Retirement Plan Developments

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2020 DOL Fiduciary Regulation Proposal

Background

- ERISA imposes fiduciary obligations on investment advisers.
- There has been a push by the DOL over the past decade to expand the scope of who is considered a fiduciary investment adviser. Most recently, a major regulatory package was finalized in 2016, but then invalidated by a federal appeals court in 2018.
- This summer, the DOL issued another regulatory package addressing this issue. Currently, most of the regulatory package is in proposed form. Over 100 comment letters were submitted, and a hearing was held in early September 2020.

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2020 DOL Fiduciary Regulation Proposal, cont.

Definition of Investment Advice Fiduciary – "Five-Part Test"

- Enacted shortly after ERISA.
- Changed in the 2016 final regulation (now vacated). Restored by the 2020 regulatory action.
    - Render advice to the plan as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing, or selling securities or other property
    - On a regular basis,
    - Pursuant to a mutual agreement, arrangement, or understanding with the plan, plan fiduciary or IRA owner, that
    - The advice will serve as a primary basis for investment decisions with respect to plan or IRA assets, and that
    - The advice will be individualized based on the particular needs of the plan or IRA.

2020 DOL Fiduciary Regulation Proposal, cont.

2020 Proposal – Reversion to original five-part test with important expansions of scope:

- "On a regular basis" prong
  - Previously understood to require an ongoing investment advisory relationship for fiduciary status to arise.
  - DOL proposal states that an investment adviser can be a fiduciary upon the adviser's first advice to the client, if an ongoing relationship develops over time.
- "Pursuant to a mutual agreement, arrangement or understanding" prong
  - Previously understood that both parties had to be clear that the relationship was fiduciary in nature.
  - DOL proposal states that this prong can be satisfied based on the reasonable understanding of the parties, even if there is no mutual agreement or arrangement is demonstrated.

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2020 DOL Fiduciary Regulation Proposal, cont.

“Deseret Opinion” and Its Withdrawal

- DOL Advisory Opinion 2005-23A issued to Deseret Mutual Benefit Administrator
- Held: When a financial planner or adviser who is neither a plan fiduciary, nor selected or promoted by the plan sponsor, advises a retirement plan participant to take a distribution and roll over the funds to an IRA in order to access a broader range of investment options, that advice is not fiduciary in nature.
- As part of the 2020 fiduciary regulation proposal, the DOL has withdrawn the Deseret Opinion, and concluded that an investment adviser would be a fiduciary when advising a retirement plan participant to take a distribution and roll over the funds to an IRA, provided that the five-part test is satisfied.
- Notably, the proposal concludes that this is the case even if the advice to roll over the retirement plan distribution is the first interaction between the adviser and participant, if the parties develop an ongoing advisory relationship with respect to investment of the IRA.

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2020 DOL Fiduciary Regulation Proposal, cont.

Proposed Prohibited Transaction Class Exemption

- Covers registered investment advisors, broker-dealers, insurance companies, banks, and individual investment professionals who are their employees or agents.
- Allows an investment advice fiduciary to receive compensation as a result of the investment advice provided. Includes a recommendation to roll over funds from a plan to an IRA, but the advice fiduciary must document the basis for this advice.
- Impartial Conduct Standards
  - Best interest standard
    - Prudence – care, skill, prudence, and diligence
    - Loyalty – does not place the adviser's interest ahead of the participant's interests
  - Reasonable compensation standard – under ERISA standards
  - No materially misleading statements

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2020 DOL Fiduciary Regulation Proposal, cont.

Proposed class exemption (cont.)

- Disclosure
  - Fiduciary status of the adviser
  - Description of the services that will be provided
  - Disclosure of material conflicts of interest
- Policies and procedures – Covered financial institution must establish and maintain policies and procedures designed to ensure compliance with the impartial conduct standards
- Retrospective compliance review – Covered financial institution must conduct an annual review to detect and prevent violations of the Impartial Conduct standards

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2020 DOL Fiduciary Regulation Proposal, cont.

ERISA Plan Sponsor Perspective

- Classic 3(21) co-fiduciary investment adviser relationship generally should not be impacted
- Smaller plans which have a broker or consultant paid based on commissions or revenue sharing from plan investments
  - Broker or consultant likely to become a fiduciary, and will need to rely on the new class exemption (or another existing exemption)
- For plans of all sizes - rollover advice is potentially fiduciary in nature
  - Impacts recordkeepers which offer IRAs and counsel participants on asset distribution to IRAs
  - Could impact plan sponsors if their recordkeepers do not comply with the exemption requirements

2020 Final Electronic Disclosure Regulations

New Electronic Disclosure Options

- Two New Voluntary Safe Harbors for Retirement Plans
  - **Website Posting**
    - Plan administrator must provide a website and Notification of Internet Availability (NOIA) stating that disclosure will be provided on the website
    - Covered individual includes participant, beneficiary, or other individual entitled to covered documents with a valid email address or smart phone number
  - **Email Delivery**
    - Plan administrator may send documents to the email address provided by the covered individual with the document in the body of the email or as an attachment to the email
    - Covered individuals must provide an email address
- DOL 2002 Safe Harbor option still available – applies to those with computer access or affirmative consent required to receive notices and documents

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2020 Final Electronic Disclosure Regulations, cont.

Safe Harbor Requirements

- Initial Notification Requirements — One Time Notice
    - Covered individual must also be furnished with initial paper notification that must explain the new electronic delivery method
- Notice of Internet Availability Requirements
    - NOIA must be provided to email address provided by participant or an employer-provided email address
    - NOIA must be sent each time a covered document is posted to the website
    - NOIA must describe the document being posted and include the address or hyperlink to the website
    - Disclosures must be posted by date of ERISA deadline
    - Disclosures must be posted for at least a year or until superseded by a new version
    - One annual NOIA can cover all disclosure documents

2020 Final Electronic Disclosure Regulations, cont.

Safe Harbor Requirements (cont.)

- Right to request paper
    - Covered individual may request one paper copy free of charge
    - Covered individual may opt out of electronic delivery entirely
- Validate email address
    - Plan administrator must ensure continued accuracy of email address upon employee termination
    - Plan administrator must attempt to correct invalid email address or treat participant as opting out of electronic delivery
- Protect security and privacy
    - Plan administrator must take reasonable measures to protect the security and privacy of the participant's personal information
- Terminated participants
    - Must take reasonable steps to get updated email address upon termination of employment, including during the off-boarding process

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2020 Final Electronic Disclosure Regulations, cont.

Alternative Safe Harbor Requirement — Email Delivery

- Plan administrators may directly distribute covered document by email
    - Document may be included as attachment to the email
    - Same general requirements for readability and access to be printable apply
    - Same requirements to protect confidentiality of personal information, paper copies, initial notice, requirements for terminated employees
    - No website required (but can be provided in addition to the website requirement)

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2020 Final Electronic Disclosure Regulations, cont.

Effective Dates and Scope

- Regulations first proposed in October 2019
- Final Rule effective on July 26, 2020
- 18-Month transition period on sub-regulatory guidance related to pension benefit statements, QDIA notices, and participant fee and investment disclosures
- Final regulations related to covered documents, including any document required to be furnished under Title I of ERISA
- Separate guidance expected from IRS and Treasury

Lifetime Income Disclosures under Qualified Retirement Plans

New Labor Department rule issued under SECURE Act requires benefit statements that show how a participant's account balance can be converted into monthly income

- Rule takes effect one year after publication in *Federal Register*
- Rule applies to defined contribution plans such as a 401(k) plan
- Rule requires that once per year a benefit statement show the single life annuity and qualified joint and survivor that could be provided by the participant's account balance.
- The rule does not require that those distribution options be offered by a plan

Lifetime Income Disclosures under Qualified Retirement Plans, cont.

The new rule provides for various assumptions to be made in the calculation of the lifetime income options

- The assumed annuity starting date is the last day of the respective benefit statement period
- The assumed age is 67 or the participant's actual age if over 67
- The described life annuity will be an annuity for a single life without a survivor benefit
- The described qualified joint and survivor annuity will be an annuity for the participant's life and an annuity at 100% of that amount for the remaining lifetime of a spouse of an equal age (regardless of whether the participant is married)
- The 10-year constant maturity Treasury Rate will be used as the interest rate in the calculations
- The gender-neutral mortality table under the current joint and survivor rules will be used

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Lifetime Income Disclosures under Qualified Retirement Plans, cont.

- As an alternative, plans that provide for distributions of annuities through a licensed insurer may use the lifetime illustrations in the actual terms of the plan's insurance contract
    - The illustrations must assume that (1) payments commence on the last day of the respective benefit statement period, (2) the participant is age 67, or actual age if older, and (3) the participant has a spouse of the same age (regardless of whether the participant is married)
- The new rule also includes model language that can be used for the lifetime income options
- Employers that use the assumptions provided in the rule and the model language for the lifetime income options will not be held liable if participants cannot actually purchase an annuity providing the projected lifetime benefits

2020 DOL ESG Regulation Proposal

Background

- ERISA requires plan investment fiduciaries to act prudently in selecting plan investments.
- A long-standing regulation requires an investment fiduciary to evaluate an investment, as part of the plan's portfolio, conduct a risk/reward analysis, and take into account portfolio diversification, liquidity, and projected return relative to the funding objectives of the plan.
- DOL and courts have consistently held that in concept, an investment fiduciary must focus on financial, rather than non-financial, benefits to participants. However, this becomes a nuanced issue in this context of environmental, social, and governance (ESG) focused investments.
- Economically target investments vs. ESG factors
    - ETI (specific outcomes – job creation and stimulating the economy in specific, distressed regions are examples).
    - ESG – mainstream publicly traded securities – evaluating ESG factors as part of the investment decision process. Can result in exclusion of specific industries (e.g., fossil fuels, tobacco, etc.).

2020 DOL ESG Regulation Proposal, cont.

Background

- 1994 DOL guidance – ETI investments are not inherently incompatible with ERISA, if an ETI investment has financial risk/return characteristics similar to other investments and otherwise fits in the portfolio from a diversification perspective. Referred to as the "all things being equal" test.
- 2008 DOL guidance – ETI – reiterates that ETIs may be consistent with ERISA, but only if they are truly equal to non-ETI alternatives. ERISA does not allow plan fiduciaries to expend plan assets to promote public policy preferences.
- 2015 DOL guidance – If a fiduciary prudently determines that an investment is appropriate based solely on economic considerations, including those relating to ESG factors, the fiduciary may make the investment.
- 2018 DOL guidance – Pushes back on the 2015 guidance, and states that the DOL's position is that if ESG factors present material business risk or opportunities with respect to an investment, that investment professionals would treat as economic considerations (e.g., environmental liabilities, poor corporate governance), then the ESG factors are economic factors and are properly taken into account.

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2020 DOL ESG Regulation Proposal, cont.

Current Regulatory Proposal/Plan Sponsor Perspective

- DOL recognizes that there is no specific definition of an "ESG" investment. For investment funds, an ESG fund is one that includes environmental, social, or corporate governance factors in its investment mandate, or in its name.
- Different calculus for DB and employer-directed DC plans versus participant-directed DC plans. For employer-directed plans, choosing an ESG investment means that plan assets will be invested in it and not in alternative investments. By contrast, for participant-directed plans, adding an ESG fund to the investment menu simply makes it available, but does not necessarily mean that any amount of plan assets will be invested in it to the exclusion of other alternatives.
- The current proposal reflects DOL's belief that it is unlikely "all things will be equal" between a specific ESG investment and a non-ESG alternative.
- Must evaluate investments solely on pecuniary factors. Must not subordinate the interests of participants in their retirement income or financial benefits to unrelated objectives, or sacrifice investment return or take on additional investment risk to promote goals unrelated to participants' financial interests.

2020 DOL ESG Regulation Proposal, cont.

Current Regulatory Proposal/Plan Sponsor Perspective, cont.

- ESG considerations are pecuniary factors only if they present economic opportunities or risks that investment professionals would treat as material economic considerations under generally accepted investment theories.
- If a fiduciary determines that an ESG alternative is economically indistinguishable from a non-ESG alternative, and the fiduciary picks the ESG alternative based on its ESG properties, the fiduciary should document specifically why the investments were determined to be indistinguishable and why the selected investment was chosen based on purposes of the plan, diversification of investment, and the interests of plan participants.
- For participant-directed account plans – not a violation of ERISA to add one or more prudently selected, well-managed, and properly diversified ESG investment alternatives, if:
    - Fiduciary uses only objective risk/return criteria in selecting and monitoring the fund, and documents this with respect to the fiduciary's selection and monitoring of the investment.
    - The ESG fund is not added as a QDIA or a component of a QDIA.

DOL Proxy Voting Regulation Proposal

Background

- “Avon Letter” – 1988 DOL advisory opinion to Avon Products – The fiduciary act of managing plan assets includes proxy voting for securities held by the plan.
- IB 94-2 – Plans may engage in shareholder activism if the plan fiduciary concludes that the costs involved are justified in light of the reasonably expected enhancement of value of the plan’s investment.
- IB 2008-02 – A fiduciary’s responsibility for managing proxies includes both deciding to vote or not vote. In so doing, the fiduciary must take into account only factors relating to the economic value of the plan’s investments. If the fiduciary determines that the cost of voting (including research on how to vote) exceeds the likely benefits of voting, the fiduciary is obligated not to vote.
- IB 2016-01 – DOL moved away from the more explicit permission in IB 2008-02 not to vote.

DOL Proxy Voting Regulation Proposal, cont.

Current Regulatory Proposal

- DOL states that prior guidance has caused some sponsors to incorrectly believe that they must always vote proxies.
- Fiduciary duty to manage stock held by a plan includes the management of appurtenant shareholder rights.
- When deciding whether to vote, the fiduciary must act solely in the economic interests of participants based on factors likely to impact the value of plan investments, and may not subordinate the economic interests of participants to any non-pecuniary objective.
- When a fiduciary decides to vote, the fiduciary must investigate material facts relating to the decision and may not simply rely on proxy advisory firms. The fiduciary must also maintain records demonstrating the basis for particular votes.

DOL Proxy Voting Regulation Proposal, cont.

Plan Sponsor Perspective

- For participant-directed defined contribution plans, such as typical 401(k) and 403(b) plans, the proposal will have limited impact, because such plans typically do not offer investments in individual securities as part of the core investment menu.
    - However, for collective investment fund options (as opposed to mutual funds) used by such plans, the proposal would likely result in the plan sponsor being required by the CIF sponsor to adopt the CIF sponsor's proxy voting policy for assets in that fund, to enable the CIF sponsor to vote all securities in the fund in a uniform manner.
- For defined benefit and employer-directed defined contribution plans that invest in individual securities, the proposal will be impactful if it had been the practice of the plan sponsor to vote proxies and otherwise assert shareholder rights with respect to the plan's investments.

Pooled Employer Plans (PEPs)

- SECURE Act amended ERISA and the Code to allow multiple employer plans called PEPs effective January 1, 2021, which allow employers of all sizes to join without any commonality of interest, such as being in the same industry or location.
  - PEPs can be either qualified retirement plans or IRAs
  - PEPs would be administered by pooled plan providers
  - Pooled plan providers are expected to be, but do not have to be, financial institutions
  - Costs and burdens on small employers implementing retirement plans would be reduced by
    - pooled purchasing power resulting in lower fees – for example, for investment management
    - reduced burdens as a result of the pooled plan provider undertaking management and administration responsibilities
    - a single annual Form 5500 filing and audit for the PEP

Pooled Employer Plans (PEPs), cont.

- PEPs offer many advantages over previously permitted multiple employer plans (MEPs)
  - Previously employers without a commonality of interest in a MEP would be treated as operating separate plans
  - Previously any qualification error by one employer in a MEP resulted in disqualification of the entire MEP
  - Under PEPs innocent employers are not penalized because of a qualification error by another employer participating in the PEP if:

    1. Assets attributable to the employees of the employer that is causing the qualification failure are transferred to a plan maintained by that employer, an IRA or another arrangement the IRS determines is appropriate.

    2. The employer that is causing the qualification failure remains liable for any resulting liabilities to the employees of such employer.

Pooled Employer Plans (PEPs), cont.

- Fiduciary Liability
  - The pooled plan provider must acknowledge in writing that it is a named fiduciary of the PEP and responsible for PEP administration
  - Participating employers will have fiduciary liability for the selection of the PEP and the pooled plan provider
  - Additionally participating employers will be responsible for selecting and monitoring investment options under the PEP where such options are available
  - To the extent participants select their own investments, in the case of a PEP which meets the requirements of a self-directed plan under 404(c) of ERISA, participants will be responsible for their own losses

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Pooled Employer Plans (PEPs), cont.

- Proposed rules by the Labor Department would allow businesses that want to offer PEPs to register with a simple electronic filing
  - Registration would be required no earlier than 90 days and no later than 30 days before the PEP is to begin
  - Registration would include information about the pooled provider, including roles of affiliates, identification of a compliance officer and agent for service of process, and existence of civil, criminal, or administrative actions involving the provider
  - Supplemental filings would be needed as to each new PEP sponsored by the pooled plan provider
  - Supplemental filings would also be needed as to any change in the provider's corporate structure, any bankruptcy filing, and any administrative or enforcement actions relevant to the PEP
  - A pooled plan provider ceasing operations must make a final supplemental filing within 30 days of the final Form 5500 for the PEP

Qualified Plan Loan Offset Rollovers

Background

- A "plan loan offset" is the amount by which a participant's account balance is reduced in order to repay a plan loan.
- This typically occurs upon an employee's termination of employment or upon the termination of a retirement plan, but it can occur upon other distributable events.
- The plan loan offset is treated as a distribution that allows for rollover.
- Under prior law, plan loan offsets could be rolled over and recontributed to another eligible retirement plan within 60 days of the date on which such offset occurred.
- This would prevent the participant from being subject to tax on the amount of the offset.

New law and regulations

- The Tax Cuts and Jobs Act modified the rules applicable to plan loan offsets, to provide an extended deadline for certain "Qualified Plan Loan Offset" amounts.
- The IRS issued proposed regulations on August 20, 2020 to implement the change in law and plan sponsors and administrators may rely upon the regulations.

Qualified Plan Loan Offset Rollovers, cont.

Definition of Qualified Plan Loan Offset

- A Qualified Plan Loan Offset is defined as an amount that:
    - is distributed from a qualified employer plan to an employee or beneficiary *solely* because of termination of employment or
    - failure to meet the repayment terms of the loan because of severance from employment of the employee; and
    - met the plan loan requirements immediately prior to termination of qualified employer plan or severance from employment of the employee.
- A Qualified Plan Loan Offset must occur within the 12-month period beginning on the date of termination of employment.
- Under the regulations, Qualified Plan Loan Offsets may be rolled over to an eligible retirement plan by the participant's tax filing due date for the tax year in which the offset occurs.

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Qualified Plan Loan Offset Rollovers, cont.

Example:

- Facts: Participant has a $10,000 account balance and a $3,000 loan balance on the date of termination of employment – June 15, 2020.
- If plan allows the participant 90 days to repay, and loan offset occurs on September 18, 2020, then it is a QPLO that can be rolled over until the end of the participant's tax filing due date with extensions.
- If loan repayment continued but the former employee defaults in July 2021, then the loan is not a QPLO and only the 60-day rollover period applies.
- If loan required immediate offset upon termination, then the offset is an QPLO and the employee may rollover the $3,000 until the end of the tax filing period with extensions.
- If the employee elected a cash distribution, the loan can still be treated as a QPLO and be rolled over to an IRA or another plan.

SECURE Act Amendment Deadline

IRS Notice 2020-68 addresses the deadline for SECURE Act plan amendments.

- Generally applicable deadline for SECURE Act amendments: last day of the 2022 plan year.
- Deadline for government plans, and collectively bargained plans (with CBA ratified before December 20, 2019): last day of the 2024 plan year.
- Amendment must be retroactive to the provision's effective date, and the plan must operate in accordance with the provision from the effective date. Amendments adopted within this time frame will not be considered an impermissible cutback even if they curtail participant rights that normally cannot be curtailed. A discretionary SECURE Act amendment may be adopted after the end of the 2022 plan year (or 2024 plan year for a collectively bargained plan), but the amendment must comply with the anti-cutback requirements.
- IRS Notice 2020-68 clarifies that these amendment deadlines also apply to optional amendments under the SECURE Act (discretionary amendments), even though discretionary amendments generally must be adopted by the end of the plan year in which they are put into effect.

Expanded 401(k) Eligibility Requirements for Long-Term, Part-Time Employees

- Tax-qualified retirement plans contain certain limitations on an employer's ability to exclude employees from participation based on the employees' period of service with the employer.
- The SECURE Act has modified this eligibility rule for 401(k) plans to allow for 401(k) plan deferrals by long-term, part-time employees.
- Under prior law, long-term, part-time employees could work for an employer for many years but never get to participate in the employer's plan because of the employees' failure to satisfy the 1,000-hour requirement in the 12-month eligibility period.
- Now, 401(k) plans may not require employees to complete a period of service greater than the <u>earlier of</u> the following two periods to become eligible to participate in a plan:
    - 1 year (i.e., 1,000 hours) of service during a 12-month eligibility period; or
    - The employee's completion of 3 consecutive 12-month periods during which the employee has at least 500 hours of service.

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Expanded 401(k) Eligibility Requirements for Long-Term, Part-Time Employees, cont.

- Employer can still require that participant turns age 21 by the end of the third consecutive year to become eligible to participate in plan.
- Employer not required to make matching or nonelective contributions for participants who become eligible under new eligibility rule, even if provided to other participants.
- Employer may also elect to exclude such participants from nondiscrimination testing.
- Each 12-month period in which employee has 500 hours of service must be treated as a year of service for vesting purposes.
- This change in law became effective for plan years beginning after December 31, 2020, but periods of service before January 1, 2021 do not count for determining whether the 500-hour requirement is satisfied.
- IRS Notice 2020-86 clarifies that the 12-month period beginning before January 1, 2021 may be disregarded for purposes of determining deferral eligibility *but* may not be disregarded for vesting purposes.

Qualified Birth or Adoption Distributions

Background

- Secure Act provides for a qualified birth or adoption distribution of $5,000 per child or adoptee made during the 12-month period after birth or adoption is finalized
- An eligible adoptee is an individual who has not attained age 18 or is physically or mentally incapable of their own support because they are not engaged in substantial gainful activity or they have a mental impairment (does not include the child of a spouse)
- Qualified birth or adoption distributions were effective as of January 2020

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Qualified Birth or Adoption Distributions, cont.

Notice 2020-68 clarifies the statute:

- Available in 401(k), 403(b), and government 457(b) plan
- Confirms that the provision is optional
- Guidance clarifies requirement that tax return must include name, age, and tax identification number of the child or eligible adoptee
- Plans must allow recontributions up to the amount of the birth or adoption distribution amounts as long as the participant is eligible to make a rollover contribution to the plan
- Plan administrator may rely upon representation that participant is eligible for distributions unless the plan administrator has knowledge to the contrary (but can request birth or adoption certificate)

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