) limit, less elective deferrals

Student loan payments were suspended Mar 2020. Reinstated Oct 2023

Match Student Loan Repayments

401(k), 403(b) and Gov't 457(b)

Match at the same rate as match on elective deferrals

Add deferrals and loan payments

Uncertain as to how this would apply to payroll period match

Match related to student loan must vest in the same manner as match on deferrals (100% if ACP safe harbor match)

Eligibility limited to employees who are eligible to receive match for elective deferrals.

Emergency Savings Accounts (ESAs)

Optional – 2024 and later

Plans can set up ESAs

- Limited to Roth accounts
- Limited to employee contributions
- No new contributions if ESA exceeds $2,500 (subject to indexing)
- Limit applies to portion of account "attributable to contributions" (i.e., not including earnings)

401(k), 403(b), Gov't 457(b)

Investment limited to interest bearing account or capital preservation fund

Emergency Savings Accounts (ESAs)

Must treat ESA savings like deferrals for purposes of the match	Match goes into match bucket, not into ESA
Limited to NHCEs	HCEs cannot contribute to ESA; But may withdraw from ESA
Can do auto-enroll up to 3%	
Withdrawal from ESA is treated like a qualified Roth distribution	Tax-free distribution of earnings

Increase Cash-out Limit

Optional for distributions in 2024 and later

Cash-out limit is currently $5,000

Impacts
- Auto rollovers
- Distributions without participant consent

Increased to $7,000
(not indexed)

Can implement operationally as of 1/1/2024 and amend by 2025

401(k), 403(b), Gov't 457(b)
(have until 2027 to amend)

Distributions: Emergency Distributions

Optional for 2024 and later

Unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses

- May rely on employee's written certification

Repayments allowed

Limits

- One per plan year
- Lesser of $1,000 or vested benefit

10% early distribution penalty does not apply

401(k), 403(b), Gov't 457(b)

Distributions: Domestic Abuse Withdrawals

- Optional for distributions in 2024 and later
- Limited to lesser of $10,000 (indexed) or 50% of vested benefit
- Made during 1-year period beginning on any date individual is victim of domestic abuse by spouse or domestic partner
- Does not apply to DB or QJSA plans
- Can repay
- 10% early distribution penalty does not apply
- Participant to self-certify that the incident of domestic abuse occurred
- 401(k), 403(b), Gov’t 457(b)

Distributions: Disaster Relief

Optional for disasters occurring on or after 1/26/2021

Similar to relief provisions for COVID and 2020 disasters

Big difference: Distributions limited to $22,000
(down from $100,000)

These distributions are different from hardship distributions

Double participant loan limits

Lesser of $100,000 or 100% of vested account balance

Loan repayment extension and suspension

- Can be automatic or upon participant request

Check FEMA.gov to see if disaster qualifies for relief

401(k), 403(b), Gov't 457(b)

Distributions: Terminally Ill Individuals

Effective for distributions made after 12/29/2022

10% early distribution penalty does not apply to terminally ill individual

- On or after doctor has certified employee has terminal illness
- Reasonably expected to result in death within 7 years

Not a new distribution event

401(k), 403(b), Gov't 457(b)

Distributions: QBADs

Recipient of Qualified Birth and Adoption Distribution (QBAD) can repay it to plan or an IRA

SECURE 1.0 did not impose a time limit for repayment

SECURE 2.0 limits repayment to 3 years, beginning on day after distribution received

Optional to add QBADs; mandatory repayment deadline

Effective for distributions made after 12/29/2022

401(k), 403(b), Gov't 457(b)

Safe Harbor Correction for Elective Deferral Failures

Optional on or after 12/29/2022

EPCRS has 0% QNEC correction for auto enrollment/auto increase plan if corrected by 9-½ months after end of plan year

- EPCRS has sunset of 12/31/2023

SECURE 2.0 makes safe harbor correction permanent

45-day written notice requirement

EXCESSIVE FEE LITIGATION

Newly Formulated Pleading Standard Based on Hughes v. Northwestern Univ.

In ERISA class actions, motions to dismiss are an important mechanism for weeding out meritless claims.

- “Divide the plausible sheep from the meritless goats.”

When analyzing a motion to dismiss, courts must “construe the complaint in the light most favorable to plaintiff, accept all well-pleaded facts as true, and draw reasonable inferences in plaintiff’s favor”.

A claim has plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.

Supreme Court Decision
Hughes v. Northwestern Univ. (Jan 24, 2022)

Supreme Court held (8-0 decision) that ERISA requires that plan fiduciaries monitor all plan investments and remove any imprudent ones.

As the Court explained, “even in a defined contribution plan where participants choose their investments, plan fiduciaries are required to conduct their own independent evaluation to determine which investments may be prudently included in the plan’s menu of options.”

If the plan fiduciaries fail to remove an imprudent investment from the plan within a reasonable time, they breach their duty.

Newly Formulated Pleading Standard Based on Hughes v. Northwestern Univ.

Glick v. ThedaCare, Inc. (7th Cir. July 2023)

Plaintiff argues that court should infer an imprudent decision-making process from:

- Fiduciaries failure to regularly solicit quotes or competitive bids, and
- Publicly available data comparing the ThedaCare plan with twelve allegedly comparable plans when it comes to recordkeeping fees.
  - The comparator plans paid a total annual recordkeeping fee of $20 to $45 per plan participant.
  - By contrast, the ThedaCare plan averaged a total annual recordkeeping fee of $97 per plan participant.

Before Hughes I and II

Dismissal of similar recordkeeping claims that relied on a price comparison of fees charged to other plans.

A failure to regularly solicit quotes or competitive bids from service providers does not, as a matter of law, breach the duty of prudence.

Newly Formulated Pleading Standard Based on Hughes v. Northwestern Univ.

These allegations move the recordkeeping claim from *possible* to *plausible*.

Together these allegations support an inference that ThedaCare engaged in an unreasonable—and therefore imprudent—decision-making process (or lack of process) when it came to selecting, retaining, and paying Transamerica for its recordkeeping and administrative services.

Newly Formulated Pleading Standard Based on Hughes v. Northwestern Univ.

Compare ***Kellogg***
(US DC, Western Mich. 2023)

Excess fee case was dismissed because the defense proved with fee disclosures that the plan participants were charged increasingly lower fees during the purported class period:

- $66 from 2016 to 2019
- $45 from 2019-2020
- $36 in 2021

What Conclusions Can We Draw

You are not required to use the lowest cost share class. But, if you are not using the lowest cost share class, you better have a good reason why – and document that reason

Your investment line-up should always include low-cost index funds (to minimize participants' claim that they were forced to use high-cost investment options)

A flat-dollar or per participant fee structure is not required under ERISA; asset-based fees and revenue-sharing are okay

- But you need to monitor fees, you need to know how much in fees the plan is paying to service providers
- Although not raised in either case, if the plan is paying recordkeeping fees with revenue-sharing, you should consider taking action to "levelize" fees across all participants

Periodically benchmark services and fees to establish that plan-related fees are reasonable


ESG

The 2022 ESG Rule, which took effect on January 30, 2023, permits, but does not require, the use of ESG considerations in investment selection by retirement plan fiduciaries.

The Rule is not a "per se" requirement to use ESG and clarifies that ESG factors may be considered as part of a fiduciary's ordinary risk-return analysis

The Rule does not allow fiduciaries to sacrifice the financial health of a plan to pursue other goals

Final Rule dovetails with the position taken by 15 Attorneys General that ESG factors should be used "to evaluate *Value* -- the risk and reward of a potential investment -- not *Values* -- a subjective preference as to whether a given business or entity merits investment based on the nature of its business."

- Ltr. From Fifteen Attorneys General to Senators Brown and Toomey and Representatives Waters and McHenry (Nov. 21, 2022), *available at* https://ag.ny.gov/sites/default/files/esg_letter_final.pdf.

The 2022 ESG Rule Encourages Consideration of Participants’ Preferences

One of the more nebulous provisions of the new rule: Participant preferences for investments can be considered in menu selection on the grounds that it can increase plan participation and deferral rates, thereby increasing retirement security.

- How should fiduciaries determine adequate participant interest?
- How much economic gain can be compromised in exchange for increased participation, if any?

How should a fiduciary consider a hypothetical ESG large-cap stock fund for a plan menu:

- Should the fiduciary compare it to other similar ESG funds or the entire universe of large-cap?
- *There is no special treatment for ESG funds, and a fiduciary should look generally at the risk and return for any and all large-cap equity funds available, whether they use ESG considerations or not.*

The issue of considering ESG in retirement plans is becoming increasingly polarized

- On January 26, 2023, twenty-five states sued the U.S. Department of Labor ("DOL") in connection with DOL's recent ESG rulemaking. Utah v. Walsh, N.D. Tex., No. 2:23-cv-0016-Z.
- The suit asserts claims under the Administrative Procedure Act stemming from alleged ERISA violations as well as an argument that DOL's new ESG rule is arbitrary and capricious.
- The plaintiffs seek a preliminary and permanent injunction and have asked the court to set aside the rule as unlawful.
- The district court did not delay the rule's effective date, and the DOL has not issued any temporary enforcement policy or compliance assistance publications.
- Hence, the 2022 ESG Rule is currently in effect (as of Feb 8, 2023), but that could change if the district court or the DOL postpones its implementation and enforcement while the legal challenge is pending.

LIMITLESS

2023 RPAG NATIONAL CONFERENCE