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Digest

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Administration favors a more fiduciary-friendly enforcement posture

Most retirement industry observers expect a new administration to put its fingerprints on numerous federal initiatives, from broad economic matters to specific social policies. So, whether we look at trade policy, law enforcement or environmental matters—whoever is in power in Washington, D.C., is bound to leave an imprint. Even with the bipartisan support we see for various retirement plan actions, there are differences between the two major political parties and with the new administration there seems to be a decided turn in favor of plan fiduciaries.

Executive action

Historically, U.S. presidents have often tried to push the limits of executive power. The executive branch—as the chief enforcer of federal law—also has broad latitude in choosing which laws to enforce ... or not. And with a legislative branch that is oftentimes gridlocked, those in the executive branch appear to be stepping into the gap. The IRS and the Department of Labor (DOL) are the two main entities that oversee

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retirement plan compliance. In particular, the DOL has taken recent steps to demonstrate its official position in several important matters.

First, after being nominated in February, Daniel Aronowitz was confirmed in September as the Assistant Secretary of Labor, overseeing the Employee Benefits Security Administration (EBSA). Aronowitz was confirmed using a Senate rule change that allows a simple majority to approve sub-cabinet-level nominees in large batches. His stated commitment is to "end the era of regulation by litigation by providing clear and effective rules." Even before Aronowitz's confirmation, the administration's influence may have been felt: In July, the DOL submitted a friend-of-the-court brief that supports plan sponsors' use of participant forfeitures to pay plan expenses.

Second, the DOL has indicated that it will replace a Biden-era rule regarding environmental, social and governance (ESG) factors in plan investments. The DOL's regulatory agenda for the coming year—and other communications—make it clear that new guidance will make it more difficult for plan sponsors to consider ESG factors when selecting plan investments. While the Biden administration's DOL guidance made it easier to include ESG investments, now it appears that new rules will require that plan fiduciaries consider purely financial factors. These rules will probably be released well into 2026 and will affect plan sponsors and participants alike.

Third, the DOL intends to rework the fiduciary rule, called the Retirement Security Rule by the Biden administration. One of the main points of contention is that this rule could impose liability, for example, on a financial advisor who gives one-time advice to someone regarding a rollover from an employer-sponsored plan to an IRA. The fiduciary rule has been revised numerous times over the past two decades and continues to cause confusion and concern. However the DOL responds, having a clear, fair and workable rule—based on the existing federal statutes—will be a welcome outcome.

Aside from the workings of various federal agencies, the executive branch has issued multiple directives from the Oval Office. In an August executive order, President Trump directed the DOL to reexamine existing guidance on private market investments within participant-directed defined contribution retirement plans and to emphasize creating new guidance that may encourage offering such investment opportunities. This, coupled with an earlier DOL rescission of the Biden administration's formal caution on cryptocurrency investing, could relax the current guidance on alternative assets.

Legislative action

Although the two other branches of the federal government are not technically part of the current administration, let's briefly consider both of them and their possible effects on retirement plan operations. Both chambers of the U.S. Congress have Republican majorities. In the retirement plan realm, this doesn't seem to make a significant difference. Largely, this could be because most retirement plan legislation has enjoyed broad bipartisan support for decades. Consider the SECURE Act of 2019 and the SECURE 2.0 Act (2022). Both were passed with overwhelming support from both parties.

Both SECURE Acts were ambitious measures that continue to result in new guidance. For example, in September the IRS released final regulations on the SECURE 2.0 Act requirement that certain participants must make catch-up contributions as designated Roth contributions. Meanwhile, there has been some talk of a SECURE 3.0 Act. Such legislation could include provisions that would expand access, enhance automatic enrollment and create lifetime income options. Other standalone bills continue to be introduced. Some, like those promoting business ownership by plan participants, may have a good chance of passing. Others, which may have more partisan roots, such as ESG bills, might not fare as well.

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Judicial action

Federal judges and Supreme Court justices are appointed for life. This lifetime tenure is designed to make appointees less susceptible to political influences. And, in fact, this has been largely true. There are many instances of expectations being dashed by jurists who rule contrary to what their background or service in prior administrations would predict. One recent concern—one that both parties could exploit—is "forum shopping" by plaintiffs who file federal cases in jurisdictions with judges that may be more sympathetic to their cause. But ultimately, the possibility that such cases may end up before the Supreme Court may temper this tactic a bit. One recent Supreme Court ruling may support the point that courts are supposed to follow the established law, irrespective of who it may favor. In Cunningham v. Cornell University, the Court lowered the pleading standard for plaintiffs that plausibly allege that a plan fiduciary engaged in a prohibited transaction under the Employee Retirement Income Security Act of 1974 (ERISA). Although this ruling may make it easier for participants to sue fiduciaries, thus increasing litigation, the Court unanimously set a new, binding precedent for lower courts to follow.

Compared with the legislative and judicial branches of government, the executive branch seems to have much more immediate power to act decisively to influence retirement plan operations. The current administration seems poised to continue its pattern of testing the limits of executive power in effecting its policy goals, including an inclination to favor plan sponsors and fiduciaries over plan participants and beneficiaries.

Participant loans: pros and cons

Four out of five 401(k) plans offer loans to participants and just under 40% of workers take a loan, early withdrawal or hardship distribution from their retirement plan at some point. Some are paying off consumer debt. Others may be remodeling houses, paying off an emergency expense or just making ends meet. Removing assets from a retirement account may seem like the last thing plan participants should do. On the other hand, knowing that they can get access to their funds may encourage workers to save more than they otherwise would. Paying themselves back with interest seems like a better bet than making payments to a bank or another entity.

Some plan sponsors may see a loan provision as an important component of a well-designed retirement plan. Others may adopt this feature grudgingly, knowing that most workers have come to expect this option. Whatever the reason for adopting a loan provision, administering loans must be done right, both for the borrowers' benefit and for plan compliance. Because loan miscues are among the most common plan failures, it may be worth reviewing the most important details.

Key compliance considerations

Before allowing a loan to a participant, plan administrators should make sure that the plan document specifically permits loans. The following loan requirements (and more) are found in IRS and Department of Labor (DOL) statutes and regulations. These rules are likely incorporated into plan operations through a "loan policy statement," which the plan administrator creates to enforce compliance with the rules.

- **Legally enforceable agreement —** This includes a promissory note, a concise repayment schedule, default provisions and other items that would normally be found in a commercial loan contract.
- **Maximum loan amount —** Normally, participants may borrow up to the lesser of $50,000 or 50% of their vested balance. If more than one loan at a time is allowed, subsequent loans are reduced by outstanding balances within the last 12 months.

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- **Repayment** — Loans must generally be repaid within five years. For loans used to buy a primary residence, the repayment period may be up to 30 years. Loan repayment must be through substantially level payments, so balloon payments are not allowed. Most plans require repayment through payroll deductions to avoid defaults.
- **Interest rate** — Loan interest rates must be reasonable. Often, interest rates are tied to the Prime Rate (e.g., Prime +1%, Prime +2%). Because plan loans are usually secured by participants' remaining vested account balance, their creditworthiness is not a factor.

Other loan details

There are many other loan provisions that can trip up both plan sponsors and participants. This is one reason that many administrators use the IRS and DOL corrections process to address plan loan compliance failures. Consequently, plan sponsors should consider using service providers that can help them comply with the loan requirements. Whatever course plan sponsors adopt, two additional points are worth making here.

First, when participants with outstanding loans separate from service, they have options. Because borrowers can no longer make loan payments through payroll withholding through the employer, they will generally be considered in default. This is not necessarily a problem: This "default" is not a blemish on a credit score—and it can be addressed in different ways.

One option is to pay off the outstanding loan amount by the end of the quarter following the default. If repayment is not made within this "cure period," the plan sponsor may have to treat the remaining loan amount as a "deemed distribution." That amount will be treated as a distribution on IRS Form 1099-R and will be taxable to the borrower. Alternatively, the former employee could request a distribution of the plan account within 12 months of the date of separation. This withdrawal allows the outstanding loan amount to be treated not as a deemed distribution, but as an actual distribution. The loan amount would still be reported on Form 1099-R, but with a different code that tells the IRS that the amount is eligible for repayment as a qualified plan loan offset or QPLO. In this case, borrowers have until their tax return due date, plus extensions, to repay the outstanding loan amount into an IRA or other eligible retirement plan.

Second, just a word about the normal tax implications of plan loan repayment. While it is true that borrowers pay the loan back—with interest—to their retirement account, the payments are made with after-tax assets. This is not a concern with the principal amount because this portion was obtained from the plan without taxation. Paying it back with after-tax assets merely restores the assets to their pre-tax status. But the interest is different. It too is paid with after-tax assets. But the interest amount was never received tax free from the plan; it is merely added to the account with assets that have already been taxed when the participant pays through payroll deduction. And because the interest paid is not tracked as an after-tax contribution (or basis), it will be taxed again when it is finally distributed to the participant, for example, in retirement. Overall, this added tax implication may not be enough to dissuade a potential borrower from taking a plan loan. The participant should at least understand this concept before making the decision.

Tough decision?

Sometimes a plan loan gives a participant enough breathing room to escape a financial setback. In other cases, a substantial loan repayment amount from every paycheck for five years can lead to more fiscal hardship. Those considering a plan loan should weigh this option with open eyes, perhaps looking for alternatives that may address the need without borrowing. And plan sponsors should be equipped to answer detailed questions from participants—without giving advice about whether a loan makes sense for a particular individual.

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