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Fiduciary Hot Topics

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TRUMP VERSUS BIDEN ON RETIREMENT POLICY

- Recently, retirement policy has taken a back seat to the pandemic and trying to get the economy back on its feet. In 2021, what can we expect to see from another Trump administration or if Biden is elected? President Trump and senior members of his administration have shown little interest in retirement policy. In contrast, the Biden campaign has put forth a number of proposals that would significantly affect Social Security and private retirement plans. The details of these proposals have yet to be flushed out but are indicative of what the priorities would be for a Biden administration.

Social Security Reform

- The last significant reforms to Social Security were in 1983, almost 40 years ago. Congress was forced to act because the trust fund was exhausted. Social Security now has challenges on several fronts including:

- Benefits are low. The average monthly benefit is about $1,500. Many recipients depend on Social Security for a large portion of their retirement income. For about one third of recipients Social Security is their only source of income.
- Benefits are being eroded by inflation as cost-of-living adjustments have not kept pace with inflation.
- The Social Security Trust Fund will be exhausted around 2035 because cash flow is now negative. In 2019, benefit payments exceeded revenues by more than $80 billion.

- Over the past four years, there has been nothing specific from the Trump administration addressing any of these issues. Before the Republican convention, the Trump campaign did put out some proposals, but these are vague. The only exception is The CARES Act which allowed employers this year to postpone paying their share of the payroll taxes until 2021. Also, the IRS gave employers the option to stop withholding employees' share until 2021. Not many employers took advantage of these programs. President Trump has indicated that he would like to forgive these amounts altogether, but that would require Congressional action.
- The Biden campaign addresses Social Security reform on a several fronts. These proposals call for increased benefits which is a significant departure from other calls for reform, most of which have focused on the System's financial integrity.
    - The proposal receiving the most attention would impose the payroll tax on income in excess of $400,000. Currently, income subject to this tax is capped at $137,700. The rate of this tax is 12.4 percent, split evenly between employees and employers.
        - The payroll tax is unlike the income tax in that it is a flat rate for everyone, employees pay their share with after-tax dollars and there are no deductions or exemptions.
        - The argument in favor of this proposal, of this course, is that the wealthy should pay more. The argument against is that this is a fundamental change because benefits have always been tied to what individuals pay into the System. Raising the payroll tax only for some, means Social Security will start to look more like a welfare program, rather than a retirement system. This may erode political support over time.
    - A second proposal would change the methodology used to calculate cost-of-living adjustments.
        - Under the current approach, benefits have not kept up with the reported rate of inflation. For example, the adjustment for 2020 was 1.6 percent while the reported rate of inflation for 2019 was 2.3 percent.
        - Biden's proposal would use the consumer price index for the elderly which reflects a higher rate of inflation than the current approach. It is estimated that annual adjustments would increase by two tenths of a percent.
    - A third proposal would increase benefits for the long-term recipients by five percent. Benefits would increase one percent per year from the 16th through the 20th year of eligibility.

Retirement Plan Proposals

- The Trump administration has put forth no significant proposals regarding retirement plans. The SECURE Act became law in December of 2019, but the bill was never a priority for the Trump Administration. The bill was a hodgepodge of policy initiatives that had been bouncing around the halls of Congress for many years. Although the most significant law affecting retirement plans in many years, all in all, it was a modest piece of legislation.

- The Biden campaign has put forth several proposals, the details of which have yet to be flushed out.

    - A flat tax credit of 26 percent for deductible contributions to 401(k)s has garnered the most attention. The concern is that higher wage earners derive a greater tax benefit from deductible contributions because they are in a higher tax bracket.

        - For example, an individual at the highest marginal rate of 37 percent, receives a tax benefit of $37 for each $100 dollars contributed. For someone with a marginal rate of 10 percent, the tax benefit is only $10.

        - Under Biden's proposal, everyone, regardless of income level, would receive a tax credit equal to 26 percent of 401(k) contributions. This credit could be applied against income taxes owed. For example, a $10,000 contribution would generate a $2,600 credit. One question is whether this would be a refundable credit. If a tax credit is refundable, to the extent the credit exceeds taxes owed, the difference is paid to the individual.

    - A second proposal is an Affordable Care Act-like solution with a "public option" for retirement. It calls for a national 401(k)-like plan that individuals may opt into if their employer does not sponsor a 401(k) or some other retirement plan. This would probably be funded through general tax increases or by requiring contributions from employers that do not sponsor plans.

CONSOLIDATION CONTINUES IN THE DC RECORDKEEPING BUSINESS - EMPOWER ACQUIRES MASSMUTUAL'S RETIREMENT BUSINESS

- In recent years, some of the larger DC recordkeepers have acquired competitors in an effort to achieve economies of scale.

- The latest is Empower's acquisition of MassMutual's retirement business. This is a substantial acquisition – 2.5 million participants and $167 billion in assets. The transaction is expected to close before yearend.

- After this transaction closes, Empower will have on its platform 12.2 million participants and $834 billion in assets. In size, it will be second only to Fidelity Investments.

- Other significant acquisitions in recent years are Empower – JPMorgan; John Hancock – New York Life; Principal – Wells Fargo; One America – Bank of Montreal.

- Five largest record keepers by assets are now:

- Fidelity $2.2 Trillion
- Empower $864 Billion
- TIAA $611 Billion
- Vanguard $560 Billion
- Alight solutions $460 Billion

DEPARTMENT OF LABOR'S PROPOSED RULES FOR ESG INVESTMENTS

- The Department of Labor's proposed rules for ESG investments in retirement plans has generated significant industry pushback.

- ESG investing looks at environmental, social and governance criteria in evaluating investments. The belief is that, over the long term, these factors can affect financial performance. ESG investing has increased in popularity in recent years. Many defined contribution plans now include ESG investments in their lineups.

- The proposed rule manifests a skepticism of ESG investing. Although the Department's position has shifted back and forth over the years (Democrats tend to favor socially responsible investing – Republicans do not) the Department has been steadfast in its position that economic returns must take priority over other considerations.

- The proposed rule makes it clear that that ESG investments must be subject to the same risk-return criteria a plan applies to evaluate other investments. Where non-pecuniary criteria are applied, fiduciaries must document how they fulfilled their responsibility to act in the best interest of plan participants. In an announcement accompanying the proposed regulations, Secretary Scalia stated that the highest priority of plan fiduciaries in making investment decisions must always be the income security of participants in retirement.

- Over 1,500 comments were received during a short 30-day comment period that ended July 30th. Many of the largest players in the business commented. Most of the comments are critical of the proposed rule and request that it be withdrawn or revised in significant ways. The gist of these comments is that the skepticism of ESG that the proposed rules manifests is unjustifiable and singles out ESG investments for special tests and requirements that are unnecessary.

- The Securities and Exchange Commission has not issued any rules regarding ESG investments and comments from the Commissioner indicate there are no plans to do so.

- Two things to note. Promulgating a regulation that contains specific criteria for evaluating investments is unprecedented. While the Securities & Exchange Commission and FINRA have promulgated many rules over the years, there are none that establish specific criteria that must be applied to evaluate a particular investment. Second, by venturing into this arena, the Department is outside of its traditional wheelhouse which is regulating the American workplace.

THE SCHLICHTER FIRM GETS ITS HAND SLAPPED

- Most class action lawsuits filed against plan sponsors have been initiated by the St. Louis firm Schlichter, Bogard & Denton. In a suit filed by the Schlichter firm against Great-West, the district court judge held for the defendant and granted its motion for sanctions. The Schlichter firm was ordered to pay $1.5 million of Great-West's legal fees. It is rare for judges to order a party to pay legal fees and do so only in the most egregious situations.

- The case combined three separate class actions against Great-West and culminated in an 11-day bench trial this past August. The plaintiffs alleged Great-West was charging excessive fees in violation of section 36(b) of the Investment Company Act. The standard is a high. Fees are considered excessive only if "*so disproportionately large they bear no reasonable relationship to the services rendered and could not have been the product of arms-length negotiating."* No plaintiff has ever prevailed in a lawsuit brought under section 36(b).

- The judge ruled that it was "imprudent" for the plaintiffs to pursue their claims because the evidence was overwhelming that Great-West's fees were reasonable under the circumstances.

- This lawsuit reveals that the Schlichter firm will pursue a cause of action even where the evidence clearly does not support its allegations. This is in hopes of a settlement granting the firm significant fees. The many cases this firm has initiated consume the money and resources of plan sponsors and are of little benefit to participants as the amount of the recoveries Schlichter has obtained represented very small amounts on a per participant basis.

For any further questions, please do not hesitate to contact your Financial Professional at info@lawleyinsurance.com.