REGULATORY Update

Q1 2023

DOL Finalizes Guidance on ESG Investing in Retirement Plans

The Department of Labor (DOL) has finalized regulations meant to show retirement plan sponsors and their investment advisors how to meet ERISA fiduciary standards of loyalty and prudence when selecting plan investments. At issue has been whether and how fiduciaries could incorporate environmental, social, or corporate governance (ESG) factors into their investment selection process. Over the years, there have been concerns that plan fiduciaries who select socially responsible or other ESG-related investments could be sacrificing returns or taking on additional risk for collateral benefits. The DOL has issued several iterations of guidance on this issue, which have alternately encouraged or discouraged the consideration of ESG factors.

In contrast to regulations issued in 2020 that were never enforced, the newest regulations make clear that fiduciaries may consider the economic effects of ESG and other collateral factors if they reasonably determine the factors to be relevant to their risk/return analysis of a particular investment or investment course of action and when they exercise shareholder rights, such as proxy voting. Examples of such factors could include evaluating a corporation's:

- Exposure to the economic effects of climate change
- Executive compensation
- Compliance with labor, employment, environmental, and tax laws
- Progress with workforce diversity and inclusion.

The final regulations permit the use of ESG investments as qualified default investment alternatives (QDIAs) and allow fiduciaries to take participant preferences for ESG investing into account when building an investment menu. Fiduciaries must still follow longstanding ERISA principles of prudence and loyalty when selecting plan investments, which means that fiduciaries must focus on relevant risk/return factors and not subordinate the interests of participants to objectives unrelated to the provision of benefits under the plan. Plan fiduciaries must focus on factors they deem relevant to a risk and return analysis, "using appropriate investment horizons consistent with the plan's investment objectives and taking into account the funding policy of the plan." These rules take effect on January 30, 2023.

Plan sponsors may want to review their plan's investment policy statement (IPS), considering the DOL's final regulations, and work with their plan advisors to ensure that their process for selecting and monitoring plan investments complies with the regulations and the plan's IPS.

DOL Proposes Fiduciary Self-Correction Option for Late Deposits

The DOL has proposed updates to its Voluntary Fiduciary Correction Program (VFCP), which hasn't been updated since 2006. The VFCP encourages plan sponsors to correct common violations under ERISA and restore losses to plan participants before becoming the subject of an enforcement action. Proposed changes would expand the transactions eligible to be corrected under the program and make it easier and more cost effective for plan fiduciaries to correct violations. The most meaningful change proposed would allow plan fiduciaries to self-correct one of the most common retirement plan fiduciary violations: late deposits of employee salary deferrals and loan payments into the plan.

To correct an error under the VFCP today, a plan fiduciary must file an application and other paperwork with the DOL for approval. If the application is complete and all breaches are fully corrected, the DOL will issue a no-action letter, providing relief from civil penalties and enforcement actions, as well as excise taxes for some of the covered transactions. With the proposed update, plan fiduciaries would be allowed to notify the DOL electronically that they save self-corrected the failure to deposit participant contributions on time. Plan fiduciaries could use this self correction option only if the following requirements are met:

- Delinquent contributions and lost earnings are deposited into the plan within 180 days of being withheld from the participant's wages or receiving the amount from the participant.
- Lost investment earnings, calculated from date of withholding or receipt, don't exceed $1,000.
- Self-correctors use the VFCP online calculator to calculate lost earnings and an online web tool to complete and file a self-correction component notice. Self-correctors must also complete and retain the self-correction retention record checklist.
- Neither the plan nor the self-corrector is under investigation.

The DOL is accepting public comments on the proposed VFCP changes and will announce when the updated program is available. In the meantime, plan fiduciaries may use the existing program.

Caution: Even if you correct late deposits under the VFCP, you still must report them on the plan's Form 5500. If you don't indicate on Form 5500 that the late deposits were corrected under the VFCP, it may be a red flag for the DOL.

Review 2022 Nondiscrimination Testing Results ASAP

Even though the 2022 plan year is over (for calendar-based plans), plan sponsors can't close the door on 2022 just yet. Year-end nondiscrimination testing must be conducted and any failures corrected before plan sponsors can turn their full attention to 2023. Although third-party administrators (TPAs) and recordkeepers will typically guide plan sponsors through the testing process and contribution limits each year, plan sponsors have a fiduciary responsibility to ensure that the plan meets testing requirements and plan limits, and to properly correct any excesses.

ADP/ACP Tests

A 401(k) plan must be tested each year to ensure that it isn't disproportionately benefiting or discriminating in favor of highly compensated employees (HCEs). Two tests are used to compare the benefits received by HCEs and non-HCEs: the actual deferral percentage (ADP) test and the actual contribution percentage (ACP) test.

Correction: There are several options for correcting a failed ADP or ACP test, but most plans will distribute to HCEs enough contributions, plus attributable investment earnings, to bring the HCEs' rate to a level that will pass the test. Alternatively, the plan sponsor may provide an extra employer contribution to non-HCEs to raise their ADP/ACP.

- Correct by March 15, 2023, to avoid a plan sponsor excise tax. Corrective distributions to HCEs will be taxable to the HCE for 2023 (excluding Roth contributions).
- Correct after March 15 but before December 31, 2023, and pay a 10 percent excise tax on the excess amount.
- If not corrected by December 31, 2023, the plan sponsor must go through the IRS's Employee Plans Compliance Resolution System (EPCRS) to correct the failure.

Top-Heavy Test

A plan is top heavy if more than 60 percent of its total assets are held by key employees as of the last day of the preceding plan year. If a plan is deemed top heavy, the company must make a contribution for each non-key employee equal to at least 3 percent of the employee's compensation for the coming year. Profit sharing contributions, matching contributions, nonelective contributions, and allocated forfeitures count toward the 3 percent requirement.

Correction: If the 3 percent contribution isn't made, the plan sponsor must correct the failure under EPCRS.

Salary Deferral Limit

A participant in a 401(k) plan may contribute up to $20,500 of their compensation as pretax and Roth salary deferrals for 2022. This limit applies to salary deferrals across all 401(k), 403(b), and SIMPLE plans in which an employee participates. If a participant is age 50 or older, they may defer an additional $6,500 for 2022. Deferrals won't be categorized as catch-up contributions unless the 402(g) limit, a plan-imposed limit, or an ADP test limit is reached.

Correction: Distribute the excess and earnings by April 15, 2023. The excess deferral is taxable to the participant in the year contributed and the earnings are taxable in the year distributed. If corrected after April 15, the excess is taxable to the participant in the year contributed, and the entire distribution (excess deferral and earnings) is taxable in the year distributed—double taxation. Also, the plan may be subject to disqualification unless the error is corrected using EPCRS.

Annual Additions Limit

The annual additions limit determines the maximum that can be allocated to a participant's account in each employer's plan each year. All employee and employer contributions allocated to a participant's account for 2022 cannot exceed the lesser of:

- 100 percent of the participant's compensation, or
- $61,000, plus up to $6,500 for catch-up contributions if the participant is age 50 or older.

Correction: Distribute excess deferrals and after-tax contributions to the participant. A distribution of pretax deferrals and earnings is taxable in the year of distribution. Any associated matching contributions must be forfeited or held in a suspense account according to the plan document. Excess annual additions should be corrected as soon as possible under EPCRS.

Address Testing Issues

It's important to review your plan's testing results promptly. Most TPAs or recordkeepers will provide clear instructions for correcting testing failures, but you may first want to ensure that your service provider had accurate data (e.g., correct definition of compensation and accurate payroll data) to conduct the tests. Once you have confirmed that the data and tests were accurate, correct any failures as soon as possible to avoid additional tax or correction procedures.

Cost-of-Living Adjustments (COLAs) for 2023

Each year, the IRS adjusts retirement plan contribution limits and other plan-related thresholds for changes in the cost-of-living index. The current high rate of inflation has triggered updates to all limits for the 2023 plan year. Plan sponsors may want to review 2023 COLAs with payroll staff to ensure that all necessary adjustments are made and to determine whether the new compensation limits will result in a change to the groups of employees classified as HCEs or key employees, which could affect 2023 nondiscrimination testing.

	2023	2022	2021
Annual compensation limit for calculating contributions	$330,000	$305,000	$290,000
401(k) & 403(b) plan elective deferral limit	$22,500	$20,500	$19,500
457(b) governmental plan elective deferral limit	$22,500	$20,500	$19,500
Age 50 catch-up contribution limit	$7,500	$6,500	$6,500
Defined contribution plan annual additions limit	$66,000	$61,000	$58,000
Highly compensated employee (HCE) threshold	$150,000	$135,000	$130,000
Key employee	$215,000	$200,000	$185,000
Taxable wage base	$160,200	$147,000	$142,800

You can find more information on retirement plan COLAs on the IRS's website.

We Can Help

As your advisor, we are ready to provide you with the ideas, guidance, and foresight to position your firm for success. If you'd like to review your plan's features or operations, or industry developments that may affect your plan, we're here to assist you.

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