THE WAGNER LAW GROUP

Forthcoming Developments and Employee Benefits

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Introduction

- Matters to be discussed:
  - PTCE 84-24;
  - Unsolicited rollover recommendations;
  - Consideration of cashouts under defined benefit plans;
  - Treatment of cryptocurrency in 401(k) plans and IRAs;
  - Tax law changes affecting investors in tax-qualified plans and IRAs; and
  - A new government agency: the Cybersecurity Guaranty Corporation.

Alternative Forms of Relief Under PTCE 2020-02

- DOL stated in preamble to PTCE 2020-02 that existing exemptions were not affected:
  - PTCE 77-4: compensation received in connection with proprietary mutual funds;
  - PTCE 84-24: compensation for sale of insurance and annuity contracts;
  - PTCE 86-128: compensation in connection with brokerage transactions; and
  - Statutory exemptions such as 408(g), level fee fiduciary, and computer-generated advice.

PTCE 84-24

- PTCE 84-24 has received greatest attention.
- Applies to all insurance companies, regardless of business model.
- DOL in preamble and FAQs indicated three ways insurance companies could avoid prohibited transactions in connection with providing investment advice for a fee:
  - PTCE 2020-02;
  - PTCE 84-24; and
  - Use of insurance intermediaries, such as insurance marketing organizations or field marketing organizations.

PTCE 84-24

- Conditions of PTCE 84-24 are easier to satisfy than the conditions of PTCE 2020.
  - Must be effected in the ordinary course of business.
  - Must be on terms at least as favorable as an arms-length transaction would be.
  - Total fees, commissions, and other consideration must be reasonable.
  - Certain disclosures to relevant fiduciary.
  - Independent fiduciary must approve transaction in writing.

PTCE 84-24

- Does not require acknowledgment of fiduciary status, because it also applies to nonfiduciary service providers.
- No best interest standard, but
- Only applies to commissions, which DOL would likely read narrowly.
- DOL reviewing more general definition of fiduciary advice.
  - May amend existing PTCEs that were focused on specific transactions, such as 77-4, 84-24, and 86-128.

PTCE 84-24

- Coverage of variable annuities and fixed indexed annuities might be eliminated commissions could be narrowly defined.
- Best interest standard could be added.

- Wild card: a lawsuit has been filed challenging DOL's reinterpretation of fiduciary rule, on both substantive and procedural grounds.
  - Cannot predict outcome of this type of challenge.
- Few of us thought prior iteration of fiduciary/conflict of interest regulations would be invalidated by a divided Fifth Circuit in 2018.

Unsolicited Rollovers

- Primary focus of PTCE 2020-02 was on rollover advice.
- Concern about advisors recommending rollovers to IRAs that advisor would manage.
- Real world does not always operate that way.
  - Plan participant on his/her own may make the rollover decision, then request advisor to manage.
  - Preamble to PTCE 2020-02 indicated such action would not be a fiduciary action.
  - Occasionally, participant will reject advisor's recommendation and roll over anyway.

Unsolicited Rollovers

- If advisor now asked how funds in rollover IRA should be invested, advisor needs to comply with PTCE 2020-02.
  - Not addressed in PTCE 2020-02, but advisor should document the unsolicited rollover.
  - Ideally, plan participant who affected rollover should acknowledge it was his/her decision, to avoid a subsequent “he said she said” dispute.
  - Necessary step to avoid liability in event IRA investments perform poorly.
  - For purposes of determining providing advice on a regular basis, advice as to how funds that were rolled over will be first transaction, not the rollover transaction.

Defined Benefit Plan Cashouts

- Not a generally available feature in traditional defined benefit pension plans.
  - If available, may not be available until age 50 or 55.
  - May be available under lump sum window arrangements in traditional defined benefit plans without regard to age.
  - Lump sum options will be available in cash balance pension plans.

Defined Benefit Plan Cashouts; Plan Sponsor Concerns

- Low interest rates produce higher value lump sums.
  - Interest rates and mortality assumptions for lump sum benefits specified by the Code.
  - Paying out such lump sums may be regarded as lost opportunity cost for investment purposes.
- Plan sponsors concerned that lump sum distribution options will be expended in a relatively short period of time.

Defined Benefit Plan Cashouts

- If available, DB plan participants should consider receiving and rolling over to an IRA.
  - Except for older, long-service employees in some traditional DB plans, receiving a distribution at an earlier age will result in actuarially reduced benefit.
  - Formula for receiving benefit prior to normal retirement date may result in benefit reduction greater than true actuarial reduction.
  - Opportunity for substantially increased benefits in rollover IRA.
- Unclear what type of rollover documentation would be required for defined benefit plan rollover to IRA.

Cryptocurrency

- Cryptocurrency may be becoming mainstream, but
- March 11 DOL guidance on direct investment in cryptocurrency in participant-directed individual account plans was unusually sweeping in rejecting this addition to investment menu of a DC plan with individual directed accounts.
  - Focus solely on the risks of cryptocurrency, not the potential returns.
  - ERISA does not prohibit any form of otherwise lawful investment, but Compliance Assistance Release 2022-01 implied direct investment in cryptocurrency was per se imprudent.

Cryptocurrency

- Even placing a low cap on percentage of account that may be invested in cryptocurrency may be insufficient.
- DOL will challenge offering cryptocurrency in brokerage windows.
- DOL's position may change as regulation of cryptocurrency increases.
  - SEC has approved a cryptocurrency futures fund.
  - SEC has been asked to approve ETF cryptocurrency funds.
  - NASDAQ may permit bitcoin trading.

Cryptocurrency

- Cryptocurrency may come to be regarded as a separate asset class.
- Compliance Assistance Release 2022-01 did not address IRAs.
  - DOL has no jurisdiction over IRAs.
  - IRA owners are fiduciaries under Code Section 4975, but not liable for breach of fiduciary duty.
- Keogh plans are not subject to ERISA Section 404, but questionable whether they can invest in cryptocurrency.
  - In general, easier to invest in alternative investments under self-directed IRAs than under tax-qualified plans.

Tax Code Revisions

- No fully restated Code since 1986.
- Perception in some circles that extreme complexity of Code favors wealthy taxpayers.
  - In response to that concern, Senator Wyden would substantially revise the Code’s partnership taxation provisions, the complexities of which favor large corporations and very high net worth individuals.
- That may be too radical, as might substituting tax credits for tax reductions for contributions to 401(k) plans, or providing that participants in nonqualified deferred compensation plans have an inclusion in income when vested, rather than upon receipt.

Tax Code Revisions

- The Supreme Court's decision not to hear an ERISA preemption challenge to the CalSavers IRA means that more states will likely adopt such plans.
  - If Congress does not believe that is an effective means of providing retirement income, consideration may be given to some form of national retirement plan.
  - An approach for treating the gig workforce that recognizes the employee/independent contractor dichotomy is not an effective tool for classification.

Tax Code Revisions

- Clearer guidance with respect to the treatment of cryptocurrency in tax qualified plans and IRAs.
- Limitations on Roth IRAs:
  - Revising Code to disallow a tax shelter involving Roth IRAs that has been challenged unsuccessfully by IRS before four circuit courts;
  - No backdoor Roths;
  - Individuals earning above $x cannot contribute to a 401(k),403(b), or IRA;
  - Disallowing IRA investments that require the investor to be an accredited investor under SEC rules; and
  - Required minimum distributions based on dollar amounts, rather than age.
    - Peter Thiel would be taxed on $5 billion under one such proposal.

Cybersecurity Guaranty Corporation (CGC)

- SEC recently issued proposed regulations for RIAs and investment companies.
  - DOL issued best practices for participants, plan sponsors, and service providers last year.
  - Cases to date involving cybersecurity breaches have involved some element of fault.
  - Even with enhanced security measures, human error will continue.
- However, it is clear that at some point, even if participants, plan sponsors, and service providers are faultless, cybersecurity breaches will occur.

Cybersecurity Guaranty Corporation (CGC)

- Neither common law of trusts nor Title I of ERISA is a strict liability system.
  - ERISA's prudence system is analogous to the tort/negligence standard.
- At some point, some very large plan will be hacked, and all plan assets will be removed.
  - This will be Cybersecurity's Studebaker moment.
- Policies covering cybersecurity breach losses will be insufficient to cover the loss.

Cybersecurity Guaranty Corporation (CGC)

- In anticipation of the occurrence of such event, a governmental agency should be established to deal with large cybersecurity losses that will occur.
  - Obviously, issues such as moral hazard will need to be addressed.

QUESTIONS?