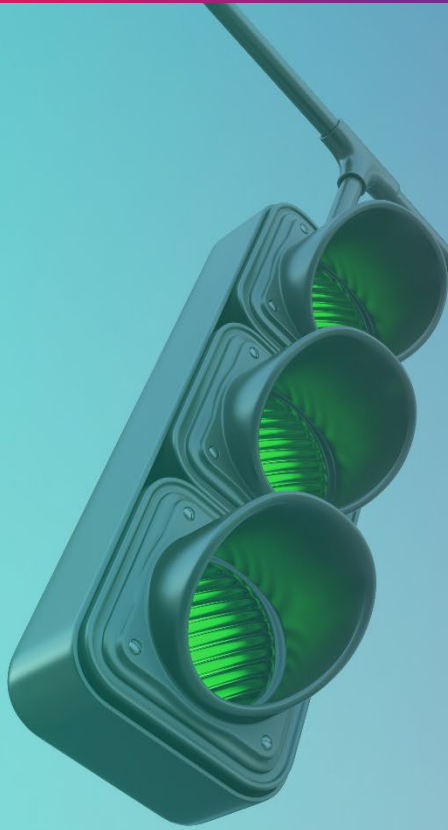


Fiduciary Hot Topics

Q4 2021



New Department of Labor Regulations Will Greenlight the Use of ESG Funds in Retirement Plans

- In August, the Department of Labor submitted new proposed ESG rules to the White House's Office of Management and Budget - the last step before publishing regulations. The proposed rules should be published before the end of this year. There is no doubt these rules will be favorable to ESG investing.
- ESG investing, which considers environmental, social and corporate governance criteria, in addition to traditional financial criteria, has greatly increased in popularity in recent years. Money invested in ESG funds at the end of 2020 was estimated at about \$17 trillion. Retirement plans have followed this trend and many now offer an ESG option.

- For many years, the Department of Labor has gone back and forth in its position regarding ESG investing. Democratic administrations tend to favor ESG investing while Republican administrations have been skeptical. At the very end of the Trump Administration, in December of last year, the Department issued new ESG rules that make it difficult for retirement plans, subject to ERISA, to offer an ESG option. The essence of these rules is that nonpecuniary factors may not be considered in selecting investment options. In effect, the fact that a fund employs ESG criteria may only serve as a tie breaker.
- Early this year the Biden administration announced that it would walk back these rules and promulgate regulations more favorable to ESG investing.

Do Class Action Lawsuits Against Plan Sponsors Accomplish Anything Beyond Generating Fees for Plaintiffs' Attorneys?

- Historically, there has been little litigation involving retirement plans. But in recent years such litigation has exploded. This began with what are known as "stock drop cases" filed following the market crash of 2008 and 2009. These cases were class actions brought against large corporate plans where publicly traded company stock was included as an investment option. The plaintiffs alleged that company stock was an imprudent investment due to a steep drop in value. Many of these cases settled for large amounts as plan sponsors were anxious to resolve these lawsuits because of the negative publicity they generated.
- Other class action lawsuits have been filed against plan sponsors typically alleging excessive fees and/or imprudent investment selection. The amounts involved in these lawsuits are large, but small on a per participant basis. Most settlements and judgments have amounted to, at most, a few hundred dollars per participant.
- The number of these cases continues to increase. In 2020, over 100 class actions were filed against plan sponsors. Until recently, these lawsuits involved only very large plans but now are being filed against smaller plans as well.
- The US Chamber of Commerce filed an Amicus Curie brief (i.e., friend of the court) in an excessive fee suit brought against the American Red Cross. The gist of this brief is that these class action lawsuits are of no benefit to anyone other than plaintiffs' attorneys. In its brief, the Chamber states the rapid increase in excessive fee litigation is not "a warning that retirees' savings are in jeopardy, but proof that converting subpar allegations into settlements has proven to be a lucrative endeavor for attorneys bringing these lawsuits."
- The Chamber's brief makes a number of good points about these class action lawsuits:
 1. There is little or no communication between the attorneys and the plan participants they purport to represent;
 2. These lawsuits are similar from case to case and are not based on the details of any particular plan;
 3. Most complaints are cookie cutter and simply lift allegations from complaints filed in other lawsuits - case in point, the complaint filed in a case against the University of Miami was cut and pasted from complaints in other cases right down to the typos;

4. The allegations in these lawsuits simply second guess, with the benefit of hindsight, the decisions of plan fiduciaries rather than alleging the use of a flawed process in making decisions; and
 5. Plaintiffs' attorneys have effectively been able to hide behind ERISA's perceived complexity and avoid the dismissal of these suits regardless of the merits, leaving sponsors with the choice of either expensive and protracted litigation or entering into a settlement.
- The negative consequences of these lawsuits are many. Most obvious, sponsors must devote time and resources to defending against these lawsuits or pay significant settlements. The cost of fiduciary insurance has increased and there is now, arguably, too much of a focus on fees because the least expensive choice available is not always the best option.

The Day is Fast Approaching When Congress Will Be Forced to Take Action to Shore Up Social Security

- The Board of Trustees for Social Security recently issued its annual report. This report states the trust fund for Social Security Old Age, Survivors and Disability Insurance (OASDI) will be depleted by 2033. This is a year earlier than projected last year.
- The primary challenge for Social Security is an aging population due to low birth rates. The number of Social Security retirees is growing faster than the number of covered workers. As a result, since 2008, the cost of benefits has been growing faster than the income generated by payroll taxes. This trend is expected to continue through 2040 and will result in the depletion of Trust Fund assets. It is estimated that when the Trust Fund is depleted there will be sufficient income going forward to pay approximately 76 percent of scheduled benefits.
- The idea of the Social Security Trust Fund going "broke" is somewhat of a misnomer as the income generated by payroll taxes has always been spent immediately. Trust assets consist entirely of US Treasuries. However, depletion of the Trust Fund is significant as Congressional action will be necessary in order for Social Security to continue to pay all scheduled benefits.
- The choices facing Congress are clear - either cut benefits or increase the payroll taxes. Obviously, neither option is attractive.
- The longer Congress puts off making a decision, the tougher the choices will be. The Board of Trustees estimates that an immediate increase in rate of the payroll tax of 3.6 percent is necessary to keep the system solvent.
- Increasing the payroll tax is problematic as this tax is already high. Currently, about 70 percent of Americans pay more in payroll taxes than federal income taxes. The OASDI tax rate is now 12.4 percent split evenly between employers and employees. This tax is unlike the income tax in that it is capped at the first \$140,800 of income; it is a flat rate; there are no deductions or exemptions; and employees must pay income taxes on their contributions. When the Medicare tax, which has no cap, is included the total payroll tax rises to 15.3 percent.
- Proposals have been introduced in Congress that would raise the payroll taxes only for high earners. The Biden campaign platform included a proposal to increase the payroll tax on income in excess of \$400,000. Social

Security has always been viewed as a public pension system because benefits are based on the amount individuals pay into the system. 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. Raising the payroll tax only for some, means Social Security starts to look more like a welfare program, rather than a retirement system. This may erode political support over time.

- Cutting benefits is also problematic as they are modest. The average monthly benefit paid by Social Security is about \$1,500. For many recipients Social Security is their primary source of income. It is estimated that for one third of recipients, Social Security is their only source of income.
- Several proposals have been introduced in Congress which would phase out benefits for high earners at a certain income level. Such proposals are problematic for the same reason as different tax rates because Social Security again starts to look less like a retirement system and more like a welfare program.

SECURE Act 2.0 - Both Houses of Congress are Considering Retirement Reforms That Appear to Have Enough Bipartisan Support to Become Law Before the End of this Year

- Bills in both the House and the Senate aim to build on the SECURE Act passed in 2019. This legislation is called Securing a Strong Retirement Act and is nicknamed SECURE Act 2.0. There is enough bipartisan support for some of these measures to become law before the end of this year.
- A number of these reforms are in the Democrats \$3.5 trillion stimulation package.
- Progressive Democrats are hoping to use the reconciliation process to push through some of their more aggressive policy goals which likely would be blocked by Republicans in the normal legislative process. These proposals include items such as universal family and medical leave and federal support for skilled nursing facilities.
- Only some of the retirement reforms being considered will ultimately be enacted and many details have yet to be worked out. Some of the more significant proposals are:
 - Require small employers to sponsor either an auto enroll IRA or a 401(k) plan - one of these proposals would require auto enrollment at 3 percent with auto escalation to 10 percent;
 - Move back the age for required minimum distributions from 72 to
 - 73 in 2022
 - 74 in 2029
 - 79 in 2032
 - Increase the catchup contribution limit from \$6,500 to \$10,000 for individuals 62, 63 and 64 years of age;
 - Give employers the option to make their contributions after tax so there would be no tax deferral for employees (not clear why anyone would elect this);
 - Allow plan sponsors to make contributions on behalf of employees not contributing to their retirement plan because they are paying off student loans (really a point of clarification as the law already allows this);

- Allow 403(b) plans to participate in MEPs.
- Direct the Department of Labor to issue new standards for benchmarking target date funds; and
- Increase to \$200,000 the amount that can be applied, without taking a taxable distribution, to purchase a qualified longevity annuity contract (QLAC) - the current limit is the 25 percent of the account up to a maximum of \$135,000.

**For any further questions, please do not hesitate to contact your
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