HEAD INVESTMENT PARTNERS

# FIDUCIARY HOT TOPICS

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## Final and Proposed RMD Rules Answer Some Questions, Raise Others

On July 18, 2024, the IRS released final required minimum distribution (RMD) rules[1], along with proposed rules addressing certain supplementary issues. This rule package is extensive and will take time to fully understand. What follows is a high-level summary of key points. The final and proposed regulations affect qualified 401(a) plans (including 401(k) plans), 403(a) annuity plans, 403(b) plans, governmental 457(b) plans, and IRAs. Generally, they apply to distribution calendar years beginning on or after January 1, 2025. For earlier years, individuals must apply the 2002 and 2004 regulations, using a reasonable, good-faith interpretation of the amendments made by the SECURE Act and SECURE Act 2.0.

### Beneficiary 10-Year Rule After RBD Requires Annual Distribution

The new rules confirm when an account owner dies on or after the required beginning date (RBD)[2] and have a non-eligible designated beneficiary (NED) (e.g., a non-spouse beneficiary) subject to the 10-year distribution rule, the NED must receive an RMD each year for the first nine years and deplete the account by the end of the 10th year following the account owner's death. A similar rule applies following the death of an NED or after a minor reaches the age of maturity. The IRS provided penalty relief for these "specified" RMDs not taken in 2021-2024 but will require them to be taken beginning in 2025.

### Confirmed RMD Ages Resulting from SECURE Acts 1 and 2

| Date of Birth | RMD Age |
|---|---|
| Before July 1, 1949 | 70 1/2 |
| July 1, 1949 to December 31, 1950 | 72 |
| January 1, 1951 to December 31, 1959 | 73 |
| January 1, 1960, or later | 75 |

### Designated Roth Account Assets

Plans will exclude designated Roth account assets when calculating RMDs and such amounts, when distributed, will be eligible for rollover.

**Solo Spouse Beneficiary Treated as Account Owner for RMDs**

When the account owner dies before the RBD and the sole beneficiary of the account is the spouse taking life expectancy payments, the surviving spouse beneficiary will be treated as the account owner automatically. This allows the surviving spouse to use the uniform lifetime table instead of the single life expectancy table to calculate payments.

When the account owner dies on or after the RBD a surviving spouse beneficiary may elect to be treated as the account owner. In contrast to death before the RBD, for death on or after the RBD, this new rule will not automatically apply but may be available under the terms of the plan document.

**"Hypothetical" RMDs**

If a surviving spouse elects the 10-Year Rule and later decides to treat the deceased spouse's IRA as their own (or do a spousal rollover), prior to doing so they must "catch up on" any RMDs that, otherwise, would have been required as annual life expectancy payments.

Many other clarifications and new nuances to the RMD rules are included in the regulations as well. A more thorough analysis is underway and will be provided later.

The impact is significant. As a result of the changes, it will be necessary for recordkeepers and TPAs to implement programming changes for distribution processing. Plan participants, IRA owners, and their beneficiaries will need to be aware of the new rules in order to ensure proper RMD amounts are taken.

## DOL Finalizes Fiduciary Investment Advice Rules, But ...

As covered in last quarter's update, on April 25, 2024, the Department of Labor (DOL) published its "Retirement Security Rule: Definition of an Investment Advice Fiduciary," a package of finalized regulations and amendments to several advice-related prohibited transaction exemptions (PTEs), including PTE 2020-02 and 84-24, as well as others. The final rule defines when an entity or person (e.g., a financial advisor) is a fiduciary because of providing advice for a fee to a "retirement investor." The final rule, as well as the amended PTEs, were scheduled to take effect on September 23, 2024. However, two lawsuits, a joint resolution for disapproval in Congress under the Congressional Review Act, and a Supreme Court ruling have emerged to put on hold and challenge the regulatory package. Currently, the September effective date has stayed. For now, the investment advice fiduciary "Five-Part Test" continues in force, as well as existing PTEs—without the latest amendments.

For background, the final regulations protect retirement investors, defined as retirement plans, plan sponsors, plan participants, beneficiaries, IRAs, IRA owners and beneficiaries, plan fiduciaries with discretionary authority, as well as Health Savings Accounts. Under the DOL's final rule (now in limbo), a person or entity (provider) will be an investment advice fiduciary, subject to ERISA's

standard of care, loyalty, and prudence to the retirement investor if the following are true. The provider makes a professional investment recommendation to a retirement investor; receives a fee or other compensation for the recommendation, and holds itself out as a trusted adviser by specifically stating that it is acting as an ERISA fiduciary; or making the recommendation in a way that would indicate to a reasonable investor that it is acting as a trusted adviser making individualized recommendations based on the investor's best interest. Typically, a provider of fiduciary investment advice must follow a PTE (e.g., 2020-02 or 84-24) to receive compensation for the advice.

**Legal and Congressional Pushback**

Two lawsuits have been filed challenging the DOL's new rule (Federation of Americans for Consumer Choice, Inc. v. DOL and American Council of Life Insurers v. DOL), alleging that the rule is inconsistent with ERISA and is an arbitrary and capricious application of ERISA's fiduciary provisions. The combination of the two cases has put a hold on the effective date of both the regulations and amended PTEs. The DOL is expected to appeal both rulings, which will take some time and may lead to the US Supreme Court's eventual involvement.
Additional pushback is coming from Congress. A Congressional Review Act (CRA) resolution disapproving the rule has been introduced in the House and Senate (see S.J.Res.79 and H.J.Res.142)3, 4. This resolution has very limited bipartisan support, so the likelihood of passage is slim and, if passed, is expected to be vetoed by President Biden.

**Impact of Overturned Chevron Doctrine**

Add into the mix the US Supreme Court's decision on June 28, 2024, in Loper Bright v. Raimondo to overturn the Chevron Doctrine, a rule that (since 1984) has required federal courts to defer to agency interpretations (e.g., the DOL's interpretations of ERISA) when a statute was ambiguous. Historically, litigation challenging DOL regulations and their application (e.g., participant fiduciary lawsuits) relied, in part, on the Chevron Doctrine. From now on, Federal courts must draw their own conclusions about the correct legal interpretation of ambiguous federal statutes. SCOTUS's overruling of the Chevron Doctrine will likely play a role in additional lawsuits challenging the DOL's newly finalized investment advice rules. More information listed in Litigation Highlights section below.

**Other Considerations**

The outcome of the upcoming election has the potential to impact the fate of the DOL's advice regulations as well. Keep in mind, that while the DOL's advice regulations may be in limbo for the time being, broker-dealers and registered investment advisors are subject to the best interest regulations and fiduciary standards of the Securities Exchange Commission.

## Abandoned Plans Program Updated for use in Bankruptcy

On May 16, 2024, the Employee Benefits Security Administration (EBSA), under the DOL, published interim final rules relating to the amendment of the Abandoned Plan Program (the Program) to allow Chapter 7 bankruptcy trustees who are responsible for administering a bankrupt company's individual retirement plan to terminate and distribute benefits to participants under the Abandoned Plan Program. Prior to this change, Chapter 7 bankruptcy trustees were unable to use this Program. The EBSA also amended prohibited transaction exemption (PTE) 2006-06, to permit Chapter 7 bankruptcy trustees who are using the Abandoned Plan Program to be able to pay themselves for their services rendered in furtherance of terminating and distributing benefits under the Program.

The Department of Labor's (DOL's) Abandoned Plan Program was implemented in 2006 and provides a process for terminating and distributing benefits from individual account retirement plans (e.g. 401(k) plans) in the situation where the plan's sponsor has closed down and abandoned the plan. When a plan is abandoned, custodians, such as banks, insurers, and mutual fund companies, are often left holding assets with no authority to terminate the plan or make benefit decisions. This means that plan participants are unable to access the retirement benefits that they have earned.

Under the Abandoned Plan Program, custodians can wind up the affairs of abandoned plans so that benefits are able to be distributed to participants and beneficiaries. In general, a plan is "abandoned" if 1) no contributions to or distributions from the plan have been made for at least 12 consecutive months; and 2) following reasonable efforts to locate the plan sponsor, it is determined that the sponsor no longer exists, cannot be located, or is unable to maintain the plan. The determination of whether a plan is "abandoned" can only be made by a Qualified Termination Administrator (QTA).

There are special rules for Chapter 7 bankruptcy trustees under the Abandoned Plan Program. For more information, please see RLC's Case of the Week Chapter 7 Bankruptcy Trustees Can Use the Abandoned Plan Program.5

## DOL Needs Plan Sponsors' Help to Populate Retirement Savings Lost and Found

In an April proposal,6 the DOL asked plan sponsors to voluntarily provide information about their missing or lost participants to help populate the Retirement Savings Lost and Found online searchable database by December 29, 2024. Section 303 of the SECURE 2.0 Act of 2022 requires the DOL, not later than two years after the date of enactment, to create the database in consultation with the IRS.

Retirement plans sometimes lose track of people owed benefits for a variety of reasons, (e.g., due to incomplete recordkeeping or people changing jobs). Workers may lose track of their retirement plans after their former employers go out of business or when companies merge, etc. The DOL considers individuals in these situations "missing participants." The goal of the database is to "... reunite workers with retirement benefits earned over their working lives and to help the Department assist them in that effort."

The notice lists the data elements needed, as well as how to submit them to the DOL (via Form 5500 filings). Plan administrators will be able to electronically submit this data as an attachment to this year's EFAST2 filing, however, the additional information "would not be considered part of the Form 5500." The DOL also is looking to establish a portal for plan administrators to submit the information directly to the Lost and Found database as an alternative to submitting the information as an attachment to Form 5500 using EFAST2. The DOL will provide the spreadsheet file template (CSV format) and intends to make available a model format that plan administrators could use to submit the information. More information is forthcoming.

### IRS issues FAQs on Disaster Relief Related to Retirement Plans

IRS Fact Sheet 2024-19 7 contains frequently asked questions (FAQs) covering certain federally declared disaster-related distributions to retirement plan participants and IRA owners, as well as plan loans under SECURE Act 2.0. The IRS issued the guidance to quickly provide general information to taxpayers and tax professionals. Because these FAQs have not been published in the Internal Revenue Bulletin, the IRS will not rely on or use them to resolve any particular case. Similarly, if an FAQ turns out to be an inaccurate statement of the law as applied to a particular taxpayer's case, the law will control the taxpayer's tax liability.
Nonetheless, taxpayers who reasonably and in good faith rely on these FAQs will not be subject to penalties for underpayment of tax as long as they have a reasonable cause standard for relief.

## Litigation Highlights

### SCOTUS Overturns Long-Standing Chevron Deference Doctrine

On June 28, 2024, the Supreme Court issued a decision (Loper Bright v. Raimondo) overturning the Chevron Doctrine, a rule that (since 1984) required federal courts to defer to federal agency interpretations of ambiguous statutes (e.g., DOL's interpretation of ERISA). Chevron is often a feature of litigation challenging DOL regulations and in plan participant lawsuits alleging fiduciary breaches. Following the ruling, federal courts must draw their own conclusions about the correct legal interpretation of ambiguous federal statutes.

In the retirement space, the Supreme Court's reversal of the Chevron Doctrine will have widespread consequences for our understanding of fiduciary responsibility and of the administration of retirement plans. It will be significantly harder for agencies to change policy by interpreting or reinterpreting the statutes they administer.

As mentioned previously, additional lawsuits challenging the DOL's newly finalized investment advice rules seem inevitable in the wake of the Chevron Doctrine reversal. Other plan governance areas, for example regarding Environmental Social Governance (ESG) investing, also will be affected. In Fifth Circuit Court of Appeals Utah et al. v. Julie Su, Acting Secretary of Labor, the court sent back (remanded) the case to the district court to determine whether the DOL's ESG rule represents the best reading of the statute or not.

**Plan Forfeitures**

Two California district courts came to different conclusions in plan forfeiture litigation. On May 24, 2024, the United States District Court for the Southern District of California denied defendant's motion to dismiss in Perez-Cruet v. Qualcomm Incorporated, finding that the sponsor's exercise of discretion to use forfeitures to reduce employer contributions, rather than to reduce participant-paid administrative costs, presented a colorable violation of ERISA's fiduciary rules. On June 17, 2024, the United States District Court for the Northern District of California granted the defendants' motion to dismiss in Hutchins v. HP Inc., a case involving nearly identical facts/claims. Based on the latter decision, defendants in Perez-Cruet v. Qualcomm have filed a motion to reconsider.
Plan sponsors should review their plan document language regarding use of forfeitures. The rules clearly allow forfeitures 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. Including all three options in the plan document gives sponsors the greatest level of flexibility, and establishing a hierarchy of their use in the plan language would take any element of employer discretion out of play.

The DOL's final Environmental Social Governance (ESG) regulations took effect January 1, 2023. ESG factors may be considered in investment selection if the fiduciary reasonably determines they are relevant to a risk and return analysis. The rules allow consideration of ESG factors in two circumstances: 1) Where a fiduciary concludes that ESG factors (e.g., climate change risk) are relevant to a risk and return analysis and 2) as a modified "tiebreaker" standard. The tiebreaker rule only matters when ESG factors do not affect the risk/return analysis and ESG factors are collateral benefits other than investment returns.

In the case, State of Utah et al. v. Martin J. Walsh and United States Department of Labor, which involved a 26-state challenge to the DOL's ESG rule, the court found in favor of the DOL's ESG rule. Plaintiffs recently filed an appeal of the lower court's decision in the Fifth U.S. Circuit Court of Appeals case (State of Utah et al. v. Julie A. Su, Acting Secretary, U.S. Department of Labor United States Department of Labor.)

In another case, Spence v. American Airlines, decided on June 20, 2024, the United States District Court Northern District of Texas held for the plaintiff, denying the defendant's motion for summary judgment. The case involved a challenge to the American Airlines 401(k) plan fiduciaries' selection/retention of funds/fund managers that pursue "ESG goals" in proxy voting. After the court decided on this motion, the parties proceeded to a bench trial that concluded on June 27, 2024. The court found evidence that the plan's committee did not consider the issue of the proxy voting policy of plan funds/fund managers and evidence of committee officials' involvement in employer ESG efforts created triable issues of fact.

### TDF Fiduciary Hygiene

With an appropriate investment policy statement, customized benchmarks, and thorough committee minutes, a plan sponsor defendant prevailed against claims of fiduciary violations in district court. On May 20, 2024, the United States District Court for the Northern District of California dismissed the plaintiffs' complaint in Bracalente v. Cisco Systems, Inc., held that defendant Cisco did not violate ERISA's prudence requirement in selecting (and retaining) a suite of BlackRock target date funds (TDFs) as the Cisco 401(k) plan's qualified default investment alternative (QDIA). Critical in this decision: An appropriate IPS crafted (in part, at least) with a view towards potential litigation; where appropriate, explicit custom benchmarks, especially for the plan's QDIA-TDFs; and adequate committee minutes reflecting review of fund performance and conforming to the standards adopted in the IPS.

## Legislative Developments

### CITs for 403(b)s Proposal

U.S. Senators Katie Britt (R-Ala.), Raphael Warnock (D-Ga.), Dr. Bill Cassidy (R-La.), and Gary Peters (D-Mich.) have introduced (S. 4917), the Retirement Fairness for Charities and Educational Institutions Act,8 to enhance investment options for 403(b) retirement plans. The Senate referred the bill to the Committee on Banking, Housing, and Urban Affairs. A similar provision was included in H.R. 2799,9 which passed the House in March and has since been referred to the Senate.

The proposal would expand retirement savings opportunities for non-profit employees by allowing 403(b) plan participants to invest in collective investment trusts (CITs). While SECURE Act 2.0 amended the Internal Revenue Code to allow CITs for 403(b) arrangements, it did not address related securities laws, thereby preventing parity with 401(k) plans. A CIT is a tax-exempt investment vehicle that provides a diversified, pooled investment option—similar to a mutual fund. Under current law, unlike 401(k) holders, 403(b) plan sponsors are not able to include CITs as an investment option. This legislation would create parity between 403(b) and 401(k) retirement savings plans.

Links:
1. https://www.govinfo.gov/content/pkg/FR-2024-07-19/pdf/2024-14542.pdf
2. RBD is April 1st of the year following attainment of the applicable RMD age; unless an exception applies.
3. https://www.congress.gov/bill/118th-congress/senate-joint-resolution/79?q=%7B%22search%22%3A%22congressional+disapproval%22%7D&s=2&r=38
4. https://www.congress.gov/bill/118th-congress/house-joint-resolution/142
5. https://retirementlc.com/resources/chapter-7-bankruptcy-trustees-can-use-the-abandoned-plan-program/
6. https://www.govinfo.gov/content/pkg/FR-2024-04-16/pdf/2024-07968.pdf
7. https://www.irs.gov/newsroom/disaster-relief-frequent-asked-questions-retirement-plans-and-iras-under-the-secure-20-act-of-2022
8. https://www.congress.gov/bill/118th-congress/senate-bill/4917/all-actions
9. https://www.congress.gov/118/bills/hr2799/BILLS-118hr2799rfs.pdf

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