Fiduciary Hot Topics

Q1 2023

The Challenges for ESG Investing

- New proposed rules for ESG investing were published in 2021. This past November the Department of Labor issued final regulations. Over 200 comments were submitted regarding the proposed regulations. The majority were favorable. The new rules largely follow the proposed rule but with a few significant changes. The rule follows an executive order signed by President Biden in May 2021 directing federal agencies institute policies to protect against the threats of climate-related financial risk.

- ESG investing aims to generate returns by picking stocks based on environmental and social concerns and issues of corporate governance in addition to looking at the financial metrics of companies. ESG investing has grown rapidly as investors become increasingly concerned about such issues, especially climate change. Assets in ESG funds have increased in recent years and now are approaching $40 trillion. Even traditional asset managers who do not follow an explicit ESG strategy, are feeling pressure to adopt ESG policies t requiring consideration of factors other than traditional financial criteria in evaluating companies.

- As administrations have changed, the Department has gone back and forth over the years on its position regarding ESG investing. Generalizing, Democrats endorse the concept while Republicans are skeptical.

- At the very end of the Trump administration, the Department issued final regulations on ESG investing which made it difficult for plan fiduciaries to add ESG options to plan investments. Almost as soon as President Biden took office, his administration announced it would walk back these rules. The back-and-forth in Washington regarding ESG investing will most certainly continue. The response to the final regulations from Republicans in Congress was to introduce the Safeguarding Investment Options Act. This legislation would amend ERISA by limiting consideration of nonfinancial factors in investment decision making for defined contribution plans.

- Key takeaways regarding the final regulations:

- The core ERISA principle remains that the duties of prudence and loyalty require plan fiduciaries to focus on traditional risk-return factors in making investment decisions. The primary goal must be income security in retirement. Fiduciaries cannot sacrifice returns or take on additional risk in pursuit of other goals.

- Investment decisions must be consistent with the plan's investment and funding policies, but the new rule allows plan fiduciaries to consider the economic effects of factors such as climate change, gender equality and racial diversity.

- While the proposed rule was well received, there was some concern that these it went beyond allowing plan fiduciaries to consider ESG factors to requiring this. The final rule makes it clear that while ESG factors may be taken into account in making investment decisions, this is not required.

- The longstanding "tiebreaker" standard is streamlined and confirms that if fiduciaries conclude that competing investments equally serve the financial interests of the plan, fiduciaries may consider collateral benefits other than investment returns.

- The same standard applies to QDIAs as to other investments—i.e., the focus should be on relevant risk-return factors. The "tiebreaker" standard may be used in selecting a QDIA and unlike the proposed rule, additional documentation is not required when this approach is used. This contrasts with the Trump Rule prohibiting using any investment as the QDIA that has an ESG component.

- Fiduciaries may consider participant preferences for ESG investments. The rule does not address how to deal with conflicting participant preferences which will most often be the case.

- The approach to proxy voting in the proposed rule is retained. This rule eliminates the special standards and presumption against fiduciaries exercising shareholder rights in the Trump rule. The final rule makes clear that the fiduciary duty to manage plan assets includes voting shareholder proxies.

SECURE 2.0 Becomes Law

In December Congress passed the Consolidated Appropriations Act, 2023 which contains a large section covering retirement referred to as SECURE 2.0. As a reminder, SECURE 2.0 is seen as building upon or enhancing the Setting Every Community Up for Retirement Enhancement Act of 2019 (the SECURE Act). The Act can be broken down into the following summarized component parts:

Expanding Coverage and Increasing Retirement Savings

- *Expanding Automatic Enrollment in Retirement Plans* – Requires new 401(k) and 403(b) plans to include EACA at 3% (not more than 10%) auto deferral with annual 1% auto increase to 10% (not to exceed 15%). Amounts to defaulted into QDIA. Does not apply to SIMPLE, plans adopted before effective date, governmental or church plans, plans sponsored by businesses in existence for less than 3 years, or plans maintained by employers with 10 or fewer employees. Effective plan years after December 31, 2024.

- *Small Employer Pension Plan Startup Credit* – Increases credit for small employers from 50% of startup costs to 100% for employers with up to 50 employees and provides additional credit (except for defined benefit plans) for employer contributions (per-employee cap of $1,000). There are dollar limitations and a phase-in of the credit. These credits would be available to eligible employers if they adopt an existing plan (like a MEP or PEP). Effective taxable years after December 31, 2022.

- *Savers Credit Enhancement* – The credit is changed from a cash payment from a tax refund to a federal matching contribution (50% up to $2,000) that must be deposited into a taxpayer's IRA/retirement plan. The match is phased out It is subject to inflation adjustments on an annual basis making them more attractive. Effective for taxable years after December 31, 2026.

- *403(b) MEPs and PEPs* – 403(b) plans may now participate in multiple employer plans or pooled employer plans. Effective plan years after December 31, 2022.

- *403(b) Plans Use of Collective Investment Trusts (CITs)* – CITs are pooled investment vehicles designed exclusively for use with qualified plans. These vehicles are alternatives to mutual funds or separate accounts and allow for greater flexibility in investment design and often fee savings. They have been utilized by 401(k), 457, and other qualified plans for decades. Additional securities/banking legislation is still required to make these available in 403(b) plans. Stay tuned . . .

- *Required Minimum Distributions (RMD)* – Moves back the date by which retired participants are required to begin taking minimum distributions from their qualified plans. Age moved back to 73 starting as of January 1,

- 2023, and to 75 starting on January 1, 2033. Also surviving spouses can elect to be treated as the deceased employee for RMDs. Effective calendar years after December 31, 2023. Special needs trust for disabled beneficiary may provide for a charitable organization as the remainder beneficiary. Effective calendar years after enactment of Act.

- *IRA Catch Up Limit Indexed* – Subject to a COLA adjustment. Effective for tax years beginning after December 31, 2023.

- *Increasing Catch Up Limits Within Plans* – The COLA adjusted $5,000 catch up limit ($7,500 for 2023) will be raised to COLA adjusted $10,000 for participants who have attained age 60, 61, 62, and 63 but not age 65, before the close of the taxable year. Effective for taxable years after December 31, 2024.

- *Matching Contributions for Student Loan Repayments* – Employers can make matching contributions into their qualified retirement plans (401(k), 403(b), SIMPLE IRA) for employee repayments made on qualified student loans for higher education. Governmental employers also permitted to do so in 457(b) or another plan with respect to such repayment. For nondiscrimination testing purposes the plan may test separately employees who receive matching contributions on loan repayments. Effective plan years after December 31, 2023.

- *Military Spouse Retirement Plan Eligibility Credit for Small Employers* - $200 per military spouse (non-HCE) plus 100% of employer contributions (up to $300) made on behalf of military spouse (maximum $500) credit for small employers. Effective after enactment of Act.

- *Small Financial Incentives for Contributions* – Plan sponsors may provide small incentives (like gift cards) to employees to spur employee deferrals. Effective after enactment of Act.

- *Withdrawals for Emergency Expenses* – 10% excise tax does not apply to distributions used for emergency expenses which are unforeseeable or immediate financial need (personal or family emergency expenses). One distribution per year, up to $1,000, and repayable within 3 years (no additional emergency distributions during this period unless repayments made). Effective for distributions after December 31, 2023.

- *SIMPLE Plans* – Employer may make additional contributions to each employee in uniform manner that cannot exceed lesser of 10% of compensation or $5,000 (indexed). Effective for taxable years after December 31, 2023.

Catch-up contribution at age 50 increased by 10% for employers with no more than 25 employees. Employers with between 26-100 employees can provide higher deferral limits but only if they provide a 4% match or a 3% nonelective contribution. Effective taxable years after December 31, 2023.

- *Nontrade/business SEP* – Can provide domestic employees (e.g., housekeeper) retirement benefits under simplified employee pension (SEP). Effective taxable years after enactment of Act.
- *Automatic Portability* – Allows service provider to provide plans with automatic portability services. Includes automatic transfer of participant's default IRA (from prior plan distribution) into new employer's plan unless participant opts out. Effective 12 months after enactment of Act.
- *Starter Plans* – Employers that do not offer a retirement plan can offer starter 401(k) or safe harbor 403(b). Auto enrollment at 3 -15% with annual limit same as IRA contribution limit with additional catch-up beginning at 50. Effective plan years after December 31, 2023.
- *Safe Harbor for Employee Elective Deferral Failures* – If error (auto enroll or escalation) is corrected within 9½ months after end of year in which error occurred, favorably to participant, and consistently among similarly situated participant. Effective for errors after December 31, 2023.
- *Long-Term Part-Time Eligibility Accelerated* – Changes eligibility from 3 consecutive years of 500 hours worked to two consecutive years. Also extends the long-term part-time coverage rules to 403(b) plans that are subject to ERISA. Effective plan years after December 2
- *529 Rollover to Roth* – Tax- and penalty-free rollover of unused dollars (up to $35,000) from 529 accounts to Roth IRA over lifetime of beneficiaries. Subject to Roth IRA annual limits and 529 account must have been open for more than 15 years. Effective for distributions after December 31. 2023.
- *Emergency Savings Accounts* – Employers may offer their non-HCEs emergency savings accounts that link to their retirement plans. Can be auto enrollment at up to 3% (capped at $2,500). Once cap reached additional contributions directed to employee's Roth (if have one) or stopped until balance dips below maximum. Contributions receive Roth tax treatment and are included in determining matching contributions. No fees or penalties can be charged to the first four distributions from the account. Portable at separation from service or can be rolled into Roth plan or IRA.
- *ESOP Changes* – Deferral of tax for certain sales of employer stock to ESOP of S-Corp. Certain securities treated as publicly traded for ESOP. Effective for sales made after December 31, 2027.

Preservation of Income

- *Qualifying Longevity Annuity Contracts (QLACs) Made More Attractive* – QLACs are designed to begin payment towards the end of individuals' life expectancy. This helps to safeguard against running out of income later in life. The 25% limit would be removed, and spouses would be allowed to share QLACs as joint and survivor annuities. Effective for contracts purchased/received on date of enactment of the Act.
- *ETFs* – Makes access to exchange traded funds broader on variable annuity platforms. Effective for segregated asset account investments made on or after 7 years after date of enactment of the Act.

- *Partial Annuitization* – Account owners may now elect to aggregate distributions from retirement accounts and annuities for purposes of determining RMDs. Effective with enactment of Act.

Simplification and Clarification of Retirement Plan Rules

- *Recovery of Retirement Plan Overpayments* – Statutorily relieves fiduciaries from seeking inadvertent benefit overpayments, but if they do so the Act puts rules in place (no interest or additional amounts can be sought, if repaid in installments the aggregate cannot exceed the amount of the overpayment, consideration of hardship imposed on recipient, etc.). Clarifies that failure to obtain repayment does not impact qualified status of plan. Effective with enactment of Act

- *Reduction in Excise Taxes* – Excises taxes imposed for failure to take RMDs have been reduced from 50% to 25% and can be further reduced to 10% if corrected during a provided correction window. Effective for taxable years after enactment of Act.

- *Lost and Found* – DOL directed to create national online lost and found database for retirement plans. Database to be created no later than 2 years after date of enactment of Act.

- *Performance Benchmark for Asset Allocation Funds* – For designated investment alternatives ("DIA") held by a plan, the fiduciaries may use a benchmark that is a blend of different broad based securities market indices if it's reasonably representative of asset class holdings of the DIA; the blend is modified at least once per year to reflect changes in holdings of DIA; it's given to participants in easy to understand fashion; and, each index used would meet requirements standing alone. DOL to update regulations no later than 2 years after enactment of Act.

- *Elimination of Notices and Disclosures* – Certain disclosures, notices and plan documents would not have to be provided to unenrolled employees if they are given an annual reminder of their eligibility with election deadlines and any document they request to which they are entitled to receive otherwise. They must be given a summary plan description. Effective plan years after December 31, 2022.

- *Increasing Cash-Out Limit* - Changing the small amount cash-out threshold from $5,000 to $7,000. Effective for distributions after December 31, 2023.

- *Expanding the EPCRS* – Corrections for loan errors, IRAs, and additional safe harbors. Rev. Proc. 2021-30 to updated no later than 2 years from enactment of Act.

- *Elimination of the "first day of the month" Requirement for Governmental 457 Plans* – Elections may be made any time before compensation being deferred is available to participant. Effective taxable years after enactment of Act.

- *Provisions Relating Firefighters and First Responders* – Age 50 retirement rule extended for private firefighters, effective for distributions made after enactment of Act. Exclude service-connected disability retirement payments from income upon attaining retirement age. Effective taxable years after December 31, 2026.

- *Top Heavy Rules and Excludable Employees* – May perform top heavy test separately for excludable employees. Effective plan years after December 31, 2023.

- *Qualified Birth or Adoption Distributions* – Repayment of QBADs restricted to 3 years. Effective retroactively to 3-

year period beginning date of distribution.

- *Hardship Withdrawals* – Administrators may rely on employee certifications of hardship requirements. Effective plan years after enactment of Act. 403(b) hardship rules changed to mirror 401(k) rules. Effective plan years after December 31, 2023.

- *Domestic Abuse Distributions* – Allow penalty-free distributions from plans for domestic abuse victims equal to lesser of $10,000 or 50% of account balance. Distributions may be repaid over 3 years. Effective for distributions after December 31, 2023.

- *Family Attribution* – Updates to stock-related ownership attribution rules to address the inequities of spouses living in community property verses separate property states and parent and minor children. Effective plan years after December 31, 2023.

- *Increase Benefit Accruals* – Plans may be amended to allow for increase in participants' benefits, by due date of employer's tax return. Effective for plan years after December 31, 2023.

- *Terminal Illness Distributions* – Penalty free distributions for terminally ill individuals. Effective for distributions after enactment of Act.

- *Long-Term Care Premium Payments for Governmental Plans* – No longer must have plan directly pay insurance premiums. Effective distributions after enactment of Act.

- *Early Distribution* – Penalty free distribution extended to public safety officers with at least 25 years of service with sponsor. Effective distribution after enactment of Act. Penalty free distributions to corrections officers of state and local governments. Effective distributions after enactment of Act.

- *Federally Declared Disasters* – Creates permanent rules for Federally declared disasters occurring on or after January 1, 2021. Can take penalty free distribution up to $22,000 for affected individuals from plan/IRA. Taken into income over 3-year period and can be repaid. Amounts distributed prior to disaster for purchase of home can be recontributed and repayments of loans can be extended.

- *SIMPLE to Safe Harbor* – Employers can replace SIMPLE IRA with SIMPLE 401(k) or other 401(k) with required employer contributions, during the plan year. Effective plan years after December 31, 2023.

- *Long Term Care Bought with Retirement Dollars* – Plans can make penalty free distributions up to $2,500 annually for payment of premiums for high quality coverage long term care insurance contracts. Effective 3 years after enactment of Act.

- *Correction of Mortality Tables*

- *Benefit Statements* – For defined contribution plans, only one benefit statement annually must be provided in paper. The other three quarterly statements may be provided electronically, unless participant elects otherwise. Effective plan years after December 31, 2025. For defined benefit plans the statement provided every 3 years must be in paper, unless participant elects otherwise.

- *Tribal Government* – Tribal courts recognized as authorized under Federal law to issue qualified domestic relations orders. Effective for orders after December 31, 2022.

- *Department of Labor Undertakings* – A myriad of directives for the DOL to report to the Government Accountability Office or Congress regarding disclosure consolidation and improvements and what information should be provided to participants to make financial decisions, impact of inflation on retirement plans, and pooled employer plans (PEPs).

- *Group of Plans* – Plans filing under Group of Plans need only submit audit opinion if they have 100 participants or more. Effective after enactment of Act.

- *Cash Balance* – Allows plan sponsors to provide larger pay credits for older employees with longer service Effective plan years after enactment of Act.

Revenue Provisions

- *Catch Up Contributions Treated as Roth* – All catch-up contributions will be subject to Roth treatment (unless employee has compensation equal to or less than $145,000 indexed). Effective taxable years after December 31, 2023.

- *Treatment of Matching or Contributions as Roth* – Provides participants with the option of matching contributions on deferrals or student loan repayments to be treated as Roth contributions (including taxability). Effective on enactment of Act.

- *Retiree Health Benefits* – Sunset extended (to end of 2032) on ability of employer to use assets from overfunded pension plan to pay retiree health/life insurance.

For more information, visit [WEBSITE] or call [PHONE].