

Legal and Legislative Update for Retirement Plans

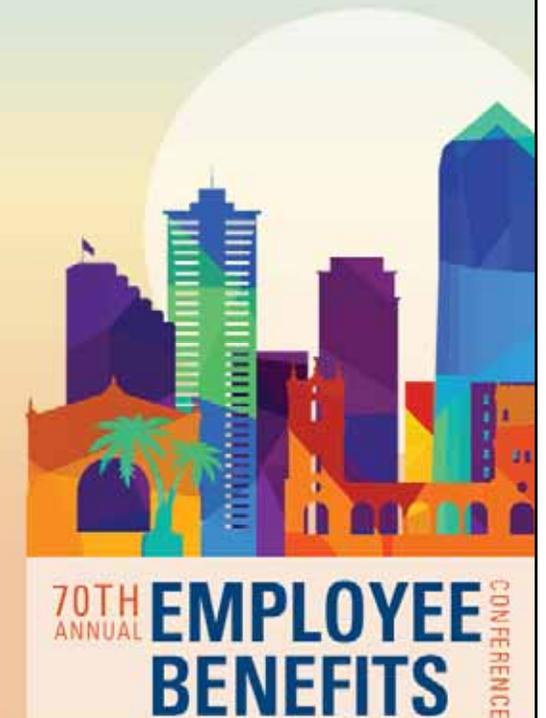
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International Foundation
OF EMPLOYEE BENEFIT PLANS 

What We'll Cover

- DOL investment fiduciary definition
- Much action on SECURE and SECURE 2.0
- Changes to death audit process for SFA applications

Who Are ERISA Regulators?

- Regulations in ERISA come from multiple government agencies—Unusual
- Most common
 - Department of Treasury
 - Department of Labor
 - Department of Health and Human Services
 - Pension Benefit Guaranty Corporation

DOL Investment Fiduciary Definition

- When ERISA was implemented in 1976, defined benefit plans were more common.
- Typically, defined benefit plans are managed by investment professionals and funded by employers, who bear the risk of investment performance.
- In the last 50 years, there's a shift towards defined contribution plans.
- Result = Investment decisions increasingly made by participants, who bear the risk of investment performance.

DOL Investment Fiduciary Definition

- DOL attempted to redefine 4 times—2010, 2016 (vacated in 2018 by Fifth Circuit), 2020 Rule (partly overturned by Florida court in 2023).
- New rule issued 10/31/23—Comment period ended 1/2/24.
- Final released 4/23/24—Effective 9/23/24.
- First lawsuit filed in Texas in 5/2/24.
- 5/15/24—U.S. House resolution to disapprove
- In July 2024, two district courts in Texas delayed the rule from taking effect

DOL Investment Fiduciary Definition

- Original 2010 5-factor test—Person was fiduciary only if met all five elements:
 - Render advice as to value of securities or other property, or make recommendations as to advisability of investing in, purchasing, or selling securities or other property,
 - On regular basis,
 - Pursuant to mutual agreement, arrangement, or understanding with plan or plan fiduciary,
 - That advice will serve as primary basis for investment decisions with respect to plan assets, and
 - That advice individualized based on particular needs of plan.

DOL Investment Fiduciary Definition

- New April 2024 Final Rule proposes that a person would be an investment advice fiduciary if:
 - Advice or recommendation provided for fee/other compensation (direct or indirect as defined in the Rule); and
 - The person makes recommendations in following contexts:
 - The person either directly or indirectly (e.g., through or together with any affiliate) makes professional investment recommendations to investors on a regular basis as part of their business. The recommendation is made under circumstances that would indicate to a reasonable investor in like circumstances that the recommendation:

DOL Investment Fiduciary Definition

- The person makes recommendations in following contexts:
 - Is based on a review of the retirement investor's particular needs or individual circumstances,
 - Reflects the application of professional or expert judgment to the retirement investor's particular needs or individual circumstances, and
 - May be relied upon by the retirement investor as intended to advance the retirement investor's best interest; or
 - The person represents they are acting as a fiduciary under Title I or Title II of ERISA.

DOL Investment Fiduciary Definition

- Notably, the 1975 Rule required explicit agreement or ongoing relationship to establish that a person was fiduciary.
- New Final Rule creates fiduciary status even if advised one time.
 - Consider the impact on participant asking Vanguard for rollover recommendation
 - 1975 Rule: Not fiduciary
 - New Rule: Could be fiduciary

SECURE 2.0 Act

- Recover of overpayments
- Required minimum distributions
- Increased cash-out limit
- Expansion of EPCRS
- Lost and found registry
- Reporting and disclosure changes

SECURE 2.0 Act—Defined Contribution Only

- More access to distributions
- Roth and catch-up contributions
- New student match and saver's match
- NBU part-time employees' participation

IRS Notice 2024-02 Clarifications

- *Automatic Enrollment:* SECURE 2.0 requires auto-enrollment for newly adopted plans “maintained by more than one employer” but the Notice does not address whether the requirement applies to multiemployer plans or only multiple employer plans.
- *Terminal Illness Distributions:* Notice offers items that must be included in the certification of terminal illness from a physician.
 - Certification must be submitted to the plan and may be relied upon by the plan.
 - Distribution must be made on or after the date of physician’s certification.
 - Unlike 401(k) hardship distributions, self-certification is not permitted.
- *Plan Amendments:* The Notice provides an additional year for plans to adopt plan amendments. Non-governmental plans amendment due by 12/31/26, collectively bargained plans due 12/31/28. Governmental plans are due by 12/31/29.

SECURE Act—Final Rules

- Final Rules issued on July 19, 2024
 - Focus on SECURE 1.0 provisions in 2022 proposed regulations and some changes from Secure 2.0
- Effective Date. Compliance with the final regulations is required beginning January 1, 2025, with a reasonable, good faith standard for prior years.
- Plan amendments are not required for most plans until December 31, 2026. Plan amendment deadline for collective bargaining plans is December 31, 2028, and for governmental plans is December 31, 2029.
- IRS issued proposed rules on the same date implementing issues reserved in the final rule

Final Regulations Regarding Required Beginning Date Rules

- Section 401(a)(9)—Required beginning date is April 1 of the calendar year following the later of (1) the calendar year in which the employee reaches the applicable age, and (2) the calendar year in which the employee retires from employment with the employer maintaining the plan
- Applicable age is defined based on the employee's age, as follows
 - employees born before July 1, 1949, the applicable age is $70\frac{1}{2}$;
 - employees born on or after July 1, 1949, but before January 1, 1951, the applicable age is 72;
 - employees born on or after January 1, 1951, but before January 1, 1959, the applicable age is 73; and
 - employees born on or after January 1, 1960, the applicable age is 75.
- Preamble notes that plans can continue to use a uniform rule based using the applicable age of $70\frac{1}{2}$.

RMDs Following an Employee's Death

- If an employee dies before the RBD:
 - Rules for DB Plans have generally not changed; for DC Plans, they added a new category of beneficiary called eligible designated beneficiary (EDB). EDB can be a spouse, child under the age of majority, disabled individual, chronically ill individual or a person who is not 10 years younger than the employee.
 - Default rule for DC Plans
 - If no designated beneficiary, the entire interest must be distributed by the end of the year which includes the 5th anniversary of the date of death.
 - If the designated beneficiary is not an EDB, the entire interest must be distributed by the end of the year which includes the 10th anniversary of the date of death.
 - If the designated benefit is an EDB, payments commence by the end of the calendar year following the calendar year in which the employee died and continue each year until the entire interest is distributed.
- Special rules if the sole designated beneficiary is the employee's surviving spouse.

RMDs Following an Employee's Death

- If an employee dies after the RBD, the employee's remaining interest must be distributed at least as rapidly as the method used to pay the employee; AND the must be paid fully paid within 5 or 10 years (whichever is applicable) of the employee's death.
- Because the requirement to satisfy both conditions has caused confusion, the final rule includes relief if a plan did not make a payment for the first 10 years after an employee's death from 2021-2024.
- Requirement to take continued annual payments includes the year of the employee's death.

Final Regulations Regarding RMDs Following Employee's Death Before RBD

- The Final Rule provides:
 - If an employee's entire interest under a DC plan is in a designated Roth account, no distributions are required to be made to the employee during the employee's lifetime and upon the employee's death, that employee is treated as having died before the RBD.
 - Under the life expectancy option, a distribution is due for the calendar year in which the EDB dies; to be paid to his/her beneficiary unless a distribution was made to the EDB in the year of his/her death.
 - For an EDB, the Plan can adopt one of the distribution options in its plan document or allow the beneficiary to choose between the two options. If Plan allows an election between both options, the Plan must specify a default rule, but only if the outcome would be different than the default rules under the Code.

Final Regulations Regarding RMDs Following Employee's Death Before RBD

- The Final Rule also provides:
 - Annual distributions continue for up to 10 years after:
 - 1) The death of an EDB who was taking life expectancy payments; or
 - 2) The attainment of the age of majority (if the EDB was a minor child of the employee taking life expectancy payments).
 - DC plans can have different rules for different categories of eligible designated beneficiaries. Ex: a DC plan may provide that only an employee's surviving spouse may elect between the 10-year rule and life expectancy payments.

Final Regulations Regarding RMDs Following Employee's Death Before RBD

- Clarifications on the definition of EDB:
 - Child includes anyone under Code Section 152(f)(1) (step-child, eligible foster child) under 21.
 - Disability is defined under Code Section 72(m)(7), but if the beneficiary is under the age of 18, a disability exists if the beneficiary has “a medically determinable physical or mental impairment that results in marked and severe functional limitations, and that can be expected to result in death or to be of long-continued and indefinite duration.”
 - Having a determination of disability from the SSA is a safe harbor.
 - Documentation of the disability or chronic illness must be provided to the plan no later than October 31 of the calendar year following the year of the employee's death.
 - Relief from the documentation requirement for calendar years 2020-2023 if documents are received by October 31, 2025.
- If there are multiple beneficiaries and at least one is not an EDB, then the rules for non-EDB apply, with some exceptions.

Final Rules—RMD Calculations for DC Plans

- Generally, the calculation rules have remained the same, with a few modifications:
 - 2002 regulations had a bifurcation rule for distributions when a portion of the account balance was used to purchase an annuity contract.
 - Final Rule provides an alternative to the bifurcation rule—a plan may permit an employee to elect to satisfy the RMD rules for the annuity contract and that account balance in the aggregate by adding the fair market value of the annuity contract to the remaining account balance and treating payment under the annuity contract as distributions from the individual account.

Final Rules—RMD Calculations for DC Plans

- If an employee dies after the RBD, continued annual distributions must be made, calculated consistent with the 2002 regulations, but in addition, the employee's entire interest must be distributed by the earliest of the following dates:
 - *If the designated beneficiary is not an EDB*, by the end of the tenth calendar year following the calendar year in which the employee died;
 - *If the beneficiary is an EDB*, by the end of the tenth calendar year following the year in which the EDB died; or
 - *If the designated beneficiary is the child of the employee who had not yet reached 21 as of the date of the employee's death*, by the end of the tenth calendar year following the year in which the beneficiary attains 21.
- These distribution requirements apply to an annuity contract purchased from a DC plan, which is otherwise generally determined under the RMD calculation rules for a DB Plan.

Final Rules—RMD Calculations for DC Plans

- If the employee dies after RBD (or the employee died before and an EDB is taking a lifetime distribution option) annual RMD payments are calculated based on the life expectancy of the designated beneficiary using the age of the beneficiary in the year following the year of the employee's death, reduced by one for each subsequent year. Special rules if the sole designated beneficiary is the participant's spouse.
- If there are multiple designated beneficiaries, general rule is to calculate the RMD payments and to determine when a full distribution must be made, based on the life expectancy of the oldest designated beneficiary.
 - Certain exceptions to the full distribution rule for a multi-beneficiary trust (a trust in which at least one beneficiary is chronically ill or disabled) and a when at least one, but fewer than all, of the designated beneficiaries is child of the employee under the age of 21.
- Amounts in Roth accounts are not included in RMD calculations for the years up to and including the employee's death.

Proposed Rules Under Secure Act

- Proposed Rules were also issued on July 19, 2024, to implement some provisions of the Final Rule.
- The Proposed Rule addresses the following issues:
 - Would clarify that the applicable age for employees born in 1959 is 75.
 - When aggregating an annuity contract and remaining account balance, the FMV of the annuity contract would be determined as of December 31 of the calendar year preceding the distribution calendar year.
 - More guidance on Roth accounts.
 - Rules to implement the provisions that allow a surviving spouse to be treated as the employee for RMD purposes.

Early Distributions Under Secure 2.0

- Code §72(t) provides that all payments from a qualified retirement plan paid before participant reaches age 59½ are subject to 10% “early distribution” penalty unless an exception applies.
- Secure 2.0 added two new optional exceptions to this early distribution penalty:
 - Emergency Personal Expense Distribution—distribution to meet unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses, up to a maximum of \$1,000 and limited to one distribution per calendar year.
 - Domestic Abuse Victim Distribution—distribution to a victim of domestic abuse during the one-year period of when the abuse occurred, up to a maximum of \$10,000.
- Plan can rely on participant self-certification.
- If the Plan allows rollover contributions, participant can repay the distribution amount within 3 years of when the distribution was made.
- Distributions are not subject to the rollover rules.

IRS Notice 2024-55

- Emergency Personal Expense Distributions
 - Facts and circumstances test—Factors include needs related to medical care, accident or loss of property due to a casualty, need to pay for funeral or burial expenses, auto repairs, or other necessary emergency personal expenses.
 - Distribution cannot exceed the lesser of (i) \$1,000 or (ii) the participant's vested account balance over \$1,000. Amount is not adjusted for inflation.
 - Notwithstanding the 1-year rule, a participant cannot receive a second Emergency Personal Expense Distribution during the following three calendar years unless (i) the previous Emergency Personal Expense Distribution is repaid to the Plan; or (ii) the participant's aggregate elective deferrals and employer contributions, after the previous Emergency Personal Expense Distribution, is at least equal to the previous Emergency Personal Expense Distribution that has not been repaid.
 - If Plan does not offer this type of distribution, but a participant takes a distribution that meets the requirements, that person can treat it as an Emergency Personal Expense Distribution on his/her tax return.

IRS Notice 2024-55

- Domestic Abuse Victim Distributions
 - Domestic abuse means physical, psychological, sexual, emotional or economic abuse or undermines the victim's ability to reason independently, which can include abuse of the victim's child or another family member living in the household.
 - Can be added to any eligible retirement plan that is not subject to spousal consent rules.
 - Distributions limited to the lesser of: (i) \$10,000; or (ii) 50% of the participant's vested account balance.
 - \$10,000 limit subject to annual cost of living adjustments.
 - If Plan does not offer this type of distribution, but a participant takes a distribution that meets the requirements, that person can treat it as a Domestic Abuse Victim Distribution on his/her tax return.

Student Loan Repayment as Elective Deferral for Matching Contributions

- Effective 2024, SECURE 2.0 permits matching contributions on behalf of participants in a 401(k), 403(b) or 457(b) plans with respect to qualified student loan payments, in same manner as if those payments were elective deferrals to plan.
- A “qualified student loan payment” (QSLP) is an employee’s repayment of a “qualified education loan” for higher education expenses of an employee, the employee’s spouse or the employee’s dependent when debt arose.
- Employee must certify annually to the employer making the matching contributions that payment has been made on the loan.

IRS Notice 2024-63

- Employee must have a legal obligation to repay the loan, such as a co-signor, but the QSLP can only be made for the person who actually makes the loan repayment.
- A plan cannot limit QSLP matches to only certain qualified education loans.
- All employees eligible to receive matches on election deferrals in a plan that has a QSLP match feature must be eligible to receive QSLP matches.
- QSLP matches can only be made to employees who are eligible for matches on elective deferrals.
- QSLP certifications must include certain specified information—the amount and date of the loan payment, that payment was made by the employee, that the loan is a qualified education loan and was used for a permitted purpose and that the loan was incurred by the employee.
- QSLP matches can be made at different frequencies than matches on elective deferrals, provided the QSLP matches are contributed at least annually.

Special Financial Assistance Program (SFA)— Changes to the Death Audit Process

- November 2023 report issued by the Inspector General's office (OIG) found 3,479 deceased participants in Central States' SFA application—equated to approximately \$127 billion in overpaid SFA.
- Report criticized PBGC for not using the SSA death master file (DMF), which it has access to.
- OIG recommended that PBGC use social security DMF for all participants.
- Effective November 1, 2023, all plans are required to submit full census data to PBGC to run through DMF.
- Plans that received SFA before change to instructions are now receiving repayment demand letters

Key Takeaways

- Even as the retirement plan landscape has seen a shift from defined benefit plans to participant-directed defined contribution plans, efforts to expand the definition of an advisory fiduciary have been blocked by political pressure and court intervention.
- Plans have the flexibility to keep the current applicable age for required beginning dates, or increase such ages consistent with Secure and Secure 2.0

Key Takeaways

- Plan administrators of defined contribution plans should decide whether to allow additional early distributions for participants who need money to address emergency personal expenses or to relocate from abusive situations at home.
- Plan administrators should consider whether to allow matching contributions on qualified student loan repayments to assist participants who are paying off student debt to also save for retirement at the same time.

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