

PANC 2020: Washington Update

Retirement plan advisers were given ideas to consider and actions to take in response to new legislation, regulation and litigation.

By *Rebecca Moore*

The retirement plan industry has been hit with so much from legislators, regulators and the courts over the past year. A trio of attorneys speaking at the 2020 PLANADVISER National Conference cut straight to what that means for advisers' businesses.

Since the Setting Every Community Up for Retirement Enhancement (SECURE) Act was passed late last year, Thomas Clark, chief operating officer, partner, The Wagner Law Group, said he's been fielding a lot of calls from adviser clients about PEPs [[pooled employer plans](#)]. "They are confused because there's not a clear next step for RIAs [registered investment advisers]," he said. "The landscape is not set. We are still promised things from the IRS and DOL [Department of Labor]. Some providers will march ahead no matter what, but there are still unknowns about who can be providers, and we are still [waiting for a prohibited transaction exemption](#) [PTE] from the DOL."

Clark said he tells his clients he's not sure if PEPs will move the needle if sponsors and advisers are only focused on cost efficiency. "We can already find cheap plans, that's not going to be the mover," he said. "To me, what will make PEPs successful is if we get guidance from the DOL that makes the fiduciary footprint for plan sponsors smaller. For example, if there's an administrative error which has to go through the voluntary correction program [VCP], and plan sponsors know PPPs [pooled plan providers] will pay for that in all cases. Or for example, if PEPs minimize the monitoring of service providers requirement for plan sponsors."

The advice Clark gives his clients is "it pays for advisers to be looking at product offerings right now, but don't feel like you're going to miss the boat by taking a deep breath and making a decision in six, 12, or 15 months. It doesn't make sense to be the first out of the gate." He added that PPPs will work with advisers who will agree to put all their plans in one PEP.

Soon after the coronavirus pandemic hit America, Congress passed the Coronavirus Aid, Relief and Economic Security (CARES) Act. David Whaley, partner, Thompson Hine, pointed out that some recordkeepers essentially forced the provisions on plan sponsors, offering the capability before plan sponsors decided what they wanted to do about offering coronavirus-related distributions (CRDs) and expanded loan limits.

Whaley said there is no need to rush at end of this year to get a plan amendment in place, but advisers need to start conversations with plan sponsors so they can document what did happen—who was eligible, what sponsors did and what providers did—so that they can incorporate the information into amendments when they come due potentially several years from now. As an example, Whaley said some plan sponsors may have provided for CRDs until June 30, rather than the end of the year as the law allowed, then stopped.

He said a big issue pertains to re-contributions of CRDs. The CARES Act allows participants to put the money back into plans over three years and these re-contributions are to be treated as rollovers. "If a rollover comes from an IRA, there's a way to check to make sure," Whaley noted. "But now if plan sponsors must accept up to \$100,000 from employees or other plans, how will they know it is from a CRD?"

He explained that an employee who took a CRD and left the plan sponsor company could come back in two years and say he needs certification that he took a CRD of a specific amount so that his new employer plan will take it as a rollover. Whaley said advisers can help plan sponsors come up with a list and a procedure in case that happens. "If regulators tell us we can rely on participant certification alone, we can move forward, but we need guidance," he said.

"Advisers are going to be heroes for getting ahead of that," Clark chimed in.

The DOL

Joan M. Neri, counsel, Faegre Drinker Biddle & Reath LLP, noted that environmental, social and governance (ESG) investing has become a big issue, especially this year. The Department of Labor (DOL) has weighed in with a [proposed regulation that would replace all previous guidance](#).

The emphasis of the guidance is on what plan fiduciaries need to do when analyzing ESG investments.

"The DOL said these types of investment have to be analyzed solely on financial factors," Neri said. "Effectively, it said ESG is subordinate to the financial interests of participants. The DOL also said ESG investments could not be used as qualified default investment alternatives [QDIAs]. But many commentators say ESG factors are also financial considerations."

Neri told conference attendees the proposed rule leaves the window open for just doing normal due diligence on ESG investments as plan sponsors and advisers do for other types of investments, and if an investment meets standards and sponsors and advisers establish prudence, it is OK to use.

Neri added that usually rules that are not finalized by the end of October, especially in an election year, could be overturned. "Rules usually need at least 60 days to stick," she said. But, Neri said she wouldn't be surprised, given the accelerated process—the DOL provided for only a 30-day and not a

60-day comment period—if the DOL gets this done soon.

The DOL also released guidance, in the form of an advisory letter, [about the use of private equity investments in defined contribution \(DC\) plans](#). Neri said the guidance was welcomed, but it is limiting. “It sets a recipe for how to evaluate funds that have private equity as a component. It says private equity can be included in professionally managed asset allocation funds,” she said. “In the example situation presented in the letter, the overall exposure to private equity was limited, and the majority of other underlying investments were more liquid.”

In its advisory opinion, the DOL said it is only addressing whether a mixed fund of this type can be designated as a plan’s QDIA, not whether a private equity fund itself can be a QDIA, Neri said. The DOL also told plan fiduciaries to do regular due diligence as with other investments, but other factors need to be taken into account. And it said plan sponsors that are not experts need to hire advisers. “There’s a marketing plug,” Neri quipped.

The unique factors are:

- Liquidity—private equity investments may not provide sufficient liquidity, so the DOL noted that it may be helpful if a plan fiduciary limits private equity exposure to a certain percentage. “By way of example, a footnote in the advisory letter said, plan sponsors can limit private equity allocations to the fund to 15% like the SEC’s [Securities and Exchange Commission] proposal to limit portfolios to 15% illiquid investments,” Neri said;
- Valuation issues—the DOL suggested that with private equity, it’s always good to see if there are independent procedures for valuation such as from the Financial Accounting Standards Board (FASB); and
- Alignment with plan characteristics—the DOL said plan fiduciaries should determine whether private equity investments align with participant demographics and look at participants’ ability to access funds through loans and distributions.

“The footnote in the DOL letter about private equity is kind of an implicit recommendation. Advisers can use it as a good marker for what is safe,” Clark said.

For advisers, Neri suggested it might be worth putting additional due diligence factors into investment policy statements (IPS) that they help plan sponsors create and maintain.

The DOL has [proposed a new fiduciary rule](#), as the prior rule was vacated in court. Neri noted that the preamble to the proposed rule [greatly expanded what it means to be an investment advice fiduciary](#). “The part of the five-part test that said advice is given on a regular basis was a way for advisers to avoid being a fiduciary in the situation of a plan participant rolling over DC plan money into an IRA, but the DOL changed that,” Neri said. “Under the new interpretation, many more advisers would become ERISA fiduciaries, subject to duties of prudence and loyalty under ERISA [Employee Retirement Income Security Act] and subject to self-dealing violations.”

She added that this is the reason the DOL has [also proposed a PTE](#) which says if advisers satisfy the impartial conduct standard (which follows the SEC’s Regulation Best Interest standard, requiring documented processes and fees), make no misleading statements and charge reasonable fees, then they are not self-dealing when recommending a rollover from which they will receive compensation.

For advisers, Neri said, the main takeaway is to look at the retail side of their business, if they have one, and establish the same prudent process as ERISA fiduciaries use. “You need to go ahead and plan now, looking at your current service model concerning rollovers,” she told conference attendees.

The Courts

There has been litigation alleging that it is a breach of fiduciary duties to [allow plan providers to use participant data for marketing and solicitation](#). Clark said it is important to note that litigation hasn’t accomplished anything, although parties in some lawsuit “snuck it in to some settlement agreements” that the practice would stop. “That doesn’t make participant information a plan asset,” he said.

While that matter navigates through courts, if advisers use participant data to further their business in any way, such as for receiving rollovers, even if just for company executives, Clark recommended they make sure the service agreements with plan sponsors say they have permission to use the data. “Secondly, advisers can look through recordkeeping agreements with plan sponsors and see if those allow the use of participant data,” he said. “As long as you are addressing it in service agreements and have had a due diligence conversation so that everyone knows what’s happening with participant data, that’s all we can do for now.”

There has also been [litigation regarding retirement plan cybersecurity](#). Clark noted that “the criminals have figured out how our systems work, how distributions work.” There’s \$7 trillion in retirement assets on the line. He suggested that advisers should first make sure plan sponsors have addressed the issue with their recordkeepers. “Most are putting out information about their cybersecurity practices,” Clark said. “Some are spending more on cybersecurity. I think that will become table stakes when choosing recordkeepers. Advisers can help sponsors create due diligence processes and stay on top of them.”

The second thing, Clark said, is to make sure all plan sponsors have fiduciary liability insurance. “Look for products that cover cybersecurity breaches. Walk plan sponsors through due diligence and help them possibly get a combined policy,” he said.

A spate of litigation [challenging the use of actively managed target-date funds](#) (TDFs) rather than passively managed TDFs has been filed over the past years. Whaley noted that both types are allowed as QDIAs. “It always comes back to what was the process for choosing one or the other, so my advice to fiduciaries is to at least once per year analyze the QDIA and document the reason for selecting or continuing to use it,” he said.

Tagged: CARES Act, DoL, IRS, retirement plan cybersecurity, retirement plan legislation, retirement plan litigation, retirement plan regulations, SECURE Act