Hot topics

for defined contribution plans

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This quarterly publication highlights recent and ongoing issues and developments that are relevant to defined contribution plan sponsors. In each issue we highlight fundamental areas in plan design and administration, member engagement, compliance and risk, and investments.

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In this issue

Talk to us

If you are interested in exploring any of these topics further, contact us at **talktous@buck.com** or call **1 866 355 6647**.

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Design and administration

Factors influencing retention of terminated participant balances

A recent survey of 401(k) plan consultants[1] asked what solutions and features may best persuade retired participants to remain in plan. The top three responses were:

1. Lower cost for comparable investments versus a rollover IRA
2. Flexibility in drawing down asset
3. Investment solutions that generate guaranteed income

Fiduciaries will want to present a complete view of the issues contrasting differences between plans and Rollover IRAs.

What this means to plan sponsors

As the entirety of the main wave of the Baby Boom generation (born 1946-1957)[2] has now reached Age 65, an increasing share of 401(k) plan assets are held by terminated participants.

While sponsors may be increasingly interested in updating plan design and communications to make remaining in the plan attractive to terminated participants (e.g., allowing periodic loan repayments to continue rather than forcing total payoff), fiduciaries may be concerned about making statements which could potentially be the basis of future litigation.

Sponsors should review all plan features to make the plan as attractive as possible to terminated participants and ensure their communications present a full picture of benefits vs. potential limitations on retaining plan assets.

[1] T Rowe Price, "2021 Defined Contribution Consultant Research Study", May 2022, https://www.troweprice.com/institutional/us/en/insights/articles/2022/q2/defined-contribution-consultant-research-study.html

[2] While the U.S. Census Bureau defined the baby boom generation as those born between 1946-1964, birth rates started declining after 1957.

Benchmark data finds record high deferral rates

Both T. Rowe Price and Vanguard reported[1,2] that 2021 average deferral rates for their recordkeeping participants reached record highs: Vanguard at 7.3%, while T. Rowe Price reported 8.5%.

Both cited plan design reasons behind the increase:

- Higher initial default rates with over 58% of Vanguard auto-enrolled plans defaulting to at least 4%, while 52% of T. Rowe Price auto-enrolled plans defaulted to 5% or more
- Higher utilization of auto-escalation, reenrollment, and under-saver sweep features were also reported

What this means to plan sponsors

Both providers report that average employee deferrals have continued to climb steadily over the last 10 years to reach these record highs.

The fact that these rates generally exceed the typical match ceiling of 6%, as well as a plan's initial default rate, demonstrates that participants recognize the importance of voluntary savings for retirement.

Sponsors should review their plan design to see if they are utilizing all the tools available to foster greater employee deferrals.

[1] T Rowe Price, "2022 Reference Point Summary", May,2022, https://www.troweprice.com/content/dam/retirement-plan-services/pdfs/insights/savings-insights/REFERENCE_POINT_2022_Commentary.pdf

[2] Vanguard, "How America Saves 2022 - Insights to Action", June 2022, https://institutional.vanguard.com/how-america-saves/overview.html

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Engagement

Coordinating 401(k) and HSA communications

A recent Employee Benefit Research Institute (EBRI) presentation, "The Three Certainties of Life: Death, Taxes and Updates From The EBRI Health Savings Account Database," highlighted that from 2016-2020 the number of HSA accounts has grown more than 60% and the amount of assets has grown by 250%.[1]

At the same time, a recent survey shows 60% of all 401(k) plans with an auto-escalation feature increase deferral beyond the ceiling for employer matching contributions.[2]

What this means to plan sponsors

These surveys highlight a potential problem when asking employees to voluntarily save for retirement as there are typically separate employee communications for health and wealth accumulation programs that lack focus on helping employees prioritize these tax-preferred contributions.

For instance, few sponsors note that, in general, HSA contributions may offer a better after-tax return than voluntary 401(k) contributions due to their tax treatment.

Sponsors need to provide employees with assistance so they can determine their contribution allocation among different benefit programs with voluntary saving components.

[1] https://www.ebri.org/videos/default-source/webinar-replays/hsaupdate_033022.mp4

[2] Profit Sharing Council of America."64th Annual Survey of 401(k) and Profit Sharing Plans" (2021)

The importance of early planning and financial advice for retirees

A recent EBRI survey[1] of over 1,100 current retirees with at least $50,000 in financial assets sought to understand use of a financial plan in retirement, financial advisor use and assistance, and reflections upon past financial decisions. Key findings included:

- Current retirees wish they had saved more and planned earlier
- Retirees with a plan and/or advisor were less likely to have financial regret, when measured as the desire to change past financial habits in order to improve their financial situation
- Few retirees (24%) reported that their former employer offered financial planning assistance, potentially reflecting an awareness-gap of available services

What this means to plan sponsors

This survey is important and validates the potential benefits of financial planning services for sponsors, as well as the need for improved communications on all the services available.

Sponsors should think about how to increase utilization of financial planning tools, particularly among pre-retiree populations.

[1] https://www.ebri.org/videos/default-source/webinar-replays/hsaupdate_033022.mp4

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Compliance and risk

New legislation on the horizon

The US Congress is currently considering three bills with significant updates to the rules governing qualified retirement plans that build upon the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act). Collectively, the legislation is referred to as "SECURE ACT 2.0"

- On Securing a Strong Retirement Act of 2022 (H.R. 2954) ("House Bill")
- Enhancing American Retirement Now ("EARN") Act ("Finance Bill")
- Retirement Improvement and Savings Enhancement to Supplement Healthy Investments for the Nest Egg ("RISE & SHINE") Act (S. 4353) ("HELP Bill")

A reconciliation of the differences between the bills may be categorized by the following major objectives.[1]

[1] As presented by Davis & Haman LLP (July 14, 2022)

1. Increase savings

Provision	Treatment in bills	Key differences in bills
Expanding auto enrollment	All three bills take different approaches with respect to increasing: Automatic enrollment Automatic escalation Automatic re-enrollment	**House Bill:** Requires newly established plans to implement auto enrollment. Note that this provision does not apply to existing plans or newly formed businesses. **HELP/Finance Bill:** Each eligible employee contributing less than the automatic enrollment rate would be automatically re-enrolled at least every three years. **Finance Bill:** Creates a new automatic enrollment safe harbor requiring auto-enrollment at 6%, with annual escalation up to 10% and: (a) matching schedule of 100% on contributions up to 2% of pay, (b) 50% on the next 4%; and (c) 20% on the next 4% of pay.
Multiple employer plans (MEPs)	Allows 403(b) plans to sponsor or participate in an open 403(b) MEP, including Pooled Employer Plans ("PEPs").	**House/HELP** provisions would apply to plan years beginning after 12/31/2022. **Finance Bill** provision would apply to plan years beginning after the Date of Enactment.

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1. Increase savings (Continued)

Provision	Treatment in bills	Key differences in bills
Emergency Saving	The **Finance Bill** would provide an exception to the 10% early withdrawal tax in the case of withdrawals from qualified retirement plans (other than DB plans), section 403(b) plans, governmental section 457(b) plans, and IRAs for "emergency personal expenses." • "Emergency personal expense" distribution means any distribution for purposes of meeting unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses. • Plan administrator may rely on the employee's certification that the distribution is eligible emergency personal expense distribution. • Aggregate emergency personal expense withdrawals limited to $1,000 per year. **HELP Bill** would allow an emergency savings account • Maximum amount that may be saved is $2,500, invested in a capital preservation option (money market, stable value fund, etc.), made on an after-tax basis. • Contributions treated as elective deferrals for purposes of matching contributions, with an annual cap of $2,500 or another cap set by the sponsor. • Amounts may be withdrawn penalty-free at any time for self-certified personal or family emergencies. • Amounts must be withdrawn from these accounts before loans or withdrawals from remaining balances are permitted. • Participants may take these accounts in cash, use them for an in-plan Roth Conversion, or roll them into a Roth IRA, at termination.	**The Finance Bill** provision would apply to distributions made after 12/31/2023 **The HELP Bill** provision (below) would be effective upon the Date of Enactment. There is no provision in the **House Bill**.

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1. Increase savings (Continued)

Provision	Treatment in bills	Key differences in bills
Enhance Saver's Credit	Sets the applicable percentage of the Saver's credit at 50% for employees under the income caps and phases out to a maximum income level.[1] The Bill also increases the adjusted gross income phaseout amount and adjusts the limits for inflation. The **House** and **Finance** bill provisions would apply to taxable years beginning after 12/31/2026. Provision not included in the **HELP Bill**.	There are differences in the income limits • Phaseout begins for joint filers at $48K in the **House Bill** and $41K in the **Finance Bill**; phaseout is 0% at $83K in House and $71K in **Finance** Bills, as well as a refundable credit in the **Finance Bill**. The **Finance Bill** also includes additional provisions • Refundable: Credit would be refundable. • Credit Must Generally be Received in a Plan or IRA: Credit of $100 or more may only be received as a pre-tax contribution to a plan or IRA. • Treatment of Contribution: Contributions made would not: (1) be taxable income to the individual, (2) count toward any applicable limits on contributions, and (3) be included for other purposes, such as nondiscrimination testing.
Student loan payments as elective deferrals	Treats student loan payments as elective deferrals for purposes of matching retirement contributions. Note that employee can self-certify repayment amounts.	**The House Bill** is effective for plan years beginning after 12/31/2022, with **Finance Bill** after 12/31/2023. Provision is not in the **HELP Bill**.
Increasing catch-up contributions	Increases the annual catch-up amount to $10,000 for participants in the period after Age 60 and before Age 65.	**House Bill** would apply to years in which a participant attains ages 62-64. **Finance Bill** would apply to years in which a participant attains age 60-63. Provision is not in the **HELP Bill**.

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2. Expand coverage

Provision	Treatment in bills	Key differences in bills
Long-term part-time workers	Reduces service requirement for long-term part-time workers (500+ hours) from three years to two. Note that the rules for long-term part-time workers only apply to employee contributions.	It appears **House/HELP Bills** would apply provision to ERISA-governed 403(b) plans, overriding universal availability rule allowing sponsors to exclude participants scheduled to work less than 20 hours per week. The **House/Finance Bill** provisions would generally apply to plan years beginning after 12/31/2022, while the **HELP Bill** would apply one year after final regulations implementing the provision are published.
Small financial incentives	Allows employers to offer employees de minimis financial incentives such as gift cards for contributing to a 403(b) or 401(k) for plan years beginning after the Date of Enactment.	This provision is in the **House/Finance Bills**, but not the **HELP Bill**.

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3. Foster use of Roth contributions

Provision	Treatment in bills	Key differences in bills
In-plan Roth contributions	Catch-up contributions in qualified retirement plans would be considered Roth 401(k) deferrals.	**House Bill** effective for taxable years starting after 12/31/2022; **Finance Bill** for taxable years starting after 12/31/2023. Not included in **HELP Bill**. **Finance Bill** provision only applies for participants whose prior year compensation exceeded to-be-determined dollar limits.
Optional treatment of employer matching contributions as Roth contributions	Plan may permit an employee to designate employer match contributions as designated Roth contributions.	**House Bill** effective on Date of Enactment; **Finance Bill** for plan years after 12/31/2023. Not included in the **HELP Bill**. **Finance Bill** would also permit plans to allow employees to designate employer non-elective contributions as Roth Contributions.

4. Preserve retirement income

Provision	Treatment in bills	Key differences in bills
Increases RMD Age	Increases the RMD age for required distributions from age 72 to age 75.	**House Bill** increases age in three phases for plan years starting after: • Age 73 – for individuals who attain age 72 after 2022, and age 73 before 2030. • Age 74 – for individuals who attain age 73 after 2029, and age 74 before 2033. • Age 75 – for individuals who attain age 74 after 2032. **Finance Bill** increases ages once beginning with 2032 calendar year. No **HELP Bill** provision.

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4. Preserve retirement income

Provision	Treatment in bills	Key differences in bills
Removes RMD barriers to annuitization	Removes certain barriers to offering commercially available life annuities in DC plans by permitting some features (e.g., modest guaranteed annual increases, return of premium death benefits, period certain guarantees) now blocked under the RMD regulations. Effective for calendar years ending after Date of Enactment.	The **House Bill** provision would apply to amounts invested after 12/31/2022. The **Finance Bill** provision would apply to amounts invested after the date of enactment. Not listed in the **HELP Bill**.
RMD treatment of in-plan Roth amounts	Individuals will not be required to begin taking pre-death distributions from their in-plan Roth amounts at age 72. The provision would apply to distributions that are required for years beginning on or after January 1, 2024.	Provision only included in **Finance Bill**.
Encourages use of QLACs*	Repeals the current 25% limit of an individual's account balance, which can be paid as premiums to purchase a QLAC. The fixed premium limit still applies.	The **Finance Bill** increases the fixed premium limit from $145,000 to $200,000, which would be indexed for inflation for years after the Date of Enactment. The **House Bill** does not include such a provision. The **House** and **Finance Bills** are applied prospectively to contracts purchased on or after the Date of Enactment. No provisions in **HELP Bill**.

*Qualifying Longevity Annuity Contracts ("QLACs") are a type of deferred income annuity under which payments begin at or near the end of an individual's life expectancy

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5. Simplify retirement plan rules

Provision	Treatment in bills	Key differences in bills
Relaxed rules on recovering overpayments	In the case of an inadvertent benefit overpayment by any retirement plan, the plan fiduciary has discretion not to seek reimbursement or reduce future benefit payments to recoup amounts. Repayment may not be sought if the event occurred three or more years before participant is notified and use of collection agencies is not permitted.	The House/HELP Bill provisions would apply as of the Date of Enactment. The **Finance Bill** provision would apply to plan years beginning after the Date of Enactment.
Collective Investment Trusts (CITs) in 403(b)s	Allows CITs to be offered in 403(b) plans. Note that the most important impact may be availability of Stable Value Funds, currently not permitted. CITs may also afford opportunities to decrease investment expenses.	The **House Bill** provision would apply to amounts invested after 12/31/2022. The **Finance Bill** provision would apply to amounts invested after the date of Enactment. Not included in the **HELP Bill**
Self-Certification for hardship and emergency distributions	Permits 401(k) and 403(b) plans to rely on an employee's self-certification that a distribution is being made due to a safe harbor expense not in excess of the amount required. Also permits governmental 457(b) plans to rely on self-certification for unforeseeable emergency distributions.	• The **House Bill** provision would apply to amounts invested after 12/31/2022. • The **Finance Bill** provision would apply to amounts invested after the Date of Enactment. • Not included in the **HELP Bill**
Harmonize 403(b) and 401(k) hardship rules	Update 403(b) hardship distribution rules to match 401(k) rules, permitting withdrawals of salary deferrals, QNECs, and QMACs (both contributions and earnings), and eliminate the requirement to take any available loans first.	• The **House Bill** provision would apply to amounts invested after 12/31/2022. • The **Finance Bill** provision would apply to amounts invested after the Date of Enactment. • Not included in the **HELP Bill**.

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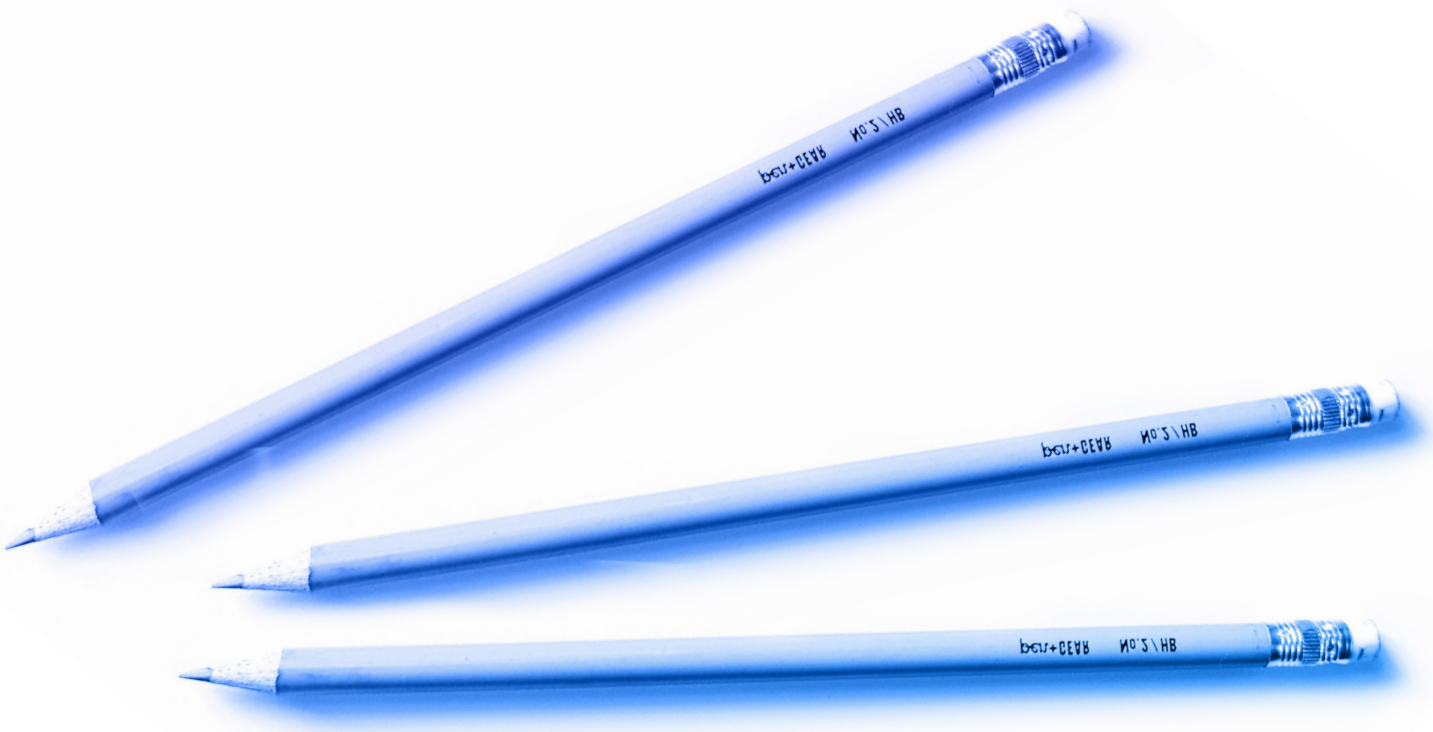
6. Miscellaneous

Provision	Treatment in bills	Key differences in bills
Penalty-free distributions for domestic abuse	Allows retirement plans to permit participants who self-certify they experienced domestic abuse within the prior 12 months to withdraw lesser of $10,000 or 50% of vested balances without 10% early distribution penalty or 20% mandatory withholding applied to eligible rollover distributions.	• The **House/Finance** bills provisions would be effective upon the Date of Enactment. • No provision in the **HELP Bill**.
Penalty-free distributions for terminally ill participants	Allows retirement plans to permit participants who can supply a physician's certification they are terminally ill to make withdrawals without any 10% early distribution penalty. Terminally ill would be defined as having an illness or physical condition that can reasonably be expected to result in death in 84 or fewer months after the certification date This provision would apply to distributions made after the Date of Enactment.	• Only included in the **Finance Bill**.



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Investments

Fund menu developments in digital assets

Fidelity announced that its recordkeeping clients could add a fund allowing participants to invest in digital assets, specifically Bitcoin, in their core 401(k) investment lineup. The announcement touted that "If Bitcoin is widely adopted by retail and institutional investors as a store of value, the upside may be substantial and relative to the initial upfront investment."[1]

Since the announcement, the price of a Bitcoin has declined almost 50% as part of a substantial decline in the value of all digital assets. Further, DOL warned 401(k) plan fiduciaries to "exercise extreme care" before including cryptocurrency [and related] investment options in plan menus.[2]

What this means to plan sponsors

Amidst the extreme market volatility in digital assets - including the bankruptcy of Celsius Networks and the potential loss of $20 billion in assets - as well as the strong objection from regulators, Fidelity's introduction of a digital assets offering was generally met with a great deal of media skepticism.

However, its undeniable that digital assets as a store of value has gained tremendous interest among the younger employees that sponsors have struggled to interest in their retirement plan offerings.

Plan sponsors should develop or better refine investment policy, including considerations on digital assets that may be of particular interest to younger employees aligning with best-practice fiduciary guidelines.

[1] Fidelity Investments. (April 2022). "Bitcoin as an aspirational store of value."

[2] U.S. Department of Labor. (March 2022). Compliance Assistance Release No. 2022-01

This presentation is for informational purposes only and is not a recommendation for any specific investment product, strategy, plan feature or other purposes.

The opinions and information contained herein should not be construed as Legal or Tax advice.

All information that is obtained from external sources cannot be guaranteed but is provided by those who have been Sustaining institution investment access for participants, active and retiree

Evolving considerations for ESG options in fund lineups

In issuing October 2021 DOL proposal updating factors allowed to be considered in evaluating plan investments to include ESG factors, the DOL commented, "that climate change and other ESG factors are often material and that in many instances fiduciaries … should consider climate change and other ESG factors in the assessment of investment risks and returns."

- Proposal is in response to the Pecuniary Factors Regulation published during the Trump administration – requiring fiduciaries to only consider issues directly related to expected returns - which sponsors may believe discourages them from offering ESG options
- Final regulations are still pending

What this means to plan sponsors

Process of considering material factors will lead to identifying an investment as having the best risk and return profile.

When there is a "tie" between two or more options, the proposal provides for a tie-breaker.

If a fiduciary "prudently concludes that competing investments …equally serve the financial interests of the plan over the appropriate time horizon, the fiduciary is not prohibited from selecting the investment…based on collateral benefits other than investment returns."

Plan sponsors should complete a study of a plan's overall investment menu configuration - reconciling its construction with investment policy - to determine where exposure to ESG may enhance participant outcomes and the optimal ways to implement options.

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Sustaining institutional investment access for participants, active and retiree

The Pew Research Center recently released a study, "Small Differences in Mutual Fund Fees Can Cut Billions From Americans' Retirement Savings." Findings cited that:

- Fee differences showing that the shifting of billions of dollars each year from 401(k)s—which are often able to purchase lower-cost institutional shares— into IRAs in which savers frequently purchase retail shares, can translate into significantly higher costs for retail investors that can eat into long-term savings significantly
- Fee disclosures are written in a technical manner that is difficult for the average consumer to understand
- Consumers could end up making decisions that chip away at their hard-earned retirement savings

What this means to plan sponsors

Increased fiduciary breach litigation, of which excessive fee complaints are the greatest, have resulted in more than 275 lawsuits filed since 2006, with nearly 100 in 2020.

While investment fees are the largest single of plan costs, there are also separate fees for core recordkeeping, participant transactions, and optional services such as advice/managed accounts and self-direct brokerage that must be considered.

Managed accounts are a burgeoning offering that layers additional fees on top of fund management fees, so a careful review on the competitiveness of these services and potential outcomes delivered for costs incurred directly by participants, is crucial.

Plan sponsors should conduct a holistic study benchmarking fees covering investment expense, plan recordkeeping and managed accounts to assure services are competitively structured to meet fiduciary guidelines on plan costs and promote expected outcomes.

Buck Global, LLC, 420 Lexington Ave, Suite 2220, New York, NY 10170

www.buck.com | info@buck.com | 866-355-6647

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