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Final and Proposed RMD Rules Answer Some Questions, Raise Others

On July 19, 2024, the IRS released final required minimum distribution (RMD) rules, along with proposed rules addressing certain supplementary issues. This rule package is extensive and will take time to fully digest. What follows is a high-level summary of some key points. The final and proposed regulations affect qualified 401(a) plans (including 401(k) plans), 403(a) annuity plans, 403(b) plans, governmental 457(b) plans, and IRAs. Generally, they apply to required minimum distributions for calendar years beginning on or after January 1, 2025. For earlier years, practitioners must apply the 2002 and 2004 regulations, using a reasonable, good faith interpretation of the amendments made by the SECURE Act and SECURE Act 2.0.

Beneficiary 10-Year Rule After RBD Requires Annual Distribution

The new rules confirm when an account owner dies on or after the required beginning date (RBD) and has a noneligible designated beneficiary (NED) (e.g., a non-spouse beneficiary) subject to the 10-year distribution rule, the NED must receive an RMD each year for the first nine years and deplete the account by the end of the 10th year following the account owner's death. The IRS provided penalty relief for these "specified" RMDs not taken in 2021-2024 but will require them to be taken beginning in 2025.

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Confirmed RMD Ages Resulting from SECURE Acts 1 and 2

Date of birth	RMD Age
Before July 1, 1949	70 ½
July 1, 1949, to December 31, 1950	72
January 1, 1951, to December 31, 1959	73
January 1, 1960, or later	75

Designated Roth Account Assets

Plans will exclude designated Roth account assets when calculating RMDs and such amounts, when distributed, will be eligible for rollover.

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DOL Finalizes Fiduciary Investment Advice Rules, But …

As covered in last quarter's update, 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 (e.g., a financial advisor) is considered a fiduciary in connection with providing advice for a fee to a "retirement investor." The final rule, as well as the amended PTEs, was scheduled to take effect on September 23, 2024. However, two lawsuits, a resolution for disapproval in Congress under the Congressional Review Act, and a Supreme Court ruling emerged to put on hold and challenge the regulatory package. As a result, the September effective date was stayed. For now, the investment advice fiduciary "Five-Part Test" continues in force, as well as existing PTEs—without the latest amendments.

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As background, the final regulations protect "retirement investors," defined as retirement plans, plan participants, beneficiaries, IRAs, IRA owners and beneficiaries, plan fiduciaries with discretionary authority, an IRA fiduciary, as well as Health Savings Accounts. Under the DOL's final rule (which is currently stayed), a person or entity ("provider") will be an investment advice fiduciary, subject to ERISA's standard of care, loyalty and prudence to the retirement investor if the following are true:

- The provider makes, directly or indirectly, a professional investment recommendation to a retirement investor for a fee or other compensation, and
- The provider 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 investor's best interest.

Typically, a provider of fiduciary investment advice must follow a PTE (e.g., 2020-02 or 84-24) to receive compensation for the advice.

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Legal and Congressional Pushback

As referenced above, two lawsuits have been filed challenging the DOL's new rule (Federation of Americans for Consumer Choice, Inc. v. DOL and American Council of Life Insurers v. DOL), generally alleging, in part, that the rule is inconsistent with ERISA and is an arbitrary and capricious application of ERISA's fiduciary provisions. The combination of the two cases has put a stay on the effective date of both the regulations and amended PTEs. The DOL is expected to appeal both rulings, which will take some time and may lead to the US Supreme Court's eventual involvement.

Additional pushback is coming from Congress. A Congressional Review Act (CRA) resolution disapproving the rule has been introduced in the House and Senate (see S.J.Res.79 and H.J.Res.142). This resolution has very limited bipartisan support, so likelihood of passage is slim and, if passed, is expected to be vetoed by President Biden.

Impact of Overturned Chevron Doctrine

Add into the mix the US Supreme Court's (SCOTUS's) decision on June 28, 2024, in Loper Bright v. Raimondo to overturn the Chevron Doctrine, a rule that (since 1984) has required federal courts to defer to federal agency interpretations (e.g., the DOL's interpretations of ERISA) when a statute was ambiguous. Historically, litigation challenging DOL regulations and their application (e.g., participant fiduciary lawsuits) relied, in part, on the Chevron Doctrine. In accordance with the Loper Bright decision, Federal courts must now draw their own conclusions about the correct legal interpretation of ambiguous federal statutes. SCOTUS's overruling of the Chevron Doctrine will likely play a role in additional lawsuits challenging the DOL's newly finalized investment advice rules.

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Other Considerations

The outcome of the upcoming election has the potential to impact the fate of the DOL's advice regulations as well. Different administrations have had different stances on how this rule should best move forward. Keep in mind, while the DOL's advice regulations may be in limbo for the time being, broker-dealers and registered investment advisors are subject to the best interest regulations and fiduciary standards of the US Securities and Exchange Commission.

Abandoned Plans Program Updated for use in Bankruptcy

On May 16, 2024, the Employee Benefits Security Administration (EBSA), under the DOL, published interim final rules relating to the amendment of the Abandoned Plan Program (the Program) to allow Chapter 7 bankruptcy trustees who are responsible for administering a bankrupt company's individual retirement plan to terminate and distribute benefits to participants under the Abandoned Plan Program. Prior to this change, Chapter 7 bankruptcy trustees were unable to use this Program. The EBSA also amended prohibited transaction exemption (PTE) 2006-06, to permit Chapter 7 bankruptcy trustees who are using the Abandoned Plan Program to be able to pay themselves for their services rendered in furtherance of terminating and distributing benefits under the Program.

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The Department of Labor's (DOL's) Abandoned Plan Program was implemented in 2006 and provides a process for terminating and distributing benefits from individual account retirement plans (e.g. 401(k) plans) in the situation where the plan's sponsor has closed down and abandoned the plan (for example, the sponsoring employer ceases to exist by virtue of a formal bankruptcy proceeding or the plan sponsor has died). When a plan is abandoned, custodians, such as banks, insurers, and mutual fund companies, are often left holding assets with no authority to terminate the plan or make benefit decisions. This means that plan participants are generally unable to access the retirement benefits that they have earned.

Under the Abandoned Plan Program, custodians can wind up the affairs of abandoned plans so that benefits are able to be distributed to participants and beneficiaries. In general, a plan is "abandoned" if 1) no contributions to or distributions from the plan have been made for a period of at least 12 consecutive months; and 2) following reasonable efforts to locate the plan sponsor, it is determined that the sponsor no longer exists, cannot be located, or is unable to maintain the plan. The determination of whether a plan is "abandoned" can only be made by a Qualified Termination Administrator (QTA). To be a QTA, an entity must hold the plan's assets and be eligible as a trustee or issuer of an individual retirement plan under the Internal Revenue Code (for example, a bank, trust company, mutual fund company, or insurer).

There are special rules for Chapter 7 bankruptcy trustees under the Abandoned Plan Program.

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DOL Needs Plan Sponsors' Help to Populate Retirement Savings Lost and Found

In an April proposal, the DOL asked plan sponsors to voluntarily provide information about their missing or lost participants to help populate the Retirement Savings Lost and Found online searchable database, which Section 303 of the SECURE 2.0 Act of 2022 requires it to establish by December 29, 2024.

Retirement plans sometimes lose track of people owed benefits for a variety of reasons, (e.g., due to incomplete recordkeeping or people changing jobs). Workers may lose track of their retirement plans after their former employers go out of business or when companies merge, etc. The DOL considers individuals in these situations "missing participants." The goal of the Retirement Savings Lost and Found database is to "… reunite workers with retirement benefits earned over their working lives and to help the Department assist them in that effort."

The Notice lists the data elements needed, as well as how to submit them to the DOL (via Form 5500 filings). Plan administrators will be able to electronically submit this data as an attachment to this year's EFAST2 filing, however, the additional information "would not be considered part of the Form 5500." The DOL also is looking to establish a portal for plan administrators to submit the information directly to the Lost and Found database as an alternative to submitting the information as an attachment to Form 5500 using EFAST2. The DOL will provide the spreadsheet file template and intends to make available a model format that plan administrators could use to submit the information. More information should be forthcoming.

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IRS issues FAQs on Disaster Relief Related to Retirement Plans

IRS Fact Sheet 2024-19 contains frequently asked questions (FAQs) covering certain federally declared disaster-related distributions to retirement plan participants and IRA owners, as well as plan loans under SECURE Act 2.0. The IRS issued the guidance to quickly provide general information to taxpayers and tax professionals. Because these FAQs have not been published in the Internal Revenue Bulletin, the IRS will not rely on or use them to resolve any particular case. Similarly, if an FAQ turns out to be an inaccurate statement of the law as applied to a particular taxpayer's case, the law will control the taxpayer's tax liability.

Nonetheless, taxpayers who reasonably and in good faith rely on these FAQs will not be subject to penalties for under payment of tax as long as they have a reasonable cause standard for relief.

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Litigation Highlights

SCOTUS Overturns Chevron and Upends Chevron Deference

As mentioned above, on June 28, 2024, SCOTUS issued a decision (Loper Bright Enterprises v. Raimondo) ("Loper Bright") overturning the ruling in the 1984 decision Chevron v. Natural Resources Defense Council ("Chevron"). The holding in Chevron required federal courts to defer to federal agency interpretations of ambiguous statutes (e.g., DOL's interpretation of ERISA). This holding was referred to as Chevron deference or the Chevron doctrine. Reliance on Chevron is often a feature of litigation challenging DOL regulations, and in plan participant lawsuits alleging fiduciary breaches. Following the ruling in Loper Bright, federal courts must now draw their own conclusions about the correct legal interpretation of ambiguous federal statutes, rather than determining whether an agency's interpretation of the statute was arbitrary and capricious.

In the retirement space, the Supreme Court's reversal of Chevron will have widespread consequences for the understanding of fiduciary responsibility and of the administration of retirement plans. It will be significantly harder for agencies to shape policy by interpreting or reinterpreting the statutes they administer.

As mentioned previously, additional lawsuits challenging the DOL's newly finalized investment advice rules seem inevitable in the wake of Chevron being overturned. Other plan governance areas, for example regarding Environmental, Social, and Governance (ESG) investing, may also be affected. In Fifth Circuit Court of Appeals Utah et al. v. Julie Su, Acting Secretary of Labor, the court sent back (remanded) the case to the district court to determine whether the DOL's ESG rule represents the best reading of the statute or not.

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Plan Forfeitures

Two California district courts came to different conclusions in plan forfeiture litigation. On May 24, 2024, the United States District Court for the Southern District of California denied defendants' motion to dismiss in Perez-Cruet v. Qualcomm Incorporated, finding that the sponsor's exercise of discretion to use forfeitures to reduce employer contributions, rather than to reduce participant-paid administrative costs, presented a violation of ERISA's fiduciary rules. On June 17, 2024, the United States District Court for the Northern District of California granted defendants' motion to dismiss in Hutchins v. HP Inc., a case involving nearly identical facts/claims. Plan sponsors should monitor this litigation as it evolves and review their plan document language regarding use of forfeitures.

ESG Investing Cases

The DOL's final Environmental. Social, and Governance (ESG) regulations became effective in 2023. According to the DOL, ESG factors may be considered in investment selection if the fiduciary reasonably determines they are relevant to a risk and return analysis. The rules allow consideration of ESG factors in two circumstances: 1) Where a fiduciary concludes that ESG factors (e.g., climate change risk) are relevant to a risk and return analysis and 2) as a modified "tiebreaker" standard. The tiebreaker rule comes into play when two investments are otherwise equal and ESG factors are collateral benefits other than investment returns.

In the case, State of Utah et al. v. Martin J. Walsh and United States Department of Labor, which involved a 26-state challenge to the DOL's ESG rule as arbitrary and capricious, the court found in favor of the DOL's ESG rule. Plaintiffs recently filed an appeal of the lower court's decision in the Fifth U.S. Circuit Court of Appeals case (State of Utah et al. v. Julie A. Su, Acting Secretary, U.S. Department of Labor United States Department of Labor.)

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In another case, Spence v. American Airlines, decided June 20, 2024, the United States District Court Northern District of Texas denied the defendants' motion for summary judgment. The case involved a challenge to the American Airlines 401(k) plan fiduciaries' selection and retention of funds/fund managers that pursue "ESG goals" in proxy voting. After the court's decision on this motion, the parties proceeded to a bench trial that concluded on June 27, 2024. The decision in this case should be forthcoming.

TDF Fiduciary Hygiene

With an appropriate investment policy statement, customized benchmarks, and thorough committee minutes, a plan sponsor defendant prevailed against claims of fiduciary violations in district court. On May 20, 2024, the United States District Court for the Northern District of California dismissed plaintiffs' complaint in Bracalente v. Cisco Systems, Inc., and held that defendant Cisco did not violate ERISA's prudence requirement in selecting (and retaining) a suite of BlackRock target date funds (TDFs) as the Cisco 401(k) plan's qualified default investment alternative (QDIA). Critical in this decision: An appropriate IPS, benchmarks and adequate committee minutes.

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Legislative Developments

CITs for 403(b)s Proposal

U.S. Senators Katie Britt (R-Ala.), Raphael Warnock (D-Ga.), Dr. Bill Cassidy (R-La.), and Gary Peters (D-Mich.) have introduced (S. 4917), the Retirement Fairness for Charities and Educational Institutions Act, to enhance investment options for 403(b) retirement plans. The Senate referred the bill to the Committee on Banking, Housing, and Urban Affairs. A similar provision was included in H.R. 2799, which passed the House in March and has since been referred to the Senate.

The proposal would expand retirement savings opportunities for non-profit employees by allowing 403(b) plan participants to invest in collective investment trusts (CITs). While SECURE Act 2.0 amended the Internal Revenue Code to allow CITs for 403(b) arrangements, it did not address related securities laws, thereby preventing parity with 401(k) plans. A CIT is a tax-exempt investment vehicle that provides a diversified, pooled investment option—similar to a mutual fund. Under current law, unlike 401(k) holders, 403(b) plan sponsors are not able to include CITs as an investment option in 403(b) plans. This legislation would create parity between 403(b) and 401(k) retirement savings plans.