

Employee Benefits Update:
- SECURE 2.0 Implementation and Timing
- ERISA Fiduciary Breach Litigation

Presented by:

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What We Will Cover During This Session

Part 1 – SECURE 2.0 review and update

- Key provisions for 401(k) and 403(b) plans
- Implementation challenges and timing
- Plan amendment deadline – recently extended to December 31, 2026!

Part 2 – ERISA fiduciary breach litigation update

- Recent trends and outcomes
- Key takeaways for plan fiduciaries

SECURE 2.0 Update

SECURE 2.0 – Background

- The SECURE 2.0 Act of 2022 was signed into law on December 29, 2022
- SECURE 2.0 contains 90 provisions intended to promote and facilitate our employer retirement benefit system, encourage individuals to save for retirement, and ease certain administrative requirements that apply to retirement plans
- Most changes take effect in 2024, 2025, and 2026, but a few took effect in 2023
- Plan sponsors now have until December 31, 2026 to amend their retirement plans to comply with SECURE 2.0 requirements, as well as SECURE 1.0, and the CARES Act

Key Changes For Retirement Plan Sponsors*

Mandatory Changes (and Effective Dates)

- Triggering age for required minimum distributions – increased to 73 for individuals who reach age 72 after 12/31/2022 (1/1/2023)
- Automatic enrollment for elective deferrals in new 401(k) plans and 403(b) plans first established after 2022 (1/1/2025)
- Catch-up contributions by certain highly paid employees required to be made as Roth (after-tax) contributions (originally 1/1/2024, now 1/1/2026)
- Eligibility of “long-term part-time employees” to make elective deferrals in 401(k) plans (2024/2025) and 403(b) plans (1/1/2025)

** There are many more. Some changes are mandatory, some are optional. See Appendix for more details.*

Roth-Only Catch-Up Contributions For High Earners

- Viewed by some as the single most disruptive provision in SECURE 2.0!
- Participants age 50 and above can make annual catch-up contributions to 401(k) and 403(b) plans (up to \$7,500 in 2024)
- Beginning January 1, 2026, catch-up contributions made by participants whose taxable wages exceed \$145,000 (indexed after 2024) can only be made as after-tax Roth contributions
- Original effective date, January 1, 2024, was extended to January 1, 2026 to allow for smoother implementation for vendors and employers
- Roth feature must be added, and administrative and payroll systems must be adjusted, if the plan does not already include Roth contributions

Long-Term Part-Time Employees

- “Long term, part time” (LTPT) employees must be allowed to make elective deferrals to their employers’ 401(k) plans and 403(b) plans
 - LTPT requirements do not affect eligibility for employer contributions
 - Plan can continue apply 1,000-hour and other permissible eligibility and allocation requirements for employer contributions
- An LTPT employee is a common law employee, age 21 or older, who is credited with at least 500 hours of service in each of two consecutive 12-month periods
 - Service counts starting with date of hire, but can switch to plan year measuring periods after end of initial 12-month period
 - Service after 1/1/21 counts for 401(k) plans, because SECURE 1.0 included an LTPT requirement for 401(k) plans (but requiring three consecutive years)
 - Service after 1/1/23 counts for 403(b) plans, because the requirement was extended to 403(b) plans in SECURE 2.0

Long-Term Part-Time Employees – Cont'd

- Plan can and should apply its regular service crediting methodology to determine LTPT employees
 - Counting actual hours
 - Equivalencies (e.g., 45 hours for a week in which EE is credited with 1 hour)
 - No need to abandon elapsed time method if that's what plan uses!
- If LTPT employee does receive employer contributions, vesting service is based on 500 hours of service per 12-month period rather than 1,000 hours of service
- Effective January 1, 2024, for 401(k) plans *applying original SECURE 1.0 rule – three consecutive 500-hour service periods – for 2024 plan year only*
- Effective January 1, 2025, for 403(b) plans
- FMI: <https://www.verrill-law.com/benefits-law-update/proposed-regulations-regarding-long-term-part-time-employees/>

Key Changes For Retirement Plan Sponsors

Optional Changes (and Effective Dates)

- Option to elect Roth treatment of employer contributions (1/1/2023)
- New penalty free in-service distribution opportunities (1/1/2024)
 - Domestic abuse victims (lesser of \$10,000 or 50% of account balance)
 - Terminal illness (death expected within 84 months)
 - Personal family emergencies (up to \$1,000, with option to repay within three years)
- Matching contributions based on qualified student loan payments (1/1/2024)
- Increased mandatory cash-out limit from \$5,000 to \$7,000 (1/1/2024)
- Increased catch-up contribution limit for ages 60 through 63 (1/1/2025)

IRS Notice 2024-02

- Extends plan amendment deadline for SECURE 1.0, CARES Act, and SECURE 2.0 to December 31, 2026, for private employer plans
- Provides guidance on implementation of many SECURE 2.0 provisions, including:
 - Automatic enrollment requirement for new 401(k) plans
 - Correction of automatic contribution errors
 - De minimis employee contribution incentives
 - Designated Roth contributions
 - Small employer (less than 100 employees) plan credits
- Much more guidance is anticipated over the next two years

Expanded Self-Correction Opportunities

- SECURE 2.0 significantly expands self-correction opportunities for plans
- **An “eligible inadvertent failure” can be self-corrected at almost any time**
 - An “eligible” failure is an administrative failure that occurs despite the existence of policies and procedures designed to prevent failures
 - Eliminates distinction between “significant failures” and “insignificant failures” and related time limits on self-correction of significant failures
 - Must be corrected within a “reasonable time” after discovery
 - Plan sponsor must take actions that demonstrate a commitment to self-correction before error is identified by the IRS
- Egregious failures, failures involving diversion or misuse of plan assets, and tax avoidance schemes are not eligible for self-correction

Expanded Self-Correction Opportunities – Cont'd

- SECURE 2.0 relaxes the fiduciary obligation to recover benefit overpayments. Plan fiduciary may choose not recover benefit overpayments so long as:
 - For individual account (i.e., most DC) plans, there is no impermissible forfeiture of a participant's benefit; and
 - For DB pension plans, plan continues to satisfy minimum funding requirements and there is no material impact on plan's ability to pay benefits to participants and beneficiaries
- Participant loan failures can be self-corrected and DOL must accept as valid, though DOL is authorized to develop alternative to VFCP application to confirm
- IRS Notice 2023-43 provides initial guidance regarding updates to EPCRS
- FMI: <https://www.verrill-law.com/benefits-law-update/secure-2-0-provides-new-and-expanded-retirement-plan-correction-rules/>

Compliance Policies & Procedures

- Plan sponsor must establish and adhere to compliance policies and procedures in order to support self-correction of inadvertent eligible failures
- SECURE 2.0 and IRS Notice 2023-43 do not prescribe specific form or content of policies and procedures:
 - May be “formal or informal” (but, in our opinion, should be in writing)
 - Should be considered part of the documentation of the self-correction
 - Should be designed and followed in a manner that should prevent operational and documentary failures from occurring
- At a minimum:
 - Identify key administrative roles and responsibilities
 - Demonstrate understanding of key legal compliance requirements (e.g., nondiscrimination testing, prudent administration of plan, etc.)
 - Require a level and scope of activities that employer can consistently reach

Implementation Challenges & Timing

- Record keepers are ready to implement increased mandatory cash-out limit (\$7,000) now, and many will do that as a default (so employer would have to take action if it wants to preserve lower limit)
- But they are not ready to implement many optional changes, but are working on:
 - internal systems configurations and legal compliance
 - plan sponsor and participant portals
 - updated plan documents and SPDs
- Many payroll vendors may still have work to do to implement Roth-only catch-up contributions for high earners
- But when they are ready, you will hear about it, and they will create a sense of urgency for you to act!

Amendment Deadline

- Employers must amend their plan documents incorporate mandatory aspects of SECURE 1.0, the CARES Act, and SECURE 2.0 by no later than December 31, 2026 (for calendar year plans) – a one year extension of original deadline!
- Amendment deadline seems far off but it will come up fast
- Remember that administration of plans will have to change to comply with effective dates before the plan amendment deadline arrives
- Recordkeepers are likely to roll out administrative changes in serial form, so expect regular communications (and requests for directions) over the next two years

What Employers Should Do Now

- Be ready to implement mandatory changes as effective dates arrive
- Starting thinking about optional changes and necessary changes to payroll and other pertinent systems
 - Adoption of optional changes are not fiduciary decisions, but plan administrative committees should be in the loop
 - If choosing to adopt optional changes, work with record keeper (and document provider, if it is not the record keeper) to memorialize implementation dates
- Keep track of hours credited to long-term, part-time employees, if any
- Establish written compliance policies and procedures to support self-correction of eligible inadvertent failures

ERISA Fiduciary Breach Litigation Update

The Beat Goes On

- Class action lawsuits alleging breaches of fiduciary duty relating to the “prudence” of 401(k) and 403(b) plan investments picked up steam after the U.S. Supreme Court decision in the Tibble case (2015), which emphasized the ongoing duty to monitor investment fees as well as investment performance in ways that accelerated litigation.
- Hundreds of cases have been filed against defined contribution retirement plans, mostly with \$250M+ in assets (but some smaller plans as well)
 - Low of 22 cases filed in 2018, high of 101 cases filed in 2020
 - 48 cases filed in 2023, down from 89 in 2022 (in part for reasons explained below)
- Few trials, but many high-profile seven and eight figure settlements
- 403(b) plans of higher ed employers have provided particularly fertile ground for plaintiffs’ lawyers, who continue to troll for plaintiffs (using Facebook and other social media)

Typical Fiduciary Breach Allegations

- Complaints generally allege that plan fiduciaries:
 - Allowed plan and participants to pay excessive fees to recordkeepers and investment vendors
 - Did not seek competitive bids from service providers or take other prudent steps to assure reasonableness of fees
 - Failed to select or monitor investment options prudently
 - Failed to make available lower cost investment options
 - Failed to remove underperforming and unduly expensive mutual funds from the fund lineup on a timely basis
- Successful plaintiffs *always* seek (and routinely receive) payment of their attorneys' fees as part of award or settlement

“Pleading Standard” Still In A State Of Flux

- “Pleading standard” is a legal term that describes what plaintiffs have to allege in order survive a defendant’s motion to dismiss
- The **Seventh Circuit** Court of Appeals and **Supreme Court** decisions in Hughes v. Northwestern University (2022-2023) delivered a mixed bag for plan fiduciaries:
 - Supreme Court rejected Circuit Court’s original holding that providing a variety of diversified investment options with lower fees is sufficient to defeat breach claim
 - Supreme Court directed the Circuit Court to reconsider in light of fiduciaries’ ongoing duty to monitor investment options (and remove imprudent options) and make a context specific inquiry considering “the range of reasonable judgments a fiduciary may make” in light of their experience and circumstances prevailing at the time
 - Seventh Circuit then sent the case back to District Court for trial on the merits

Some Recent Cases Raise The Bar For Plaintiffs

- Recent decisions have dismissed complaints that were too general (rather than context specific) and failed to plead specific facts about the fees and performance of challenged investments, and record keeping fees, sufficient to give rise to an inference that fiduciaries acted imprudently
- In Smith v. CommonSpirit Health (2022), the **Sixth Circuit** Court of Appeals affirmed dismissal of claims alleging that:
 - The offering of certain actively managed funds instead of index funds was itself an indication of imprudent decisions by plan fiduciaries, based on common sense and defendant's plausible explanation; and
 - Record keeping fees were excessive, because plaintiffs failed to allege that the services provided to the plan were equivalent to services received by comparator plans

Higher Bar For Plaintiffs – Cont'd

In Albert v. Oshkosh Corp. (2022), the **Seventh Circuit** affirmed the lower court's dismissal of allegations:

- That recordkeeping fees were excessive, because the complaint failed to provide context regarding the actual services provided and therefore did not move the claim “from possibility to plausibility”
- That certain actively managed funds were imprudent because they were more expensive than index funds, because the complaint failed to provide a comparison to a meaningful benchmark
- That investment advisor fees were excessive, because merely alleging that the defendant fiduciaries failed to solicit competitive bids is not a sufficient basis to state a claim that the fees were excessive

Higher Bar For Plaintiffs – Cont'd

- In Matusek v. MidAmerican Energy Co. (2022), the **Eighth Circuit** affirmed the dismissal of claims alleging excessive recordkeeping fees and excessive investment management fees where allegations relied primarily on industry-wide averages, finding that references to averages alone (without a comparison of actual services provided) are not informative and do not provide a sufficient benchmark to create inference that fiduciaries acted imprudently
- Note that several District Court decisions in other federal circuits still allow breach of fiduciary duty claims to proceed based on a more relaxed pleading standard, and litigation is likely to continue (and settlements will still be lucrative for plaintiffs' attorneys) until Supreme Court settles the pleading standard issue

New Frontier – Health Plan Fiduciary Breaches

- With arrival of new required disclosures regarding direct and indirect compensation under DOL regulations, and possible slow down in retirement plan cases, plaintiffs' attorneys are starting to troll for plaintiffs to bring excessive fee cases against self-funded group health plans
- Theories are similar to those used to challenge excessive record keeping fees – lower cost providers were available, or fiduciaries failed to take steps to make sure fees were reasonable
- New litigation initiative may be supported by DOL enforcement activity in health plan investigations and the publication of findings by DOL

Key Takeaways For Plan Fiduciaries

- No such thing as set it and forget when it comes to oversight of plan administration and investment of plan assets
 - Monitor the performance of, and fees paid to, plan service providers
 - Monitor the performance of, and costs of, plan investments
- Process and documentation are key to demonstrating compliance with fiduciary standards and mounting a strong defense to claims
- When cases do go to trial and appeal, courts will focus on:
 - Fiduciary governance structure and practices of plan sponsor
 - Role of independent advisors
 - Process by which service providers and investment funds are selected and deselected

Recommended Practices For Plan Fiduciaries

- Know your responsibilities as a fiduciary!
- Adopt, understand, and follow a written Committee Charter and an Investment Policy Statement
- Understand and monitor the fees and expenses that are being paid by the plan and plan participants
- Compare fees and costs for plan record keepers and other service providers
- Compare investment fees and expense ratios against appropriate benchmarks – higher fees should be linked to above-average service and performance
- Follow a prudent process and maintain good documentation of process

Bonus Topic: EBSA Enforcement Activities

- EBSA enforcement activities involving benefit plans continues to be robust
 - Agency recovered \$1.4 billion for plans and participants in FY2022
 - Includes \$931 million from enforcement actions, \$422 million from complaint resolution process, and \$8 million from VFC Program
- Retirement plans
 - Missing participants
 - Late transmittal of employee deferrals to 401(k) plans and 403(b) plans
 - Processing and payment of benefits to terminated vested participants
 - Cybersecurity compliance
- Health Plans
 - Administrative fees (especially hidden fees)
 - Cybersecurity compliance

Appendix: **SECURE 2.0** Summary

EFFECTIVE 2023

CHANGED RULE (ACT SECTION)	BRIEF SUMMARY	COMMENTS
Increased triggering age for RMDs (§107)	Required beginning date for RMDs are increased to: <ul style="list-style-type: none"> • Age 73 starting 1/1/23 (if age 72 attained after 12/31/22 and 73 before 1/1/33) • Age 75 starting 1/1/33 (if age 74 attained after 12/31/32) 	Effective for distributions made <u>after</u> 12/31/22, for individuals who turn 72 after 12/31/22 Mandatory change
Employee self-certification for hardship withdrawals (§312)	Administrator may rely on employee certification that (i) they have had a safe harbor hardship event; (ii) the distribution is not in excess of need; and (iii) employee has no alternative means to satisfy the need).	Effective for plan years beginning on or after January 1, 2023
Roth matching and nonelective Contributions (§604)	401(a), 403(b), and governmental 457(b) plans <u>may</u> allow employees to choose whether employer matching or nonelective contributions will be treated as Roth after-tax contributions	Effective for contributions made after 12/29/22
Distribution on account of terminal illness (§326)	10% additional tax on early distributions waived for distributions taken by a terminally ill participant	Effective for distributions after 12/29/22

Effective 2023

CHANGED RULE (ACT SECTION)	BRIEF SUMMARY	COMMENTS
Federally declared disaster distributions and loans (§331)	Up to \$22,000 per disaster may be distributed from an individual’s retirement plan or IRA for those affected by a federally declared disaster. Distribution is not subject to the 10% early withdrawal tax and may be repaid during the three-year period beginning after the date of distribution	Effective for disasters occurring on or after 1/26/21
Financial incentives for plan participants (§113)	Participants may receive small financial incentives (not paid with plan assets) for contributing to a 401(k) or 403(b) plan	Effective plan year beginning after 12/29/22
Automatic portability transactions (§120)	Provides a prohibited transaction exemption that will allow service providers – particularly the Portability Services Network consortium – to automatically roll-in involuntary distributed accounts back into an employer-provided plan with an active account for the participant.	Effective for transactions beginning 12/29/23 Estimated to save \$1 trillion in retirement savings

Effective 2024

CHANGED RULE (ACT SECTION)	BRIEF SUMMARY	COMMENTS
Matching contributions for student loan payments (§110)	Permits employer contributions based on an employee's qualified student loan payments, up to the annual elective deferral limit, for 401(k), 403(b), SIMPLE IRAs, and 457(b) plans	Effective for plan years beginning after 12/31/23 Will require coordination with TPA to confirm loan payment amounts and the type of loan
Emergency savings accounts linked to individual account plans (§127)	Plan sponsors of individual account plans may offer an emergency savings account linked to a participant's plan account. Employers can automatically enroll employees in these accounts up to 3% of their salary with a cap of \$2,500	Effective for plan years beginning after 12/31/23
Distribution for small emergency expenses (§115)	Participants may take up to \$1,000 in a calendar year as an emergency personal expense distribution. The distribution is exempt from the 10% early withdrawal tax	Effective for distributions after 12/31/23

Effective 2024

CHANGED RULE (ACT SECTION)	BRIEF SUMMARY	COMMENTS
Domestic abuse distributions (§314)	<p>Domestic abuse victims may withdraw penalty-free the lesser of \$10,000 or 50% of their account under a defined contribution plan during the 1-year period beginning on the date on which the individual is a domestic abuse victim.</p> <p>Participants may self-certify eligibility and withdrawals may be repaid over a period of three years.</p>	Effective for distributions made after 12/31/23
Increase in mandatory cash-out limit (§304)	The mandatory cash-out threshold is increased from \$5,000 to \$7,000	Effective for distributions made after 12/31/23 Mandatory

Effective 2025

CHANGED RULE (ACT SECTION)	BRIEF SUMMARY	COMMENTS
Increased catch-up contribution limits (§109)	Catch-up contribution limits are increased for individuals aged 60 to 63 to \$10,000 (indexed) or 50% more than the regular catch-up amount, whichever is greater	Effective for plan years beginning after 12/31/24 Mandatory
Inclusion of long-term, part-time employees (§125)	401(k) plans and 403(b) plans must permit participation by employees who have worked at least 500 hours (but less than 1,000 hours) per year for two consecutive years	Effective for plan years beginning after 12/31/24 Mandatory
Plan amendment deadline (§501)	Plan documents must be amended to comply with SECURE 1.0, CARES Act, Taxpayer and Certainty Act of 2020, and SECURE 2.0 no later than the last day of first plan year beginning on or after 1/1/26	Calendar year retirement plans will have to be amended by 12/31/26 (a one-year extension of the original deadline) Employers should keep track of when optional provisions are adopted

Effective 2026

CHANGED RULE (ACT SECTION)	BRIEF SUMMARY	COMMENTS
Catch-up contributions as Roth contributions (§603)	Catch-up contributions must be made as Roth contributions for participants whose prior year wages exceed \$145,000	Effective for taxable years beginning after 12/31/25 Mandatory
Plan amendment deadline (§501)	Plan documents must be amended to comply with SECURE 1.0, CARES Act, Taxpayer and Certainty Act of 2020, and SECURE 2.0 no later than the last day of first plan year beginning on or after 1/1/26	Calendar year retirement plans will have to be amended by 12/31/26 (a one-year extension of the original deadline) Keep track of when optional provisions are adopted

QUESTIONS?