HEAD INVESTMENT PARTNERS

Fiduciary Hot Topics

Q3 2023

Assets in Retirement Plans Top $35 Trillion

- According to data released by the Investment Company Institute, retirement assets in the US grew by 3.5% quarter over quarter to 35.4 trillion dollars. This is as of the end of the first quarter of the year. These assets represent approximately 31 percent of US households' net worth.
- In the private sector, the vast majority of these assets are held in defined contribution plans, but in the public sector significant retirement assets remain in traditional defined benefit pension plans.
- Some good news is the data show that participants and IRA holders have not reacted to market volatility. By and large, they held the course through the market downturns in 2008-09, 2020 and 2022.
- The lion's share of assets in defined contribution plans and IRAs is invested in mutual funds with a large portion in asset allocation tools such as target date funds.
- Rollovers to IRAs from retirement plans continue to increase every year. Internal Revenue Service records show that in 2020 (the most recent year for which there is data) rollovers to IRAs totaled $618 billion.

Where the Money Is

$35.3 trillion	**Total assets in US retirement plans**
$6.9 trillion	**401(k) plans**
$1.2 trillion	**403 (b) plans**
$1.2 trillion	**Other types of defined contribution plans**

$12.5 trillion	**IRAs**
$759 billion	**Federal Employees Retirement System Thrift plan**
$7 trillion	**Government defined benefit pension plans**
$3.2 trillion	**Private sector defined benefit pension plans**
$2.2 trillion	**Insurance company reserves**
	Defined Contribution Plan and IRA Assets Invested in Mutual Funds
$4.3 trillion	**401(k) plans - 62% of assets - $1.2 trillion of this is in asset allocation tools, mostly target date funds**
$5.2 trillion	**IRAs - 42% of assets - $1 trillion is in asset allocation tools, mostly target date funds**

In the future, Plan Sponsors Will Have to Pay More Attention to Allocating Unused Balances in Forfeiture and Revenue Credit Accounts

- Historically there has been little formal guidance from either the Treasury Department or the Internal Revenue Service concerning forfeiture and revenue credit accounts. In February, the Treasury Department published a proposed regulation regarding the use and timing of assets held in plan's forfeiture accounts. The good news is that the proposed regulation, by and large, conforms to the industry's prevalent understanding of the use and timing of forfeitures.

- In the absence of formal guidance, it has been the general understanding that forfeitures may be used in one of three ways:

  - Pay reasonable plan expenses such as recordkeeping fees,
  - Reduce employer contributions, or
  - Allocate to participants' accounts.

- A revenue credit account exists where plan investments generate revenue credits to cover the cost of record keeping that exceed the record keeper's fee. In this circumstance, the recordkeeper allocates the excess to a revenue credit account.

- It has been the general understanding that the balance in revenue credit accounts may be used in the same manner as the balance in forfeiture accounts, with the exception that amounts in such accounts cannot be applied to offset employer contributions because these credits originate from participant accounts.

- With regard to timing, it has generally been understood that the balance in forfeiture and revenue credit accounts must be exhausted by the end of the plan year and may not remain unallocated from year to year. The Internal Revenue Service confirmed this in a newsletter issued in 2010 stating that the balance in forfeiture accounts should be allocated by the end of the plan year in which the forfeitures occur. However, the Internal Revenue Service has never made a serious effort to enforce this rule and plan sponsors often allowed the balances in forfeiture and revenue credit accounts to grow year over the year.

- The proposed regulation confirms the general understanding that these amounts should not remain unallocated indefinitely. With regards to timing, the proposed regulation requires that the balance in a forfeiture account be allocated within 12 months of the end of the plan year in which the forfeitures occur.

- The proposed rule has an effective date of January 1, 2024. There is a transition rule that treats forfeitures that occur prior to this effective date as if they had occurred in 2024.

- With clear guidance on the timing of forfeitures, it seems likely the Internal Revenue Service may step up its enforcement efforts.

- Although this guidance does not mention revenue credit accounts, it may be arguable that similar timing could apply to their usage in similar fashion as forfeiture accounts. It is desired that the final regulation address this.

Changes to Form 5500 Will Allow a Greater Number of Small Plans to Avoid the Annual Audit Requirement

- From time to time the Department of Labor, the Internal Revenue Service and/or the Pension Benefit Guaranty Corporation make revisions to Form 5500.
- Revisions made to the 2023 Form 5500 relate to SECURE Act amendments made to ERISA. The changes are intended to improve reporting of financial information and plan expenses. There are new compliance questions concerning safe harbor status and how a plan satisfied certain discrimination and coverage tests.
- A significant change affects the methodology for determining if a plan has less than 100 participants and is, therefore, treated as a small plan exempt from the annual requirement to retain an independent auditor. Under the current rule, all eligible individuals must be counted, even those who elect not to participate. **Going forward only participants and beneficiaries with account balances on the first day of the plan year must be counted.**
- There is a rule known as the 80/120 rule intended to prevent plans with close to 100 participants from regularly falling within and without the scope of a required audit. Under this rule, a plan treated as a small plan in the previous year will continue to be exempt from the audit requirement if has less than 120 participants. This rule works as follows:

Number of Participants at Beginning of Current Year	Requirements Followed for the Previous Year Form 5500	Requirements to be Followed for the Current Year Form 5500
80 – 99 (inclusive)	Small plan	Small plan
80 – 99 (inclusive)	Large plan	May elect to file Form 5500 again as a large plan or switch to a small plan
100 – 120 (inclusive)	Small plan	May elect to file Form 5500 again as a small plan or switch to a large plan
100 – 120 (inclusive)	Large plan	Large plan
More than 120	Small plan	Large plan
More than 120	Large plan	Large Plan

Technical Corrections to SECURE Act 2.0

- Mistakes are inevitable in drafting legislation. This is especially true in tax legislation as tax law is complex and more nuanced as compared to other areas of the law. Technical corrections are made to rectify unintended glitches and mistakes so that the legislation reflects the original intent of Congress.
- Congress has informed the Treasury Department that it intends to make four technical corrections to SECURE Act 2.0 (see below). These corrections will fix minor glitches in the statute. More changes are expected. One such change is the result of the industry lobbying to push back the effective date from 2024 for the new rule that individuals with wages exceeding $145,000 may make catch up contributions only on a Roth basis.
- **Catch Up Contributions:** The section of the statute under which individuals with wages exceeding $145,000 in the

previous year may only make catch up contributions on a Roth basis includes a conforming provision that inadvertently eliminated catch up contributions after 2023. The letter indicates that this was not Congress's intent.

- **Age for Minimum Required Distribution:** The SECURE Act incrementally increases the beginning date for required minimum distributions from age 72 to 75. The timing for the increase from age 73 to 75 is not clear. The letter states that the increase from 73 to 75 in 2033 is intended to apply to individuals who turn 73 after 2032 and not individuals who turn 74 after 2032.
- **SEP and SIMPLE IRA Roth Contributions**: The Act permits SIMPLE IRA plans and SEP plans to include a Roth IRA. The letter clarifies that Roth contributions to SEP and SIMPLE IRAs are not intended to count against the Roth IRA contribution limit.
- **Small Employer Tax Credit**: The Act increases from 50 percent to 100 percent the startup credit to cover plan expenses for employers with no more than 50 employees - annual limit of $5,000. There is also a new tax credit equal to a percentage of employer contributions - limited to $1,000 per employee. The letter clarifies that the new tax credit for employers that make contributions to the plan is intended to be in addition to the start-up tax credit and thus should not count toward the annual $5,000 limit on the start-up tax credit.

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