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Qualified retirement plans agenda

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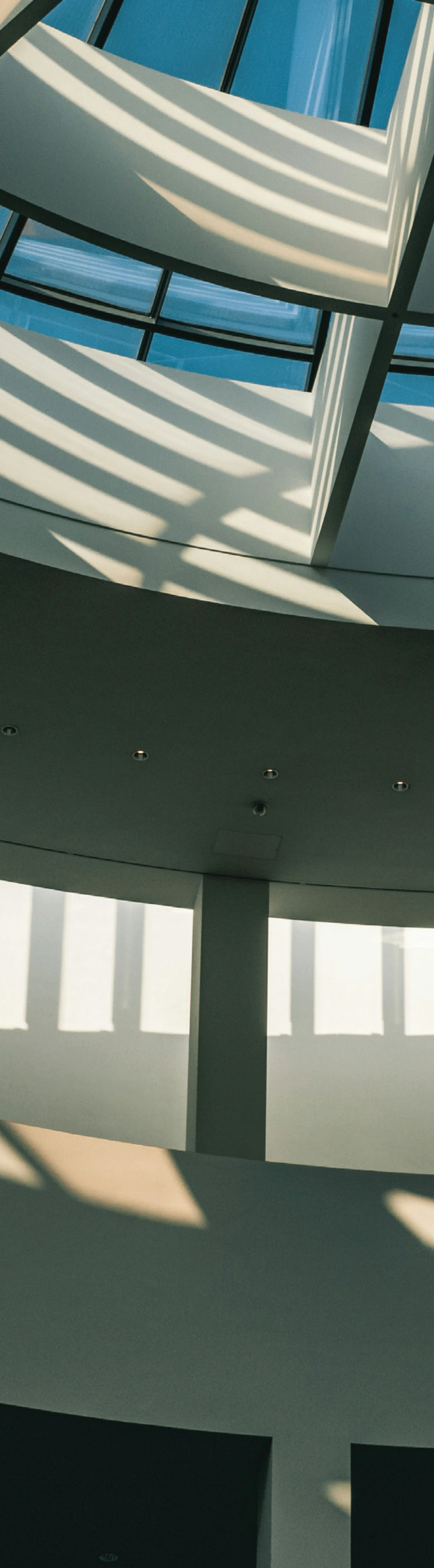

This qualified retirement plans agenda brings plan sponsors news of current legislative, litigation, and other developments concerning tax-qualified retirement plans. Sponsors are encouraged to be aware of these issues and assess whether any action is required or desired for their retirement plans.

Although the mandatory deadline to adopt required amendments to qualified retirement plans remains December 31, 2026 for most plans, plan sponsors will find that amending plans to reflect any required or selected optional provisions when those provisions become effective can help avoid errors in administration, as well as help communicate those changes to plan participants and beneficiaries.

Some of the provisions in recent pension legislation will require support from the plan's recordkeeper or third-party administrator, and coordination will likely be necessary before implementing any plan design changes.

A glossary of commonly used abbreviations used in this agenda can be found at the end.

All qualified retirement plans

Required minimum distributions

The SECURE Act and SECURE 2.0 Act both made significant changes to the date by which plan participants and beneficiaries must begin receiving distributions of qualified plan benefits.

First, plan participants must begin receiving distributions of their qualified retirement benefit by April 1 of the year following the year in which they reach their applicable required minimum distribution age. SECURE and SECURE 2.0 staggered increases in this age based upon the participant's date of birth, as shown in the following table:

PARTICIPANT'S DATE OF BIRTH	RMD AGE
January 1, 1960, or later	75
January 1, 1951, to December 31, 1959	73
July 1, 1949, to December 31, 1950	72
Before July 1, 1949	70½

Second, the SECURE Act made significant changes to the distribution periods for certain beneficiaries to receive their benefits and limited the ability to "stretch" these distributions over longer periods, particularly where the participant had reached their required beginning date before death. The IRS issued final regulations on July 19, 2024, updating its prior regulations from 2002 and 2004, adding provisions regarding SECURE and some SECURE 2.0 changes to the RMD rules, and proposing additional regulations relating to other SECURE 2.0 changes. The final regulations will apply for calculating RMDs beginning with the 2025 calendar year.

The IRS has previously issued temporary relief from the RMD requirements through 2024 pending final regulations being issued. Of note in the final regulations: For participants who die after reaching their RMD age, any beneficiary required to complete distribution within ten years must receive minimum annual payments during that period and cannot wait until the end of the ten-year required distribution period before receiving any payment.

Updated cybersecurity best practices

The DOL recently updated its 2021 guidance on best practices in cybersecurity for plan sponsors, plan fiduciaries, recordkeepers, and plan participants. The "Tips for Hiring a Service Provider" are designed to help plan sponsors and fiduciaries prudently select a service provider with strong cybersecurity practices and monitor their activities. The "Cybersecurity Program Best Practices" are designed to assist plan fiduciaries and recordkeepers in mitigating cybersecurity risks in plan administration. The "Online Security Tips" offer plan participants rules for reducing the risk of fraud and loss in their online retirement accounts. The updated guidance also clarifies that these best practices apply to all ERISA-covered plans, not just qualified retirement plans.

Monitoring controlled group compliance

Many qualified retirement plan rules depend upon whether a sponsoring or participating employer is under common control with other corporations, known as a "controlled group." For this purpose, companies are under common control, and treated as a single employer, if they are at least 80 percent owned in common or are held by five or fewer common owners of a controlling interest of each group that have effective control. Similarly, corporate structures that involve an "affiliated service group" relationship will also be treated as a single employer. Plan sponsors need to understand if they are a member of a controlled group or an affiliated service group, and whether any other group members sponsor qualified retirement plans, to ensure that the nondiscrimination testing on the plans is properly performed. Otherwise, the testing results will not necessarily indicate whether the plan actually meets the nondiscrimination qualification requirements.

Fiduciary rule on providing investment advice

The DOL released its latest attempt to revise its guidance on what it means to "provide investment advice" that would make some financial advisors and other investment professionals fiduciaries under ERISA. The DOL expressed particular concern over those providing investment advice on rollovers where participants are encouraged to move their retirement savings out of ERISA-covered plans into individual retirement accounts.

Shortly after the DOL released its latest rule and related prohibited transaction exemptions this spring, the rule was challenged in two separate cases resulting in two separate injunctions preventing the rule from taking effect. The DOL is appealing these injunctions. As a result, this rule will not be enforced anytime soon and may never be.

Inadvertent benefit overpayments

The IRS released guidance in October 2024 addressing how "inadvertent benefit overpayments" impact qualified retirement plans and how such payments may be treated as eligible rollover distributions, if certain conditions are met.

Defined contribution profit sharing and 401(k) plans

Investment and recordkeeping fee litigation

Cases alleging fiduciaries of qualified DC plans allowed their plans to pay excessive investment or recordkeeping fees continue to be filed, settled, and adjudicated with mixed results. Some employers have found settlement more economically effective than defending a prudent fiduciary process through litigation.

Although some fiduciaries have prevailed on early motions to dismiss, many courts are letting litigation proceed to discovery stages, which has increased settlement activity. Published analyses of settlements show that although there have been a handful of significant settlements reached, many cases are settled for "nuisance value" or some discount of the expected cost of litigation.

Nevertheless, a steadily increasing number of courts have vindicated plan fiduciaries by deciding motions to dismiss, motions for summary judgment, trial verdicts, and appeals in their favor. Studies also report that mutual fund average expense ratios are continuing to fall, which is generally good for plan participants as well as plan sponsors and fiduciaries because it makes plaintiffs' suits less valuable and, accordingly, less likely to be filed.

Success in defending against fee litigation suits generally requires a well-designed fiduciary governance structure and process, as well as documented faithful execution of that process, to both manage fiduciary obligations and establish fiduciary compliance. Plan fiduciaries are encouraged to continually evaluate their fiduciary governance and compliance strategies.

Use of forfeitures litigation

A new variety of litigation against plan fiduciaries concerns the use of forfeitures to pay certain plan expenses that would otherwise be paid by the plan's sponsor. Forfeitures arise when participants leave employment before becoming fully vested in employer contributions credited to their account.

Under traditional IRS guidelines that were recently updated in early 2023, DC plans may use forfeitures to reduce – or offset – other employer contribution amounts, pay administrative expenses of the plan, or be allocated to participants. The new lawsuits allege that any exercise of discretion that uses forfeitures for any purpose other than to pay expenses that would otherwise be paid by participants, or to provide additional benefits to participants, is a breach of fiduciary duty and a self-dealing prohibited transaction.

In addition to standalone complaints on the use of forfeitures, these claims are being added as additional counts to fee litigation complaints (described above) as well. Three federal district courts have reached divergent conclusions on whether these allegations are sufficient to state a fiduciary breach claim. One federal district court has determined that fiduciary breach claims could not be asserted against a plan that did not provide for discretion in how forfeitures were used.

Plan sponsors are encouraged to review their use of forfeitures practices and procedures and determine whether any changes to the plan language is appropriate.

Plan design changes resulting from SECURE and SECURE 2.0

Many plan design changes are available as a result of SECURE and SECURE 2.0. Plan sponsors will likely need to assess what new options they may want to offer, and coordinate with their recordkeeper, third-party administrator, and payroll team or vendor to ensure that the design change can be effectively administered.

Required provisions (beginning in 2025)

Automatic enrollment is now mandatory beginning in 2025 for newly established 401(k) plans. For any plan that was "established" on or after December 29, 2022 (the date of enactment of SECURE 2.0), the plan must begin automatically enrolling new employees starting in 2025.

A plan is "established" for this purpose if the document adopting the plan was signed before the enactment date. The IRS has released initial guidance concerning how plans that are part of a multiple-employer plan and may experience spinoffs and mergers may be grandfathered for purposes of this rule.

Long-time part-time employees must be made eligible for 401(k) and 403(b) plans at least for purposes of making employee deferrals if they are not otherwise eligible to do so. SECURE required that DC plans be opened up to employees who complete at least 500 hours of service each year for three consecutive years to make employee elective deferrals.

Beginning 2025, SECURE 2.0 reduces the consecutive period from three to two years. The IRS issued proposed regulations for long-time part-time employees in November of 2023, and final regulations are expected by the end of 2024. In early October, the IRS issued important guidance clarifying that 403(b) plans may exclude part-time employees that do not qualify as long-time part-time employees without violating the consistency requirement applicable to 403(b) plans.

For employers wishing to avoid tracking hours for part-time employees, they could offer the employee deferral portion of their plans to these employees without making them eligible for employer contribution. Employers are still allowed to exclude employees based on legitimate business criteria that are not hours-based distinctions.

Optional provisions (available in 2025)

The ***required minimum distribution*** rules have been revised as discussed above. The IRS clarified in its final regulations that qualified retirement plans are not required to implement the increases in RMD age and may keep the RMD age at 70 ½. However, DC plan sponsors may want to take advantage of the new rules and allow their participants to extend their required commencement date as long as permitted, which will generally require a plan amendment.

Increased catchup limits are available for participants who are aged at least 60 but have not reached age 64 before the end of the first plan year beginning in 2025. These participants will be allowed to contribute up to an adjusted limit of $11,250 (as indexed annually) each year to their 401(k) accounts.

Plans may need to be amended to allow for these contributions, and in some instances may need to be amended if the plan does not want to offer these increased limits. The requirement that all catchup contributions be designated as after-tax Roth contributions for employees whose compensation exceeds a specified limit remains on hold until after the IRS transition period expires at the end of 2025.

Other optional provisions (can be adopted anytime)

SECURE 2.0 expanded several ***early in-service withdrawal options*** that are exempt from the ten-percent early withdrawal penalty that would normally apply. New exemptions include withdrawals for reasons related to domestic violence, terminal illness, and up to $1,000 for emergency personal expenses, as well as withdrawals and increased loan limits for victims of federally declared disasters. The new rules allow plan administrators to rely on participant representations that they are eligible for an exempt distribution, unless the plan administrator has contrary knowledge. Generally, plans will need to be amended to permit these in-service distributions, although terminal illness distributions will require the participant to otherwise be distribution eligible, as SECURE 2.0 did not create an independent distribution right for terminal illness as it did with other distribution options.

Emergency savings accounts can be established within qualified DC plans to allow only non-highly compensated employees to set aside up to $2,500 in post-tax Roth dollars to fund a participant emergency savings account. Emergency savings accounts are different from the emergency personal expense withdrawals discussed above that are exempt from the ten-percent early withdrawal penalty. A plan could offer either one or both emergency options.

Employers may provide ***matching contributions on employee student loan payments*** meeting certain minimum qualification requirements, or QSLPs. SECURE 2.0 provides a structure for employers to design their DC plans to provide matching contributions on QSLPs as if those QSLPs were elective deferrals.

The IRS recently issued guidance describing additional details concerning the parameters that such a program must or may include, including details around employee certification of the QSLP and allowing plans to adopt a claim deadline for submitting QSLP-matching contribution requests that is shorter than the deadline for returning excessive deferrals (two and a half months after the close of the plan year). The guidance allows employers thinking about implementing such a program to begin designing and implementing one.

Employers may increase their plan’s automatic cash out distribution threshold to $7,000 from $5,000 for participants who terminate employment with small vested balances. This amount is not indexed for annual inflation adjustment, so it requires an act of Congress to modify. Employers are still required to rollover any amount between $1,000 and $7,000 for participants who do not affirmatively direct their small balance distribution.

Defined benefit pension plans

Pension derisking litigation

New lawsuits have been filed against a growing handful of plans that have transferred their DB plan pension liabilities to a specific insurance company in "derisking" transactions. These transactions can involve lifting out a portion of a plan's liabilities – for example, only participants currently in pay status or participants with small benefits – or providing future annuity payments when DB plans are terminated.

Plaintiffs in these suits allege that transferring pension obligations to an insurance company makes them less secure in their benefits and causes them to lose ERISA and PBGC protections. Motions to dismiss these suits have been filed claiming that participants do not have standing to assert these claims, because participants are still being paid the benefits they have been promised under the plan and therefore have suffered no harm. Sponsors who are considering derisking transactions are encouraged to explore the full range of fiduciary factors with selecting an insurance company as an annuity provider.

In addition, SECURE 2.0 directed the DOL to review its existing sub-regulatory guidance on fiduciary standards for selecting annuity providers, known as the "safest available annuity" standard. The DOL's initial report on this topic was inconclusive, but promised further analysis would be forthcoming.

Actuarial assumption litigation

Despite some early success in defeating lawsuits alleging that a plan's actuarial assumptions were outdated, plaintiffs have continued to appeal these decisions and file new suits, many of which have survived motions to dismiss or settled.

In the wake of these suits, many plan sponsors have evaluated whether the actuarial assumptions that are set forth in their pension plans should nevertheless be updated, including using more up-to-date mortality factors.

SECURE 2.0

While the bulk of SECURE 2.0 changes are focused on DC plans, some design changes are possible for DB plans as well.

Cash balance plan design

Changes to the nondiscrimination testing rules open up potential options for cash balance plan designs that utilize variable interest crediting rates and allow plans to provide greater pay credits for longer service employees without violating the anti-backloading rules applicable to DB plans.

Required minimum distributions

As discussed above, the RMD rules have been revised. The IRS clarified in its final regulations that qualified retirement plans are not required to implement the increases in RMD age and may keep the RMD age at 70 ½.

Of note, SECURE and SECURE 2.0 did not change the requirement for DB plans to make actuarial adjustments to the benefits of participants who continue working beyond April 1 of the year following the year the participant reaches age 70 ½ until they actually retire. As a result, DB plans may wish to keep the RMD age at 70 ½. Plans may need to be amended to reflect the choice an employer makes.

Next steps

SECURE and SECURE 2.0 opened up many options for employers to implement design changes to their qualified retirement plans to meet the changing needs of their workforce. Deciding to implement these changes may require coordination with the plan's service providers to ensure that they can be administered.

Plan sponsors and plan fiduciaries are also encouraged to implement overall benefit compliance strategies and prudent fiduciary governance processes to meet compliance obligations and mitigate risk. While there are some retirement plan-related rumblings on Capitol Hill being referred to as "SECURE 3.0," as well as a SECURE 2.0 technical corrections bill, that could be enacted in the lame duck session of Congress following the November election, employers looking to enhance the features of their retirement plans have many options currently available to choose from.

Glossary

- Code – Internal Revenue Code
- DC plans – Defined contribution plans, which can include profit sharing, 401(k), and 403(b) plans
- DB plans – Defined benefit plans, or traditional pension plans, that are subject to the minimum funding requirements of the Code
- DOL – US Department of Labor
- ERISA – The Employee Retirement Income Security Act
- IRS – Internal Revenue Service division of the US Department of Treasury
- PBGC – Pension Benefit Guaranty Corporation, a US government agency
- QSLP – Qualified student loan payment
- RMD – Required minimum distributions from qualified retirement plans under Code Section 401(a)(9)
- SECURE Act – The Setting Every Community Up for Retirement Enhancement Act of 2019 (Division O of the Further Consolidated Appropriations Act, 2020, Pub. Law 116-94)
- SECURE 2.0 Act – The SECURE 2.0 Act of 2022 (Division T of the Consolidated Appropriations Act, 2023, Pub. Law 117-328)

For more information

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