Year-End Update: Opportunities for Retirement Plan Sponsors and Fiduciaries

October 2023

Introduction

As year-end approaches and plan sponsors and fiduciaries begin to think about 2024, we are pleased to present this Year-End Update focusing on many of the issues that may be of concern for the remainder of this year and some planning opportunities to consider for the new year.

While plan sponsors and fiduciaries have plenty to do between now and year end, it is important that they not lose sight of areas that may benefit from their attention. These areas can include strategies to mitigate fiduciary risk, amending plan documents in anticipation of a future annuity buyout or plan termination, and actions that may position the plan sponsor to avoid future claims, litigation, or adverse audit findings.

Aon's consultants are available to work with you to identify and implement these strategies during the remainder of 2023 and into 2024.

Please contact any member Aon's Retirement Legal Consulting & Compliance team or your Aon consultant for more information or assistance.

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Planning Ahead: Plan Amendments to Facilitate Future Action

While there are a number of plan amendments that plan sponsors make in the normal course of administering their plan, from responding to statutory and regulatory changes, to plan design updates, as well as accommodating various operational issues, there are several plan amendments that should be considered as part of prudent planning for future opportunities.

While some plan changes are required to be adopted by a certain date (*e.g.*, amendments under the SECURE 2.0 Act of 2022, discussed below), there are other plan amendments that are not presently required but can help a plan sponsor move quickly in the event they choose to pursue one or more pension strategies in the future.

- **Pension Risk Transfers.** Survey data shows that many pension plan sponsors have or will consider a pension risk transfer transaction (*e.g.*, an annuity buy-in or buy-out). Often times, once a decision is made to pursue such a transaction, sponsors need to move quickly. Prior litigation in this area has demonstrated the importance of having plan terms and related disclosures in place well in advance of engaging in the transaction. Plan sponsors considering a pension risk transfer will want to amend their plan to expressly provide for the annuity purchase and to include updates to the summary plan description to inform participants (including retirees and terminated vested employees) of the plan sponsor's right to transfer the pension obligation to a third-party annuity provider. Having these provisions in place well in advance of a pension risk transfer can mitigate the risk to plan sponsors and fiduciaries of participant claims or possible litigation.

- **Pension Plan Termination: Pre-planning Amendments**. We have worked with many employers that have terminated their pension plans or are considering terminating a plan in the future. Any decision to terminate will require several actions to be taken in short order. One of the areas of greatest importance, and which can be quite time consuming if not evaluated early in the process, is reviewing plan provisions and operational features that may be impacted by the decision to terminate. From a plan provision standpoint, some of the areas to be addressed include:
  - Designation of the plan administrator and the Employee Retirement Income Security Act of 1974 ("ERISA") fiduciary or fiduciaries that will select an annuity provider to receive the plan's assets and liabilities upon termination;
  - Review of qualified joint-and-survivor ("QJSA") election and qualified preretirement survivor annuity ("QPSA") waiver periods;
  - Determining whether benefit commencement at normal retirement age (*e.g.*, age 65) is required;
  - Review of how the plan presently handles suspension of benefits administration and the potential impact such administration may have on insurer pricing;
  - Whether to retain or remove certain ancillary benefit plan features (*e.g.*, supplemental disability and death benefits);
  - Adding provisions specific to terminating the plan, including what will happen to any surplus assets remaining after the trust liquidation; and
  - Updates for possible cash-outs of accrued benefits, including deemed cash-outs, and missing participants.

  These and other areas can prove to be quite time consuming once the employer has decided to terminate their plan. The sooner they are addressed, the more likely the plan termination can proceed smoothly and without any unnecessary delay.

- **Spinoffs.** We have seen a significant uptick in transactions involving corporate and plan restructuring. As 2023 concludes and sights are set on 2024, plan sponsors may want to take the opportunity to inventory and review their plan terms and related documents. Many a transaction has encountered some bumps along the way once it is discovered that plan documents do not exist, are unsigned, or have not been updated to reflect current plans terms or administration. Corporate transactions can move quite quickly and are unlikely to wait for benefit or HR issues to be resolved. From a corporate and fiduciary standpoint, conducting some high-level due diligence at the end of the year to confirm potential open items and actions needed to address will position the HR and benefits organization to “hit the ground running” once a transaction is announced and avoid the need to play catch-up as the transaction moves forward.
- **CARES Act, SECURE Act, Miner’s Act, and SECURE 2.0**. The list of required and discretionary amendments needed to comply with recent tax law changes under the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), the Setting Every Community Up for Retirement Enhancement Act of 2019 (“SECURE Act”), the Bipartisan American Miners Act of 2019 (“Miner’s Act”), and the SECURE 2.0 Act of 2022 (“SECURE 2.0”) have been fully described by various practitioners over the past year. Since the timing for adopting these amendments has been generally extended to December 31, 2025, many plan sponsors are awaiting further regulatory guidance before amending their plans. While we believe this is an appropriate position in many instances, plan sponsors should nonetheless be mindful that, in the interim, their plans need to be administered consistent with these tax law changes. Thus, plan sponsors may want to review with plan recordkeepers how these changes are currently being administered and whether such administration is consistent with the plan sponsor’s intent. Depending on the circumstances, some employers may choose to amend their plans presently to confirm plan operations and address any subsequent guidance at a later time.

  Among the statutory changes referenced above are an increase in the maximum mandatory cash-out limit from $5,000 to $7,000 and an extension of the same payment deferral rights under a plan’s minimum distribution rules to a surviving spouse as would have been available to the participant had the participant survived. Sponsors of defined contribution (“DC”) plans looking to increase plan participation may want to consider adopting other permitted discretionary changes available under SECURE 2.0, such as: adding pension-linked emergency savings accounts of up to $2,500 to the account balances of non-highly compensated employees; an emergency personal expense distribution option of generally up to $1,000; and adding tax advantaged withdrawal opportunities up to the lesser of $10,000 or 50% of the vested account balance for participants who are victims of domestic abuse.

Fiduciary Opportunities for Risk Mitigation

Now is also a good time for plan sponsors to evaluate plan governance processes that are in place to mitigate risk to the employer and plan fiduciaries. While there are always things plan sponsors and fiduciaries can consider doing to mitigate risk, we have highlighted a few of the issues we see clients focusing on most recently and which may be possible to address before the end of the year.

- **Upcoming Proxy Voting Requirements**. In late 2022, the U.S. Department of Labor ("DOL") issued final regulations ("Final Rules") which address the extent to which ERISA fiduciaries may consider environmental, social and governance ("ESG") factors when making investment decisions and exercising shareholder rights, such as voting proxies, on behalf of ERISA-covered plans. Although the Final Rules generally became effective on January 30, 2023, there is a delayed effective date with respect to pooled investment vehicles. This delayed rule is to take effect on December 1, 2023.

  The rule, which employers and investment fund managers have been wary of for some time, will apply to collective investment trusts ("CITs"), group trusts, or other investment pools that could be considered ERISA plan assets. In these situations, plan fiduciaries must now be mindful that the investment manager of a pooled investment vehicle must take into consideration the policies of the participating plans and vote proxies in proportion to each plan's economic interest. Compliance with ERISA requires the investment manager to reconcile, so far as possible, the conflicting plan sponsor policies (assuming compliance with each policy would be consistent with ERISA). Alternatively, the investment manager of a pooled vehicle may require participating plans to accept the investment manager's Investment Policy Statement including proxy voting provisions before the plan sponsor is permitted to invest in the pooled vehicle. Some CIT managers are now offering participating plans the opportunity to select a proxy voting theme or strategy from a predefined set of options provided by a proxy voting service. Aon's Retirement Legal Consulting & Compliance consultants and investment professionals can assist plan sponsors in reaching out to their investment managers to confirm how the investment manager will be handling proxy voting requirements

- **DC Plan Fees and Expenses**. In following the numerous DC plan lawsuits and the issues being focused on by plaintiffs' attorneys and courts, plan sponsors and fiduciaries would be well advised to review their current plan governance and, to the extent necessary, take action to preempt many of the fee-related or other claims likely to be alleged in a lawsuit. While much of this litigation is focused on plan fees and expenses, it is important to remember that plan fiduciaries are not required to select the least expensive recordkeeper. To the contrary, the plan fiduciary should select the recordkeeper that is most appropriate for the plan — the difference in fees from one recordkeeper to another, while important, is just one of several factors to be considered. Differences in fees and expenses, for example, may be justified to the extent that the services, investments, and support of the current recordkeeper would be reasonably viewed by the plan fiduciary as superior to that of an alternative selection. Periodically reviewing fees and expenses (through periodic benchmarking or other activities) and documenting the review process and information relied upon in the selection process can go a long way to protecting plan fiduciaries from a fiduciary breach claim.

- **Cybersecurity**. With the DOL's cybersecurity guidance having been issued, plan fiduciaries are on notice that the DOL considers the protection of plan and participant data to be a high priority and an obligation of fiduciaries. That guidance, coupled with the increase in litigation involving data breaches of DC plans, underscores the importance of plan fiduciaries assessing their and their third-party service providers' efforts to protect plan and participant data. Assessing internal and third-party safeguards and developing a record of the process followed should provide protection in the event of a data breach involving plan information or a DOL audit of plan data security safeguards. It is important to note that the audience for these data security assessments and related reports is the plan fiduciaries, not the employer's IT department. The DOL wants plan fiduciaries to be aware and accountable as to how their plan and participant data is protected — hence the need for fiduciaries to assess how plan data is protected. Aon's plan governance and cyber solutions team is well positioned to assist plan fiduciaries in documenting the process followed and developing a record to support such an assessment.
- **Monitor Indirect Revenue Payments Involving DC Plans**. In anticipation of possible future exposure, plan sponsors should be aware that at least one federal court of appeals believes ERISA requires plan fiduciaries to evaluate indirect revenue paid to the recordkeeper from plan assets. Since the use of plan assets to pay plan expenses is a high priority enforcement item for the DOL, plan fiduciaries should have a review process and record of considering such fees and expenses notwithstanding their indirect nature. Examples of such indirect expenses that may warrant additional understanding and evaluation include revenue sharing fees paid to the recordkeeper from third-party mutual funds or by other investments funds available within a 401(k) or other DC plan's brokerage window. Attention should also be given to fees paid to the recordkeeper from other third-party service providers, such as a firm providing fee-based investment advice to participants. While it remains to be seen whether this court decision will be followed by other courts, it provides an early warning to plan fiduciaries of an area that may be susceptible to participant litigation and potentially adverse DOL audit findings. We are continuing to follow this case and can assist plan fiduciaries with evaluating these arrangements from a plan fee and expense standpoint and the need for disclosure of such fees to participants.
- **Actuarial Equivalence.** Over the past several years, numerous lawsuits have been filed against defined benefit pension plans, their fiduciaries, and their sponsoring employers, alleging that the longevity and interest rate assumptions used to calculate optional forms of payment such as the QJSA are out-of-date and produce benefits that are too low. The path forward in such cases remains unclear. Several employers that have made prospective changes to their plans' actuarial equivalence methodology have found themselves litigating actuarial equivalence determinations for periods prior to the recent changes. While there have been a few settlements in this area, employers may be best served by reviewing existing actuarial equivalence calculation methodologies with their legal counsel and plan actuary but proceeding cautiously before considering any changes or making a formal determination as to whether such methodologies are reasonable. This situation remains subject to change to the extent these cases go to trial, or the Internal Revenue Service ("IRS") issues guidance on this issue.

Best Practice Opportunities

- **Qualified Domestic Relations Orders ("QDROs")**. Determining whether domestic relations orders ("DROs") are qualified and effectively communicating with all interested parties can require both technical expertise and a significant amount of time and effort. With limited internal resources, many employers would prefer to outsource such work to outside experts. Depending on the employer, many HR and benefit team members may not see many DROs during the course of a year. Each time an order is received, it requires that someone put aside their day to-day work and once again get up to speed in terms of determining whether the DRO is qualified. In these and other situations, consideration may be given to outsourcing the qualification of DROs to a third party. Not only does that free up internal staff but it may also prove to be more efficient since the third party will likely have much more expertise and can address these matters far more efficiently than individuals for whom DRO qualification is not a regular part of their responsibilities. In situations where the cost of outsourcing may be a concern, consideration should be given to utilizing model orders and procedures to reduce the number of decisions and review time that may be needed. Aon's team of QDRO specialists is available to provide all levels of support necessary to fully evaluate and approve a DRO or provide the necessary model documents to permit in-house qualification of such orders.
- **Plan Restatements**. With the elimination of the five-year determination letter cycle several years ago, sponsors of individually designed retirement plans generally have no obligation to restate their plan documents on any IRS-mandated schedule. However, periodically restating a retirement plan, including incorporating individual amendments adopted since the last plan restatement, can have many benefits and represents a best practice. Benefits of a periodic restatement include helping make plan terms easier to follow and administer, thereby mitigating the risk of operational errors. With the recent expansion of self-correction opportunities available under SECURE 2.0, restating the plan document may also present an opportunity to confirm how the plan has been administered in actual operation and take any corrective action to ensure plan terms and plan operations are aligned. If discrepancies are identified in the context of a plan restatement, any resulting plan document or operational issues can potentially be self-corrected by the plan sponsor without application or other involvement by the IRS.
- **Plan Disclosures**. Plan sponsors understand that ERISA requires certain periodic disclosures be made to participants, including summary plan descriptions, summary annual reports or annual funding notices, and statements of deferred vested benefits. Against the backdrop of possible ERISA clams and appeals or even litigation, sponsors should look at each required disclosure as an opportunity to augment a plan's procedural protections. Possible protections include amending the plan and disclosing discretionary plan features such as a plan-specified limitations period (*i.e.*, a plan provision stating that participants cannot sue the plan after a certain number of years) or mandatory arbitration provisions, both of which need to be communicated to participants in specific ways to be legally effective.

  In addition to procedural protections, plan sponsors should also look to comply with these required disclosures in the most cost-effective way possible. For most plans, and most participants in such plans, confirmation that electronic disclosures are being used to the greatest degree possible should be considered. Not only does this avoid unnecessary plan expense but it is also far more efficient in terms of documenting disclosures and maintaining the associated records.

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