# Q2 2024 Legislation Update

### President Biden's FY2025 Budget Proposal

President Biden released his budget proposal for fiscal year 2025 on March 11, 2024. The budget includes several retirement-related proposals targeted at "high-income taxpayers" (HITs), defined as joint filers with adjusted gross income (AGI) exceeding $450,000, head-of-household filers with AGI above $425,000 and single filers with AGI above $400,000. These are preliminary proposals yet to be formalized (if at all) into bills.

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## Under the Budget Proposal

- HITs with total vested account balances in "tax-favored retirement arrangements" exceeding $10 million in a year would have to distribute at least 50 percent of the excess, regardless of the account holder's age. Tax-favored retirement arrangements include qualified defined contribution (DC) plans, 403(a) annuity plans, 403(b) plans, governmental 457(b) plans, and IRAs.
- Where the total in these retirement accounts exceeds $20 million, the HIT would have to withdraw the lesser of 1) the excess over $10 million, or 2) the total in Roth IRAs and designated Roth DC accounts.
- If a HIT makes contributions (but not rollovers) to an IRA that would put the aggregate balance in retirement accounts over $10 million, the overage would be treated as an excess IRA contribution subject to a 6 percent excise tax.
- DC plan administrators would be required to annually report to the IRS, and to the participant, retirement account balances over $2.5 million.
- The proposal, essentially, would eliminate "backdoor" Roth IRAs for HITs. It would limit rollovers and conversions by HITs to designated Roth retirement accounts and/or to Roth IRAs. HITs would not be able to convert:
  - Pre-tax DC assets or IRA assets to Roth IRAs or designated Roth 401(k) accounts;
  - After-tax DC plan or IRA assets to a Roth IRA or designated Roth 401(k) accounts.

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Since this proposal would only apply to DC plans, its adoption could increase the attractiveness of defined benefit plans for certain sponsors and participants. The Build Back Better Act of 2021, which was considered, but not enacted, included similar proposals.

**Broader tax proposals in the budget**

The FY2025 budget proposal also includes increases in the corporate tax rate, the highest marginal personal income tax rates, the 3.8 percent "Medicare tax" on net investment income and the capital gains tax rate as follows:

- The corporate tax rate would increase from 21 percent to 28 percent.
- The tax rate for high-income earners would be increased to 39.6 percent.
- The "Medicare tax" on net investment income would be increased from 3.8 percent to five percent for taxpayers earning over $400,000.
- Long-term capital gains and qualified dividends of taxpayers with taxable income of more than $1 million ($500,000 for married filing separately) would be taxed at ordinary income tax rates, with 37 percent being the highest rate (40.8 percent including the net investment income tax).

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It is conceivable (but unlikely) that the proposed $10 million cap on retirement savings balances or the limitation on rollovers might get some bi-partisan support as revenue raisers in non-tax legislation (e.g., another "infrastructure" bill). The tax increases will most likely not get any bi-partisan support in this Congress, but, if Democrats win back control of the House of Representatives, they could be an element of a 2025 tax bill.

***H.R. 82 The Social Security Fairness Act of 2023***

The Social Security Fairness Act of 2023 (H.R.82) is seeing renewed activity. Introduced in 2023 by Rep. Garret Graves (R-LA-6), in March 2024, Rep. Graves and Rep. Abigail Spanberger (D-Va.) called on the House Ways and Means Committee to hold a markup on the bill. If enacted, H.R. 82 would eliminate the government pension offset (GPO) and the windfall elimination provision (WEP). The GPO reduces Social Security benefits for spouses, widows, and widowers who also receive government pensions of their own. The WEP reduces Social Security benefits for individuals who also receive a pension or disability benefit from an employer that did not withhold Social Security taxes. With strong bi-partisan support, there are currently 319 co-sponsors.

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## Regulatory Update

*Final DOL Investment Advice Fiduciary Rule Casts a Broader Fiduciary Net*

On April 25, 2024, the Department of Labor (DOL) published its "Retirement Security Rule: Definition of an Investment Advice Fiduciary," a package of finalized regulations and amendments to several advice-related prohibited transaction exemptions (PTEs), including PTE 2020-02 and 84-24, as well as others. The final rule defines when an entity or person is a fiduciary because of providing advice for a fee to a "retirement investor." The final rule, as well as the amended PTEs, are effective September 23, 2024. Both amended PTEs 2020–02 and PTE 84–24 include a one-year transition period after their effective dates under which parties must comply only with the "Impartial Conduct Standards" and provide a written acknowledgment of fiduciary status for relief under these PTEs. Filings of lawsuits challenging the new fiduciary rule have already begun.

The final regulations under the Retirement Security Rule define "retirement investors" as retirement plans, plan sponsors, plan participants and beneficiaries, IRAs, IRA owners and beneficiaries, plan fiduciaries with discretionary authority, as well as Health Savings Accounts. Under the DOL's final rule, a person or entity (provider) will be an investment advice fiduciary, subject to ERISA's standard of care, loyalty and prudence if the following are true.

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The provider:

1. Makes, directly or indirectly, a professional investment recommendation to a retirement investor;
2. Receives a fee or other compensation for the recommendation, and
3. Holds itself out as a trusted adviser by
   - Specifically stating that it is acting as an ERISA fiduciary; or
   - Making the recommendation in a way that would indicate to a reasonable investor that it is acting as a trusted adviser making individualized recommendations based on the retirement investor's best interest.

Under the DOL's old fiduciary rules (i.e., the Five-Part Test), a person/entity was a fiduciary if they satisfied all the following requirements:

1. Renders advice to an investor as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property;
2. On a regular basis (not just once or sporadically);
3. Pursuant to a mutual agreement, arrangement, or understanding with the investor that;
4. The advice will serve as a primary basis for investment decisions; and
5. The advice is individualized based on the particular needs of the investor.

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The new fiduciary advice test under the Retirement Security Rule:

- Changes the "regular basis" rule to one that simply requires the provider to be in the business of giving professional investment advice on regular basis to its clients. Therefore, someone in the "investment advice business" would satisfy this requirement even if the advice in question was a one-off (e.g., a one-time recommendation to take a distribution and/or complete a rollover).
- Focuses on the advisee's reliance on the adviser's recommendation (i.e., the advice need only be, "undercircumstances that would indicate to a reasonable investor in like circumstances that the recommendation is based on a review of the retirement investor's particular needs or individual circumstances …, etc."). And providing that disclaimers by the adviser "will not control to the extent they are inconsistent with the person's oral or other written communications, marketing materials,applicable State or Federal law, or other interactions with the retirement investor."
- Eliminates the old rule's "primary basis" language, instead requiring only "that the recommendation is made under circumstances that would indicate … that the recommendation … may be relied upon by the retirement investor as intended to advance the retirement investor's best interest."

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Under the new definition of investment advice fiduciary, some providers, who were not fiduciaries under the prior rules, may become one. For example, even one-time recommendations related to a rollover could be categorized as fiduciary advice under the new rules. If an advice fiduciary receives compensation that creates a conflict of interest, the transaction may be prohibited and, therefore, would require the use of a PTE to proceed legally. The final rule package contains amendments to PTEs that are available for the management of conflicts of interest, two of which are PTE 2020-02 and 84-24. Both exemptions require that investment recommendations adhere to "Impartial Conduct Standards" explained next.

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*Amended PTE 2020-02*

PTE 2020-02 allows a broad array of investment advice fiduciaries to receive compensation that would otherwise be prohibited if they comply with the following conditions:

- The provider meets the "Impartial Conduct Standards," which means 1) providing advice in the retirement investor's best interest, 2) charging only reasonable compensation, and 3) making no materially misleading statements.
- With respect to rollovers, prior to the rollover, the provider produces documentation of the reasons a recommended rollover is in the retirement investor's best interest.
- The affiliated financial institution acknowledges fiduciary status in writing and describes the services it provides and any material conflicts of interest that may exist.
- The affiliated financial institution adopts policies to ensure compliance with the Impartial Conduct Standards and conducts a "retrospective review" of compliance, certified by a senior executive officer.

*Amended PTE 84-24*

PTE 84-24 is tailored for use by independent insurance agents who recommend annuities issued by more than one insurance company. The DOL added a new section to PTE 84-24 to provide relief for independent insurance agents providing fiduciary advice, subject to conditions like those in PTE 2020-02.

However, unlike PTE 2020-02, the insurance company selling its products through the independent agent is not required to provide a written fiduciary acknowledgment and is not treated as a fiduciary merely because it exercised oversight responsibilities over independent agents. Instead, the independent insurance agent is required to acknowledge its fiduciary status, and the insurance company is required to exercise supervisory authority over the independent agent about an agent's recommendation of the insurance company's own products.

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*Notice 2024-35 Relief for 2024 Specified RMDs*

IRS Notice 2024-35 provides relief for qualified retirement plans, beneficiaries of plan participants and IRA beneficiaries regarding specified required minimum distributions (RMDs) that are not paid in 2024. Specifically, the notice provides that if the plan meets certain requirements, it will not fail to be qualified for failing to make a specified RMD in 2024, and the IRS will not assess an excise tax on an individual for failing to take a specified RMD. A specified RMD is a distribution required under the proposed regulations interpretation of the 10-year rule for beneficiaries. The IRS provided this same relief for certain RMDs in 2021, 2022, and 2023, and is extending the relief to certain RMDs in 2024. The notice also announces RMD final regulations that are yet to be published will not apply until calendar years beginning on or after January 1, 2025.

## Litigation Update

*Environmental Social Governance (ESG)*

In the case of Spence v. American Airlines et al, the United States District Court Northern District of Texas ruled in favor of the plaintiff and denied American Airlines' motion to dismiss on February 21, 2024. The finding allows the plaintiff to proceed with his claim that American Airlines improperly favored environmental social and governance (ESG) funds in the American Airlines 401(k) plan at the expense of workers' financial interests. The case argues that fiduciaries of the plan violated ERISA's fiduciary prudence and loyalty rules, "… by knowingly including funds 'that are managed by investment managers that pursue non-financial and nonpecuniary ESG policy goals through proxy voting and shareholder activism."

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*Defined Benefit Risk Transfer*

On March 11, 2024, a group of plaintiffs filed a class action lawsuit (Piercy et al. v. AT&T Inc. et al.) against AT&T and State Street Global Advisors, in connection with the transfer to Athene Annuity and Life Company of benefit obligations of over $8 billion for approximately 96,000 participants in the AT&T Pension Benefit Plan. State Street was an advisor on the transaction. The lawsuit represents the first major challenge to a pension risk transfer of defined benefit plan obligations to a "private equity-backed" insurer, whom the plaintiffs argue is "risky.". The suit alleges that, in selecting Athene for this risk transfer, defendants breached their ERISA fiduciary duties of loyalty and prudence and, under DOL Interpretive Bulletin 95-1, their obligation to select the "safest available annuity." A similar lawsuit focused on pension risk transfer has been filed against Lockheed.

*Cybersecurity*

A $8.7 million settlement was reached in the class action lawsuit Sherwood, et al. v. Horizon Actuarial Services, LLC, filed in the United States District Court for the Northern District of Georgia, Atlanta Division. The case arose from a cyberattack at Horizon that led to a data breach of sensitive personally identifiable information (PII) held by the defendant. A group of cybercriminals breached two servers of Horizon, an actuarial consulting firm that specializes in multi-employer plan benefits. The class members alleged Horizon failed to reasonably secure, monitor, and maintain the PII provided by its customers and business associates. In December 2023, Horizon modified the initial proposed settlement of $7.6 million to $8,733,333 and submitted it for court approval. The settlement agreement does not require Horizon to admit to any wrongdoing.

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Cybersecurity is of increasing concern for qualified retirement plan sponsors, service providers and participants. The Department of Labor has identified it as an area for potential examination. In lieu of formal regulations, to date the Department of Labor has issued "best practices" for each audience.

- Tips for Hiring a Service Provider: This piece helps plan sponsors and fiduciaries prudently select a service provider with strong cybersecurity practices and monitor their activities, as ERISA requires.

- Cybersecurity Program Best Practices: This piece assists service providers, like record-keepers, in their responsibilities to manage cybersecurity risks by following certain best practices.

- Online Security Tips: This piece offers plan participants and beneficiaries who check their accounts online basic rules to reduce the risk of fraud or loss.

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