DC download

Wealth Management

Issue 4, 2022

Retirement plan news from Capitol Hill

Is your target date fund due for review?

Plan sponsors have a fiduciary duty under ERISA to prudently select and monitor plan investment options, as well as ensure that no more than reasonable fees are paid by the plan for necessary expenses. Over the last decade, retirement plan-related litigation has been focused on alleging plan fiduciaries breached their duties by retaining high-fee investments in the plan when lower cost comparable options were available. Recently, however, a batch of lawsuits have been filed alleging that plan fiduciaries were imprudent in their selection of low fee investments, specifically target date funds (TDFs). These suits claim that plan fiduciaries selected low fee TDFs without considering the funds' ability to generate returns and failed to compare the funds' past performance against comparable alternatives. This litigation is in early stages, and the courts have not yet weighed in on whether the plaintiffs accurately assessed the TDFs' performance, appropriately used past performance as a comparison standard, or selected appropriate comparison funds. Nonetheless, it highlights the importance for plan fiduciaries to have a prudent, documented decision-making process in place for selecting and monitoring all plan investments, including TDFs.

The inherent nature of TDFs can make them challenging to benchmark and compare because different TDF suites have different investment goals. Some are designed with a "to" retirement glide path, meaning the underlying investments are gradually allocated to be at their most conservative in the target year of retirement. This would be beneficial for retirees who tend to distribute or move their savings from the plan shortly after retiring. Other TDFs are designed with a "through" retirement glide path, meaning the underlying investments do not reach their most conservative asset allocation until some year beyond the target retirement year. These TDFs may be most beneficial for retirees who don't plan to withdraw their retirement savings from the plan immediately but make periodic withdrawals throughout their retirement. Even within each category, TDF asset allocation can vary depending on the investment provider and manager's strategy and goals. Plan fiduciaries should understand the glide path and investment goals for the TDF they select for their plan and whether the TDF's glide path is appropriate for their plan participants.

Morningstar recently analyzed TDF use in retirement plans and concluded that plan sponsors may not always consider participants' behavior or needs when selecting target date glide paths. The study found that

- Participants distributed their assets from the plan at approximately the same percentages when either glide path is used, and
- Plans tended to choose "through" TDFs, even if a plan's participants were more likely than average to take their money out of the plan at retirement.

Participants who do not understand the amount of equity exposure they have when they retire may not be benefitting from their TDF investment in the way in which it was intended. To ensure the plan's TDF investment

Continued on page 2

Is your target date fund due for review?, continued from page 1

remains a prudent option for the plan's participants, plan fiduciaries should include certain factors in their investment and fee reviews to help determine whether the TDF glide path is appropriate based on participant behaviors. Plan sponsors may also want to consider educating plan participants about the TDF selected for the plan and how the underlying equity exposure can impact their account balance at retirement.

The DOL provides a tip sheet to help plan fiduciaries establish a process for selecting and monitoring TDFs. The DOL recommends that plan fiduciaries review multiple factors when assessing whether a TDF remains a prudent option for the plan, including the following:

- Principal strategies and risks of the TDF, or of any underlying asset classes or investments that may be held by the TDF
- When the TDF will reach its most conservative asset allocation—at or after the target date
- Investment performance and fees and expenses of the TDF and underlying funds
- How well the TDF's characteristics align with eligible employees' ages and likely retirement dates
- Other participant characteristics, such as salary levels, turnover rates and withdrawal pat-terns
- Changes to the TDF's investment strategy or management team
- Whether the fund's manager is effectively carrying out the fund's stated investment strategy
- Changes to the plan's objectives in offering a TDF

The DOL also reminds plan fiduciaries to document their investment selection and review process, including how they reached decisions about each investment option.

Increasing focus on ESG investing

Given the current administration's focus on tackling the climate crisis and the Department of Labor's pending regulations on ERISA fiduciary responsibilities in selecting plan investments, the retirement plan industry is anticipating an increased focus on environmental, social, and governance (ESG) integration, socially responsible investing and impact investing.

In addition to issuing two executive orders in 2021 directing government agencies to, among other tasks, review regulations in regard to tackling the climate crisis and evaluating climate-related financial risks, President Biden signed the Inflation Reduction Act of 2022 into law on August 16, 2022. This Act was designed to reduce inflation, lower the federal deficit, and fight climate change. It includes provisions to help pay for these initiatives, including creating a 15% minimum tax for corporations earning over $1 billion, setting a 1% tax on corporate stock buybacks, lowering Medicare prescription drug costs, and increasing the IRS's budget to assist with collecting tax revenue. The Act does not include any provisions that directly affect retirement plans but could affect retirement plan investments because of its support for developing clean energy sources and other climate-related tasks. The emphasis this administration has placed on fighting climate change and encouraging U.S. companies and workers to support environmental initiatives is likely to make ESG factors more relevant to evaluating the value of a company or industry's operations or finances. In time, more plan participants may become keenly interested in investments that support social or environmental issues.

The Department of Labor has submitted final regulations for review that would provide guidance to ERISA plan fiduciaries as to whether ESG factors should be considered as material when making a prudent evaluation of an investment's financial risk/return potential. The DOL's "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" regulations are expected to be published by the end of 2022.

Plan fiduciaries may want to work with their financial advisors now to ensure they understand how ESG factors affect investment valuations and their selection process, as well as educating plan participants on the concepts of integrating ESG factors into investment decisions.

IRS delays 2022 amendment deadline

Plan sponsors may have one less task on their year-end to-do list for 2022. The IRS recently issued Notice 2022-33 and Notice 2022-45 to extend the December 31, 2022 deadline to amend qualified retirement plan documents for changes made by the SECURE Act of 2019 and the CARES Act of 2020. The new amendment deadline is December 31, 2025, for calendar-based, nongovernmental plans. The extended deadline also applies to amendments required for plans that incorporated distribution and loan relief for qualified disasters under the Relief Act of 2020 and for changes to pension plan in-service distributions under the Miners Act.

The extension may have been provided in part because the IRS has not yet finalized regulations that would clarify some changes made by the SECURE Act, like those affecting beneficiary distributions. These clarifications could be pertinent to accurately drafting amendment language, depending on the plan document. An additional benefit of the extension is that plan sponsors and their document providers will have to complete only one amendment for the above named acts and SECURE Act 2.0, should it pass in the near future.

Regardless of the plan amendment deadline, plan sponsors must operate their plans according to the new rules as of their effective dates, or implementation date in the case of optional provisions. The optional provisions include allowing for coronavirus-related distributions and loan relief in 2020, waving 2020 RMDs, and allowing for child birth/adoption distributions. Plan sponsors should keep close track of the optional provisions incorporated into plan operations and the timing to properly complete the plan amendment when it is required.

RBC Wealth Management will continue to monitor legislative and regulatory developments and provide updates if upcoming changes could affect your plan.

Wealth Management

250 Nicollet Mall | Minneapolis, MN 55401

22-20-02658_20250 (10/22)