ALERTS

Retirement Plan Update: DOL Final Rule On ESG Investing And Exercising Shareholder Rights And SECURE 2.0 Act Impact Retirement Planning In 2023 And Beyond

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Highlights

On Nov. 22, 2022, the DOL issued the Final Rule which permits plan fiduciaries to consider environmental, social and governance factors when selecting retirement plan investments and to exercise shareholder rights, such as proxy voting

Plan sponsors and fiduciaries should review investment fund options and proxy voting practices as applicable for consistency with the Final Rule

The SECURE 2.0 Act of 2022 includes certain changes to tax-qualified retirement plans that have been contemplated by lawmakers in recent years. Many changes impact plan years subsequent to 2023, and no plan amendments are required immediately, but plan sponsors and fiduciaries should start the process for implementation of desired and required changes

The end of 2022 brought a flurry of guidance for tax-qualified retirement plans. This alert addresses key provisions of the Department of Labor's

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(DOL's) final rule, entitled "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" (the Final Rule) as well as the SECURE 2.0 Act of 2022 (the Act), to help retirement plan sponsors and fiduciaries prepare for 2023 and beyond.

Action Steps for Plan Sponsor and Fiduciaries

- Review investment policy statements for plans in connection with the Final Rule and revise as applicable.
- Provide notice to plan participants related to any changes in investment funds related to the Final Rule.
- Review proxy voting practices (if applicable) for consistency with the Final Rule.
- Review required changes under the Act with plan recordkeeper to address timeline for implementation of desired/required changes.
- Consider optional plan design changes in the Act and discuss implementation with plan recordkeeper.
- Prepare and distribute participant communications related to plan changes under the Act.
- Review plan amendment requirements under the Act related to plan changes with employee benefits counsel.

DOL Final Rule

On Nov. 22, 2022, the DOL issued the Final Rule, which permits plan fiduciaries to consider environmental, social and governance (ESG) factors when selecting retirement plan investments and to exercise shareholder rights, such as proxy voting. Prior guidance required plan fiduciaries to make plan investment decisions solely based on pecuniary factors. The Final Rule allows fiduciaries to consider ESG factors when analyzing projected returns on an investment, as long as those factors are economically relevant to the investment. Note that fiduciaries are permitted, but not required, to consider such ESG factors. The Final Rule applies the same requirements for the selection and monitoring of a qualified default investment alternative (QDIA) under a plan as applicable to other investment funds, eliminating prior restrictions applicable specifically to the selection of a QDIA. A simplified form of the tie-breaker test remains in the Final Rule, which means that fiduciaries are permitted to consider non-economic, collateral benefits (e.g., ESG factors) to "break a tie" when choosing among otherwise prudent investments. Under the Final Rule, investments do not have to be indistinguishable to apply the tie-breaker test, but the plan fiduciary must determine that competing alternative investments equally serve the financial interests of the plan. The heightened documentation requirement that previously applied when considering non-economic, collateral benefits is not included in the Final Rule.

The Final Rule also addresses shareholder rights and proxy voting. The Final Rule retains the requirement that proxies be voted as part of the process of managing a plan's investments, unless a plan fiduciary determines that voting proxies may not be in the plan's best interest (e.g., when it results in significant cost or effort). It provides that a fiduciary does not have specific monitoring obligations for third-parties authorized to vote proxies, which is a departure from prior guidance; in this regard, a fiduciary's monitoring obligations are same as their duties with respect to the selection and monitoring of other plan service providers. The Final Rule eliminated safe harbors for certain types of policies out of concern that safe harbors could lead fiduciaries to believe it is permissible to broadly abstain from proxy voting. Finally, the Final Rule eliminates the requirement that fiduciaries maintain certain types of records on proxy voting activities and other exercises of shareholder rights. Proxy voting and other exercises of shareholder rights are subject to the same record maintenance requirements as other fiduciary activities. The Final Rule is generally effective 60 days after its publication in the Federal Register (i.e., Jan. 30, 2023), except that delayed applicability (i.e., one year after publication) applies to certain proxy voting provisions (to allow fiduciaries and investment managers additional time to prepare).

SECURE 2.0 Act of 2022

Executed by President Joe Biden on Dec. 29, 2022, the SECURE 2.0 Act of 2022 (the Act) includes certain changes to tax-qualified retirement plans that have been contemplated by lawmakers in recent years. Many changes impact plan years subsequent to 2023, and no plan amendments are required immediately, but plan sponsors and fiduciaries should start the process for implementation of desired and required changes. The following is a summary of key changes in 2023, 2024 and beyond.

2023

- The required minimum distribution (RMD) age, which is the age when distributions from retirement plans must begin for terminated participants and 5 percent owners, is increased to age 73 for individuals who reach age 72 after 2022 and to age 75 for those who reach age 74 after 2032. Also in 2023, the excise tax for failure to begin RMDs timely is reduced from 50 percent to 25 percent (and, in some cases, 10 percent).

- A participant in a defined contribution plan may elect to have employer matching or non-elective contributions made on a Roth basis starting in 2023, if permitted under the plan.

- An employer may provide a de minimis financial incentive to encourage employees to enroll in a defined contribution plan, starting in 2023. The incentive may not be paid with plan assets.

- The administrator of a defined contribution plan that offers hardship withdrawals may rely on an employee's certification as to the hardship event and the amount needed for the withdrawal starting in 2023.

- Starting in 2023, withdrawals taken from a plan by a participant who has been determined by their physician as being terminally ill are exempt from the 10 percent tax on early withdrawals and may be repaid to the plan within three years.

- Special withdrawal relief is available for federal disasters occurring on or after Jan. 26, 2021 if a participant lives in a federal disaster area and suffers an economic loss related to the disaster. A plan may provide that a withdrawal of up to $22,000 may be made within 180 days after the disaster; the 10 percent early withdrawal tax does not apply. The participant may repay the withdrawal to the plan within three years.

- If, within 180 days after any federal disaster occurring on or after Jan. 26, 2021, a loan is taken from a defined contribution plan by a participant who lives in the federal disaster area in order to cover an economic loss resulting from the disaster, the limit on the loan is the lesser of $100,000 or 100 percent of the participant's vested account balance. Additionally, plan loan payments that are due (for existing or newly obtained loans) from participants living in such a federal disaster area and suffering an economic loss during the 180 days after the disaster may be delayed for one year, and the five-year payment deadline can be extended accordingly.

2024 and Beyond

- The small benefit cash-out threshold is increased to $7,000 as of Jan. 1, 2024, if specifically provided under a plan.

- A retirement plan may be amended to incorporate a benefit increase (other than a matching contribution increase) by the due date for the plan sponsor's tax return for the year to which the increase applies (rather than the last day of the plan year, as under the current rule), for plan years beginning on and after Jan. 1, 2024.

- A defined contribution plan established after Dec. 31, 2024 must include an eligible automatic contribution arrangement for newly eligible employees with contributions of at least three percent of compensation and annual automatic increases of at least one percent until a contribution level of at least a 10 percent (but not more than 15 percent) of compensation is attained, starting with the 2025 plan year. Additional requirements apply, and exceptions apply to governmental plans, small plans and plans of new employers.

- For tax years beginning after Dec. 31, 2024, a participant who is age 60, 61, 62 or 63 can make catch-up contributions equal to the greater of $10,000 or 150 percent of the applicable catch-up limit, indexed for inflation.

- Starting in 2024, catch-up contributions made by participants with compensation of $145,000 (indexed for inflation) or more in the prior year must be made on a Roth basis.

- For plan years beginning on and after Jan. 1, 2024, a plan may provide that an employer may make matching contributions under its defined contribution plan on certain qualified higher education loan repayments made by plan participants, as if the loan repayments had been deferral contributions made to the plan.

- The requirement (set to commence in 2024) that defined contribution plans (other than collectively bargained plans) permit employee elective deferrals by part-time employees who completed 500 hours in each of three consecutive years changes for plan years beginning on or after Jan. 1, 2025 so that it applies when an employee completes at least 500 hours in each of two consecutive years .

- If permitted under a defined contribution plan, starting in 2024, a participant who withdraws up to $1,000 (or a smaller amount that leaves at least $1,000 of vested benefits in the account after the withdrawal) and certifies that it is for a personal or family emergency, is not subject to the 10 percent early withdrawal tax on the withdrawal and may repay the withdrawal within three years. Certain requirements and restrictions apply.

- If permitted under a defined contribution plan, starting in 2024, a participant who withdraws up to the lesser of $10,000 (indexed for inflation) or 50 percent of their vested balance and certifies that they have been the victim of domestic abuse by a spouse or domestic partner within the prior year is not subject to the 10 percent early withdrawal tax on such amount and may repay the withdrawal within three years. Certain requirements and restrictions apply.

- RMDs to participants from a designated Roth account in a defined contribution plan will not be required during the participant’s lifetime, starting with RMDs for 2024 (payable by April 1, 2025), but will still be applicable upon a participant’s death.

- Beginning in 2024, defined contribution plans may be amended to add “pension-linked emergency savings accounts” for nonhighly compensated employees, which may provide for automatic enrollment of up to 3 percent of compensation. Accounts are limited to $2,500 in employee contributions and must be held in a cash account. Monthly participant withdrawals are permissible. Additional requirements apply.

- A government matching contribution of 50 percent applies to taxpayer contributions to IRAs and eligible retirement plans for taxpayers below a specified adjusted gross income threshold in tax years beginning after Dec. 31, 2026.

The above summary describes certain significant changes in the Act that impact retirement plans and is not all-inclusive. Additional provisions in the Act affect participant notice and statement requirements, plan correction rules, annuities, certain 457 and 403(b) plan matters, defined benefit plan interest crediting requirements and many other retirement plan rules. The Act also requires the Secretaries of the Internal Revenue

Service and the DOL to establish an online searchable database for individuals to use to determine if they have money under a retirement plan. Plan sponsors will be required to provide information necessary for the database.

To obtain more information, please contact the Barnes & Thornburg attorney with whom you work or Lori Shannon at 312-214-5664 or lori.shannon@btlaw.com.