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Fiscal Year 2024 Budget Includes Proposed Modifications to Retirement Plans

On March 9, 2023, the Biden Administration released its Fiscal Year 2024 Budget. The related General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals included a description of "modifications to rules relating to retirement plans" consistent with, for the most part, proposals that were, at one point, part of the Administration's 2021 "Build Back Better" proposal. These include a proposed $10-$20 million cap on retirement account accumulations, plan sponsor reporting on account balances of more than $2.5 million, and the elimination of certain "Roth conversions," for certain high-income taxpayers (e.g., joint filers with income over $450,000). While action on these initiatives is not expected this year, targeting large retirement account balances has some populist appeal, has had the support of Democrat policymakers for some time, and is likely to persist beyond the next election.

More State-Mandated Plans in Sight for Businesses Without Retirement Plans

Minnesota, Missouri and Vermont have become the latest states to pass legislation mandating state-sponsored retirement plans for employees without access to plans in the workplace. Most states have at least considered offering state-sponsored retirement plans, with 10 states having active programs. Only four states are hold outs: South Dakota, Alabama, Florida and Alaska. But businesses without a retirement plan do not need to be forced into an ill-fitting, state-mandated plan considering the new and enhanced plan designs available, plus increased plan startup tax credits for those businesses that qualify.

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Retirement Savings for Americans Act (S 5271) Would Create Government-Run Plan

Congress is poised to re-introduce a bill similar to the Retirement Savings for Americans Act (S 5271) of 2022. If the bill is resurrected for 2023, it would establish a new savings program, "The American Worker Retirement Plan" (AWRP), that would give eligible workers access to federally-sponsored, portable, tax-advantaged retirement savings accounts.

Key features of the AWRP are described below:

- Available to full- and part-time workers without access to an employer-sponsored retirement plan.
- Automatic enrollment at 3% of income, with the ability to increase or decrease the deferral rate or opt out.
- Independent workers would also be eligible.
- Low- and moderate-income workers would be eligible for a federal 1% automatic contribution (as long as they remain employed) and up to a 4% federal matching contribution via a refundable federal tax credit, phased out for those with income above certain levels.
- Accounts would remain attached to workers throughout their lifetimes, and workers would be able to stop and start contributions at will.
- The accounts would be the property of the worker and the assets could be passed down to future generations to help them build wealth and financial security.
- Participants would be given a menu of simple, low-fee investment options to choose from, including lifecycle funds tied to a worker's estimated retirement date, or index funds made of stocks and bonds.

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While the provisions in the bill have bipartisan support, there is some skepticism in the industry as to whether a government-run retirement savings plan would be in the best interest of eligible workers. Even more reason for business owners who do not offer a retirement plan to consider sponsoring their own workplace retirement plans now, before a federally-mandated plan takes form.

Bill Would Allow 403(b)s to Invest in CITs

The newly introduced Retirement Fairness for Charities and Educational Institutions Act of 2023 (HR 3063) would amend current securities laws to fully clear the way for 403(b) plans to invest in collective investment trusts (CITs). The SECURE Act of 2022 amended tax laws in the Internal Revenue Code to allow 403(b) plans to use CITs but stopped short of making similar accommodating changes to securities laws. The bill has been referred to the House Committee on Financial Services.

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Changes to Key Retirement Policy Congressional Committees

In the Senate, Bernie Sanders (I-VM) has taken chairmanship of the Senate Health, Education, Labor, and Pensions (HELP) Committee from Patty Murray (D-WA). Dr. Bill Cassidy (R-LA) is now Ranking Member. We note that longtime committee member and retirement policy advocate Rob Portman (R-OH) has retired and that his bi-partisan partner in many retirement policy initiatives, Ben Cardin (D-MD), has announced his retirement at the end of his current term. Senators Ron Wyden (D-OR) and Mike Crapo (R-ID) will, respectively, continue as Chairman and Ranking Member of the Senate Finance Committee.

In the House, Rep. Virginia Foxx (R-NC) has taken over as Chairwoman of the House Education and the Workforce Committee, and Bobby Scott (D-VA) has now become Ranking Member. Rep. Jason Smith (R-MO) has taken over Chairmanship of the Ways and Means Committee, and former Chairman Rep. Richard Neal (D-MA) has now become Ranking Member.

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Current Status of ESG and Proxy Voting Regulations

The Environmental, Social and Governance (ESG) and proxy voting rules for qualified retirement plans have been a controversial issue for Democrats and Republicans. As of March 2023, the (Biden) Department of Labor's (DOL's) 2022 revision of the (Trump) DOL regulation stands. Consequently, fund managers for ERISA plans may include ESG considerations in the investment process for plans, and plan fiduciaries may consider climate and ESG factors when exercising shareholder rights, such as in proxy voting. However, if such factors are considered, they must be based on issues that the fiduciary reasonably determines are relevant to a risk and return analysis.

As background, in March 2023, Congress passed a Congressional Review Act resolution that would have voided the (Biden) DOL's 2022 ESG investment rule for retirement plans. President Biden, subsequently, vetoed that resolution; and Congress failed to over-ride his veto.

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IRS Proposes Stricter Rules for Use of Plan Forfeitures

The IRS is calling for stricter guidelines on the use of plan forfeitures. On February 24, 2023, the IRS issued a proposed regulation regarding the use of forfeitures in defined benefit and defined contribution plans, including 401(k) plans. A public comment period on the proposed rule ended May 30, 2023, with a scheduled effective date for plan years beginning on or after January 1, 2024. However, plan sponsors may rely on the proposed rule immediately.

Under the proposed guidance as currently written, plan sponsors must use forfeitures incurred under a defined contribution (DC) plan within 12 months following the close of the plan year in which the forfeiture arises. Further, such forfeitures may only be used to:

1. Pay plan administrative expenses;
2. Reduce employer contributions under the plan; or
3. Increase benefits in other participants' accounts in accordance with plan terms.

The regulation provides transition relief for forfeitures that arise in any plan year beginning before January 1, 2024. Those prior forfeitures will be treated as if they arose in the first plan year that begins on or after January 1, 2024.

As a best practice, plan sponsors should consider reviewing the forfeiture provisions in their retirement plans for any necessary updates (e.g., to include all three acceptable usages so that all forfeitures can be used up within the required 12-month period).

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IRS/DOL Changes Participant Count Rules for Form 5500 Audits

On February 24, 2023, the Department of Labor (DOL), IRS and Pension Benefits Guaranty Corporation (PBGC) published final Form 5500 forms and instructions applicable for plan years beginning on or after January 1, 2023. Simultaneously, the DOL issued final regulations in support of those forms and instructions. For more information, please see the final regulations for Annual Reporting and Disclosure.

The DOL requires sponsors of employee benefit plans subject to the annual Form 5500 series of returns and schedules to include an audit report from an independent qualified public accountant (IQPA). There is an exception to this requirement under DOL Reg. 2520.104-46 for "small plans" (i.e., those with fewer than 100 participants at the beginning of the plan year). The current rules, applicable for the 2022 Form 5500 filing, count individuals who are eligible to participate even if they have not elected to participate and whether they have an account in the plan or not.

Under the new rules, for plan years beginning on or after January 1, 2023, participant count for the audit waiver will be based on the number of participants and beneficiaries with account balances at the beginning of the plan year. This change is intended to reduce the number of plans that need to have an audit, lower expenses for small plans and encourage more small employers to offer workplace retirement savings plans to their employees. Note that a plan may qualify for the audit waiver even if there are more than 100 participants under the "80 to 120 Participant Rule." This rule states if the number of participants covered under the plan as of the beginning of the plan year is between 80 and 120, and a small plan annual report was filed for the prior year, the plan administrator may elect to continue to file as a small plan and, therefore, qualify for the audit waiver.

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Key Considerations in Plan Lawsuits from the Seventh Circuit Court Decision

A recent Seventh Circuit Court decision, upon remand from the U.S. Supreme Court, articulated a set of considerations that could prove useful both for retirement plan plaintiffs contemplating lawsuits and plan fiduciaries wishing to avoid being sued. In January 2022, in *Hughes v. Northwestern University*, *142 S. Ct. 737 (2022)*, the Supreme Court vacated a 2020 Seventh Circuit decision for defendants in an ERISA prudence case involving two 403(b) plans, remanding the case to the Seventh Circuit for further consideration. On March 23, 2023, the Seventh Circuit handed down its decision in this litigation, siding with plaintiffs on the issues of recordkeeping fees and the selection of retail share classes. Key takeaways include the following items:

- Generally, quoting the court: “To plead a breach of the duty of prudence under ERISA, a plaintiff must plausibly allege fiduciary decisions outside a range of reasonableness.” That is probably the best one-sentence explanation of how to think about these issues.
- With respect to recordkeeping: While a fiduciary has no duty to “constantly solicit quotes for recordkeeping services to comply with its duty of prudence [with respect to plan expenses] fiduciaries who fail to monitor the reasonableness of plan fees and fail to take action to mitigate excessive fees…may violate their duty of prudence.”
- The use of retail share classes remains a significant vulnerability, and justifications for their use (e.g., higher quality services, attractiveness for small accounts, lack of availability of institutional share classes, or a better revenue sharing deal) may not be considered on a motion to dismiss.