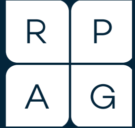


ERISA Update

Support Your Clients; Add Value as the Advisor

1

401(k) Investments in Cryptocurrencies

401(k) Investments in Cryptocurrencies

U.S. Department of Labor Compliance Assistance Release No. 2022-01 (March 10, 2022)

What is compliance assistance?

Information and guidance to assist employers on how to comply with federal laws.

Summary: Plan fiduciaries should not permit direct investments in cryptocurrencies or other products whose value is tied to cryptocurrencies.

Cryptocurrency investments present significant risks to participants' retirement accounts:

- Investment in cryptocurrency is highly speculative, subject to extreme price volatility.
- Participants less likely to have "sufficient knowledge" to make "informed decisions".
- Custodial and recordkeeping concerns.
- Concerns about the reliability and accuracy of cryptocurrency valuations.
- Evolving regulatory environment.

U.S. Department of Labor Compliance Assistance Release No. 2022-01 (March 10, 2022)

2

Litigation Update

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

- Participants claimed that plan fiduciaries violated their duty of prudence by offering needlessly expensive investment options and causing the plan to pay excessive recordkeeping fees.
- 7th Circuit Court of Appeals held that plan fiduciaries satisfied their duty of prudence by offering low-cost index funds as plan investment options, even though other plan investment options may have been imprudent.
  - The court found that the plan provided an adequate array of investment choices, including "the types of funds plaintiffs wanted (low-cost index funds)."
  - The court reasoned that these offerings "eliminat[ed] any claim that plan participants were forced to stomach an unappetizing menu."
  - Because participants' preferred type of investments were available, they could not complain about the flaws in other options.

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

- Supreme Court held (8-0 decision) that lower court's reasoning was not correct. ERISA requires that plan fiduciaries monitor all plan investments and remove any imprudent ones.
- Plan fiduciaries are required to evaluate and determine which investments may be prudently included in the plan's menu of investment options.
- 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.

Alas v. AT&T Services, Inc. US District Court, Central District California (Sept 28, 2021)

Participants claimed that plan fiduciaries failed to control the administrative expenses that plan participants paid to the plan's recordkeeper.

The plan fiduciaries presented extensive evidence that they acted prudently in monitoring the plan's recordkeeping expenses.

- They periodically reviewed the ERISA Section 408(b)(2) disclosures and invoices provided by the recordkeeper.
- They hired outside experts to evaluate the reasonableness of the recordkeeper's compensation.
  - The outside expert confirmed that the plan had a lower recordkeeping rate than other plans.
  - After new negotiations with the recordkeeper, the plan obtained an even lower price for recordkeeping services.

Alas v. AT&T Services, Inc. US District Court, Central District California (Sept 28, 2021)

- The plan's contract with the recordkeeper included a "most favored customer" clause, which ensured that the recordkeeping fees were "not less favorable than those currently extended to any other" similarly situated customer.

Court held that the monitoring the plan fiduciaries engaged in, both through periodic reviews and through hiring of outside experts, suffices to show "care, skill, prudence, and diligence" in monitoring the reasonableness of the recordkeeping fees.

Reetz v. Lowe's Companies US District Court, Western District of North Carolina (Oct 10, 2021)

An investment consulting firm (Aon) did not breach its fiduciary duty as the investment advisor to the plan in proposing and encouraging the plan to transfer over one billion dollars in plan assets to an investment fund managed by Aon.

Aon was 3(38) investment advisor to the plan.

Aon selected the Aon Growth Fund as an investment option for the plan.

Reetz v. Lowe’s Companies US District Court, Western District of North Carolina (Oct 10, 2021)

Fund used multiple managers for the underlying funds, as compared to “single manager” lineups for proprietary “off the shelf” funds. Among the court’s findings of fact:

- There is inherent conflict of interest in single manager lineups because the sub-managers are affiliated with the “manager of managers”, the manager of managers decides how to allocate assets among the underlying funds, and there is an incentive to favor higher-fee options to maximize fees.
- Under multiple manager structure, Aon was able to change manager selections to improve expected risk/return profile.

Reetz v. Lowe's Companies US District Court, Western District of North Carolina (Oct 10, 2021)

At the time the fund was added to the plan, the fund had a track record that was less than 3 years. Among the court's findings of fact:

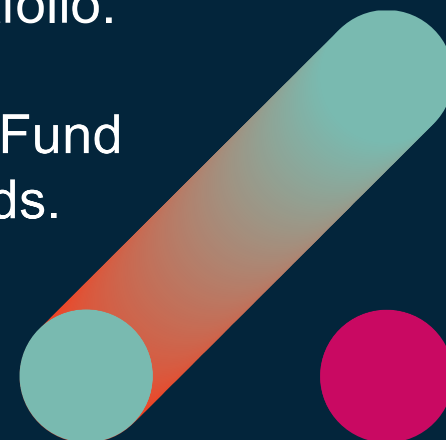
- Functionally, custom target date funds and white label funds that are created for a specific plan do not have a track record as distinct investment funds before they are added to the plan.
- Nonetheless, the DOL has recommended that plan fiduciaries consider custom target date funds.
- In evaluating a custom target date fund, plan fiduciaries should focus on the track records of the underlying managers.

Reetz v. Lowe's Companies US District Court, Western District of North Carolina (Oct 10, 2021)

Fund offered at various times asset classes such as REITS, commodities, high-yield debt, emerging market debt. Among the court's findings of fact:

- Plans rarely offer such asset classes as distinct investment options, due in part to the concern that participants would not understand how to integrate them into a diversified portfolio.

Court found that Aon's process for selecting the Aon Growth Fund for the plan was reasonable and in line with industry standards.



3

Lifetime Income Disclosures in Defined Contribution Plans

SECURE Act (2019) requires an annual lifetime income disclosure for 401(k) and other defined contribution plans.

Key Takeaways

Applies to all ERISA-covered defined contribution plans (e.g., 401(k), 403(b)) regardless of whether annuities/lifetime income options are offered under the plan.

Provide, at least annually, **two lifetime income illustrations (LII):** Estimated monthly payments based on (1) single life annuity, and (2) joint and 100% survivor annuity.

Note: Both LIIs are required regardless of participant's marital status.

LIIs are based on the **participant's account balance as of the last day of the statement period**, not on a projected balance that considers future contributions and investment returns.

Effective Dates

For participant-directed plans

Plans that issue quarterly participant statements must include the first LIIs on the quarterly participant statement ending June 30, 2022.

For non-participant-directed plans

LII must be on the statement for first plan year ending on or after Sept 19, 2021 (e.g., participant statement for plan year ending Dec 31, 2021, which is due no later than Oct 15, 2022).

Assumptions for LII Calculations

Factor	Required Assumption
Commencement date and age of participant on that date	Commencement date will be last day of benefit statement period. Participant will be age 67 on the commencement date (if participant is over age 67, use his/her actual age)
Interest rate	10-year constant maturity rate, as of 1st day of last month of the statement period
Mortality	Unisex mortality tables under IRC Section 417

Example of how LII might appear on benefit statement:

Account balance as of June 30, 2022	Monthly payment at age 67 (single life annuity)	Monthly payment at age 67 (qualified joint and 100% survivor annuity)
$125,000	$645/month for life of participant	$533 for life of participant $533 for life of surviving spouse

Disclosure **must** include the following explanations:

- Commencement date and age assumptions, including how starting benefits earlier/later could reduce/increase monthly payments
- What a single life annuity is and how it works
- What a 100% QJSA is and how it works, and availability of other survivor % options
- Marital status and age assumptions and impact on payments if spouse is older or younger than participant
- Interest rate assumptions
- Mortality assumptions and use of IRS tables
- Fact that actual monthly payments may "vary substantially" from LIIs
- LIIs are fixed amounts that will not increase to reflect inflation
- Assumption that participant is 100% in account balance
- Assumption that participant will repay any outstanding plan loans

Limitation on Fiduciary Liability

Example: Participants mistakenly believe that the LIIs are promises or guarantees of a specific income stream, and therefore sue if at retirement their account balance does not generate the illustrative income stream.

No fiduciary liability by reason of providing the LII disclosures so long as fiduciaries use the DOL model language or "language that is substantially similar in all material respects" to the DOL model language.

Fiduciaries may not change any of the required assumptions (i.e., commencement date, age, interest rate, mortality). Otherwise, waiver of fiduciary liability will not be available.

Use of Third-Party Administrator's Projections

- Many plans provide various illustrations in participant benefit statements calculated by the plan's third-party administrator, projecting the account balance to normal retirement age.
  - For example, the projections show a participant the amount he/she will have at retirement if he/she continues to contribute at the same rate.
  - Lifetime income illustrations under the SECURE Act require illustrations based on the participant's current account balance (as opposed to projecting it to normal retirement age).
  - FAQs clarify that plan fiduciaries can provide additional illustrations to supplement (**but not replace**) those illustrations required by the SECURE Act.

4

DOL Proposes Rule Encouraging ESG

On October 14, 2021, the Department of Labor (the "DOL") published a proposed regulation, *"Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights".*

- The proposal follows the DOL's announcement on March 10, 2021, that it was re-examining the regulations published by the Trump administration (the "2020 ESG Rule").

- In the same announcement, the DOL stated that it would not enforce the 2020 ESG Rule.

ESG Factors May Be a Permissible Consideration

- The Proposed Rule adds language to expressly state that, when considering projected returns on an investment, a fiduciary's duty of prudence *"may often require an evaluation of the economic effects of climate change and other environmental, social, or governance factors on the particular investment or investment course of action."*

- The proposed change includes three examples that, depending on the facts and circumstances, may be material to a fiduciary's prudent risk-return analysis. These examples are…

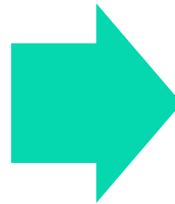
Climate change-related factors

Governance factors

Workplace practices

Qualified Default Investment Alternative ("QDIA") Permitted to Consider ESG

The Proposed Rule would apply the same fiduciary standards to the selection and monitoring of a QDIA as applied to other designated investment alternatives, including permitting consideration of ESG factors.



This approach provides fiduciaries additional leeway by removing the restrictions included in the 2020 ESG Rule that prohibit plans from utilizing as a QDIA a fund or model portfolio if its objectives or goals or its principal investment strategies include, consider, or indicate the use of one or more non-financial factors.

The Tie-Breaker
Test

- The Proposed Rule reaffirms the DOL's long-standing "tie-breaker" position that fiduciaries are permitted to consider non-economic, collateral benefits when choosing among otherwise prudent investments.
- The DOL explains in the preamble that the change is necessary because the 2020 ESG Rule's *"indistinguishable"* standard appears to be chilling the consideration of ESG factors by fiduciaries making investment decisions.
- Under the Proposed Rule, investments do not have to be "indistinguishable" to permit consideration of collateral objectives that favor one investment over the other.

"Two investments may differ on a wide range of attributes, yet when considered in their totality, can serve the financial interest of the plan equally well. These investments are not indistinguishable, but they are equally appropriate additions to the plan's portfolio."

Other Changes

One change to the regulation is the return to familiar investment concepts using terminology such as "financial interests" and "collateral benefits."

The term "pecuniary" and its definition have been eliminated altogether.

Monitoring the proposed regulations for final version

Potential update to Investment Policy Statement templates

ESG Balanced CIT

ESG Scoring mechanism programmed later this year

5

SECURE Act Changes to Safe Harbor 401(k)/403(b) Plans

SECURE Act Changes to Safe Harbor 401(k)/403(b) Plans

Annual Notice Requirements

- ADP safe harbor plan that provides for nonelective 3 percent employer contribution is no longer required to provide an annual safe harbor notice.

Retroactive Safe Harbor Design

- Plan may be amended after the beginning of the plan year to provide safe harbor nonelective contributions for the plan year provided that
  - The safe harbor nonelective contribution is at least 4 percent
  - The amendment is adopted on or before the last day of the following plan year.

6

New Notice Requirement for Discretionary 401(k) Matching Contributions

New Notice Requirement for Discretionary 401(k) Matching Contributions

If you use a fully discretionary match, which is one where you do not pre-select the rate or period of the matching contribution, then you must satisfy **two** notice requirements when approving a discretionary match:

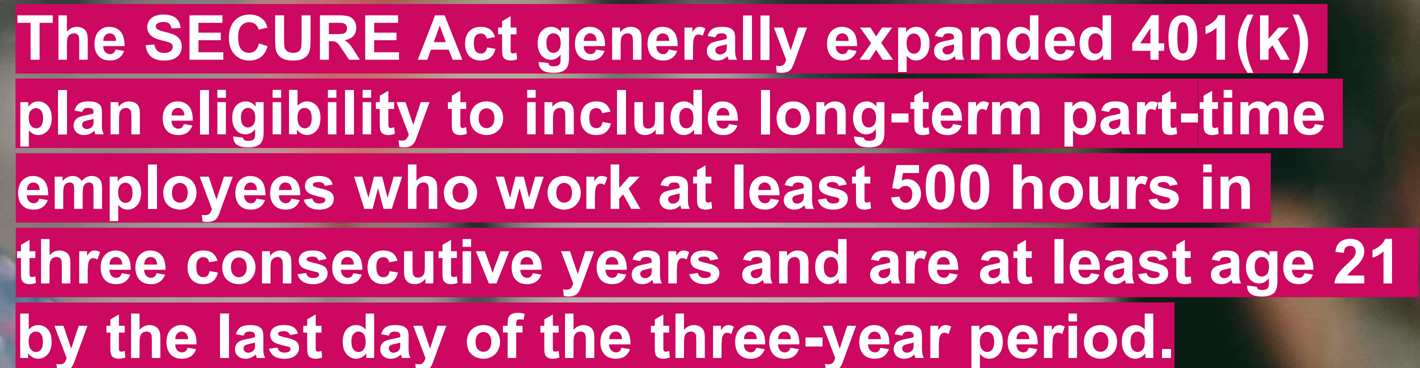
You must provide the plan administrator (or trustee, if applicable), written instructions describing

1. How the discretionary matching contribution will be allocated to eligible participants, such as a uniform percentage of contributions or a flat dollar amount,
2. The computation period(s) to which the discretionary matching contribution formula applies, such as each pay period or the entire plan year, and
3. If applicable, each business location or business classification subject to separate discretionary matching formulas.

Participants who receive the discretionary matching contribution must be notified of the same items within 60 days following the date the discretionary match is made to the plan.

7

Part-time Eligibility Rules



The SECURE Act generally expanded 401(k) plan eligibility to include long-term part-time employees who work at least 500 hours in three consecutive years and are at least age 21 by the last day of the three-year period.

Plan sponsors needed to start tracking hours beginning in 2021, but plans are not required to permit these newly eligible employees to make 401(k) plan deferrals before 2024.

8

IRS Updates

IRS Updates the EPCRS Correction Program Rev. Proc. 2021-30

Extended correction period for significant failures under SCP

The SCP allows plan sponsors to self-correct insignificant operational failures at any time, but they may correct significant operational failures only within a specified period.

- Prior to the new EPCRS, the self-correction deadline for significant operational failures was generally the last day of the second plan year following the plan year in which the failure occurred.
- The new EPCRS extends the end of the self-correction period for significant operational failures to the last day of the third plan year following the plan year in which the failure occurred.

IRS Updates the EPCRS Correction Program Rev. Proc. 2021-30

This change also affects the deadline for the safe harbor correction method for employee elective deferral failures in 401(k) and 403(b) plans.

Under this safe harbor, elective deferral failures can be corrected with reduced qualified non-elective contributions ("QNECs") by certain deadlines.

- Elective deferral failures that do not exceed three months can be corrected without any QNEC under some circumstances.
- Failures that exceed three months but do not exceed the SCP correction period for significant failures may be corrected with a 25% QNEC.

  Thus, the extension of the correction period for significant failures under the SCP extends the safe harbor deadline for correcting elective deferral failures with a 25% QNEC.

IRS Updates the EPCRS Correction Program Rev. Proc. 2021-30

Expanded Ability to Correct by Plan Amendment Under SCP

The prior version of EPCRS expanded the ability of plan sponsors to correct operational failures by plan amendment. This allowed sponsors to amend a plan to conform the terms of the plan with the plan's operations and thereby correct a failure.

However, the ability to take advantage of SCP required that these corrective amendments, among other things, result in an increase of a benefit, right, or feature that applied to all employees eligible to participate in the plan.

IRS Updates the EPCRS Correction Program Rev. Proc. 2021-30

Expanded Ability to Correct by Plan Amendment Under SCP

The new version of EPCRS still requires that corrective amendments result in an increase of a benefit, right, or feature.

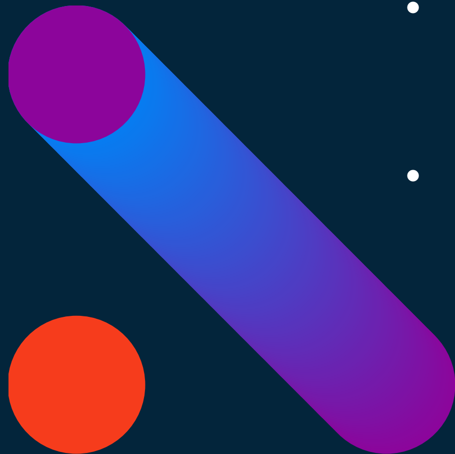
However, that increase is no longer required to apply to all employees eligible for the plan. This is a helpful change for plan sponsors, as operational failures often do not affect all employees eligible to participate.

IRS Updates the EPCRS Correction Program Rev. Proc. 2021-30

Extended Availability of Safe Harbor Correction Method for Elective Deferrals Under Automatic Contribution Features

EPCRS provides a safe harbor correction method for certain elective deferral failures affecting employees who are subject to an automatic contribution feature in a 401(k) or 403(b) plan.

IRS Updates the EPCRS Correction Program Rev. Proc. 2021-30



Pursuant to this safe harbor, if a failure to implement an automatic contribution feature or a failure to implement an affirmative election of an employee subject to an automatic contribution feature does not extend beyond 9 ½ months following the end of the plan year of the failure, no QNEC is required if specified conditions are met.

- The prior version of EPCRS offered this safe harbor correction method only for failures that began on or before December 31, 2020.
- The new EPCRS extends the safe harbor by three years, to failures that begin on or before December 31, 2023.

Outlook for Retirement Plan Legislation in 2022

SECURE 2.0 – Bipartisan bills introduced in 2021 that are still in play.

Key provisions likely to be included in a final bill:

- Permit 403b plans to invest in collective investment trusts (CITs)
- Permit employers to make matching contributions to plans on behalf of employees who are repaying student loans
- Allow employees who work at least 500 hours in two consecutive 12-month periods to contribute to 401(k) plans