IFS | Q3 2018
Legislative & Regulatory Update

The Retirement Enhancement and Savings Act of 2018

The Retirement Enhancement and Savings Act of 2018 (RESA) is a bipartisan Senate bill, sponsored by the heads of the Finance Committee, Sens. Orrin G. Hatch (R-UT) and Ron Wyden (D-OR). It was introduced in March of this year and is expected to reach the senate floor this fall. RESA has a number of provisions aimed at encouraging retirement savings and making it easier for small businesses to offer retirement plans.

Multiple Employer Plans – The bill would make it easier for small businesses to pool together in Multiple Employer Plans (MEPs), allowing them to take advantage of economies of scale and reduce both recordkeeping and investment costs. Two major impediments with the current system are tax law and ERISA regulation. Under the current tax law, for purposes of nondiscrimination testing, employers are evaluated individually. This means that if one employer is out of compliance, it risks the tax status for all other employers in the plan. Under ERISA, MEPs have a commonality of interest requirement. Therefore, most existing MEPs are sponsored by trade associations whose members meet certain requirements and professional employee organizations (PEOs) that share a co-employer relationship with their clients. Section 101 of RESA addresses both of these issues by removing the commonality of interest requirement and amending the tax code so that if one participating employer fails nondiscrimination testing it doesn't risk the favorable tax status for the other participating employers.

Encourage Increased Savings – RESA contains multiple provisions aimed at encouraging increased savings rates. The bill would remove the 10% cap on auto-escalation for a safe harbor plan. This would allow employers to provide auto-escalation above 10% for auto-enrollment safe harbor plans, without losing their safe harbor status. Additionally, the legislation encourages new startup plans by increasing the tax credit for startup costs and encouraging additional savings by introducing a $500 per year credit for new 401(k) and SIMPLE IRA plans that include auto-enrollment. The credit is in addition to the plan start-up credit and would also be available to employers that convert an existing plan to auto-enroll.

Encouraging Lifetime Income Options – Many fiduciaries are hesitant to offer a lifetime income option due to the fiduciary liability associated with selecting a provider. In the event an annuity provider can no longer pay the contract holder, a plan sponsor or other fiduciary may be liable for their selection of the insurer. The bill would offer fiduciaries a safe harbor regarding the prudence requirement for selecting guaranteed retirement income contracts. The safe harbor would provide protections from liability for any losses that may result to the participant or beneficiary due to an insurer's inability to satisfy its financial obligations under the terms of the contract. This means that fiduciaries must still have a prudent process with respect to the selection of an insurer, but are offered protection in the event a future default. The bill also requires that at least annually, participant statements include an illustration of the monthly payments the participant would receive if the total account balance were used to provide lifetime income streams. This would make it easier for participants to see the relationship between their future income and what they have saved.

401(k) Student Loan Benefits

Student loan debt has quickly become one of the largest financial burdens that college graduates face and has resulted in major changes to the way people save. According to the Q2 2018 Quarterly Report on Household Debt and Credit issued by Federal Reserve Bank of New York, student loan debt was $1.41 trillion as of June 30, 2018, making it the largest category of non-mortgage consumer debt. This burden has had impacts on both homeownership and retirement savings. For example, 40% of bachelor's degree holders with no student debt own a home by age 30 compared to 30% of their fellow graduates who have student debt.

When it comes to retirement savings, graduates with student loans accumulate 50% less retirement wealth by age 30 [1]. Historically, 401(k) plans were reluctant to offer student loan benefits due to "contingent benefit rules." These rules prohibit employers from making 401(k) participation a pre-requisite for receiving other benefits (e.g., health insurance or student loan benefits) However, a recent private letter ruling (PLR) by the IRS may help relieve some of the burden. In this PLR the IRS allows 401(k) plan participants to qualify for the company's 5 percent 401(k) match if the participant contributes at least 2 percent of their eligible pay to student loan payments through payroll deductions. Because the guidance is in the form of a private letter ruling, it is only applicable to the company that requested it. However, it sheds light on how the IRS may handle future student loan benefits and may open the door to wider adoption going forward.

The Importance of Having a Prudent Process – Sacerdote v NYU

Since 2006, we have seen an increase in the number of lawsuits filed against 401(k) plan sponsors for breach of fiduciary duty. But it wasn't until a decade later that similar lawsuits have begun targeting large university 403(b) plans. At IFS, we believe the best defense against litigation is to have a thorough and documented prudent process, and we encourage all plans to establish such processes. In the first 403(b) fee case to go to trial, Sacerdote v NYU, demonstrates the importance of having a prudent process. In this case, the plaintiffs alleged that the retirement plan committee members that oversee two NYU plans breached their fiduciary duties by failing to monitor investments and by allowing the plans to pay excessive recordkeeping costs. The argument is similar to many of the cases brought by Schlichter Bogard & Denton LLP, the law firm that has been successful in litigating private employer ERISA fiduciary breach lawsuits. However, the NYU retirement plan committee members were able to defend themselves based on their documented prudent processes. To help understand how the prudent process came into play, we refer to two of the main claims in the case and how having a prudent process impacted US District Judge Katherine Forrest's decision.

Claim: Using multiple recordkeepers resulted in excessive fees; the participants argued that the committee could have consolidated recordkeepers and negotiated lower costs.
Judge's Ruling: The committee had prudently investigated consolidating recordkeepers and had conducted a RFP process for recordkeeping services. Over the preceding years, the plan was successful in lowering costs through this process and had documented why they retained multiple recordkeepers. Additionally, they found that it was in the participants' best interest to retain

1. Rutledge, Sanzenbacher, & Vitagliano, "Do Young Adults With Student Debt Save Less For Retirement?," 2018

multiple recordkeepers, as only TIAA-CREF had the ability to service TIAA-CREF annuities (where the majority of assets were held).

Claim: The committee retained underperforming funds that should have been removed from the investment menu. The participants asserted that the committee used inappropriate benchmarks to review the fund's performance.
Judge's Ruling: The committee had created and followed an investment policy statement (IPS) since 2011, which provided the criteria for how funds are evaluated, reviewed, and replaced. There were documented quarterly meetings, in which all investments were reviewed in detail and the IPS was used as a guide. The expert witness for the defense testified that REITs were a poor benchmark, since the Real Estate fund invested directly in properties and held more cash. After further review, the judge found that when compared to an appropriate benchmark the funds did not underperform as badly as the plaintiffs allege and that the real estate fund was a good diversifier.

In mid-September the defendants filed a motion seeking “appropriate monetary and non-monetary sanctions," including attorneys' fees related to this lawsuit. Additionally, the plaintiffs have appealed the case however it is currently put on hold due to unresolved motions pending in the lower court.

Source: Institutional Fiduciary Solutions at Raymond James & Associates, Inc.