



THIS QUARTER'S HOT TOPIC

ESG Investments in Retirement Plans: Considerations for Plan Sponsors

by Kelsey Mayo
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As part of the Biden Administration's whole government approach to addressing climate change, the **Department of Labor (DOL) published proposed rules on selecting plan investments that are far more favorable to environmental, social, and governance (ESG) focused investments** than final rules adopted by the Trump Administration's DOL. These proposed rules are a significant departure from past rules and may warrant an adjustment in approach on this topic.

What should retirement plans do about ESG investing?

The Employee Retirement Income Security Act (ERISA), which governs most retirement plan investment decisions, requires that plans make investment decisions solely in the financial interests of plan participants, and with sufficient care, skill, and prudence. While the current DOL appears to believe ESG-focused investing in retirement plans can be prudent, it is important to remember that the DOL's latest guidance does not change the fundamental duty to prioritize participants' investment returns.

Plans investment fiduciaries should consider carefully whether and how to implement any ESG-focused investment strategies. Below are a few questions plans might ask when considering an ESG-focused investment:

- **Is the investment expected to outperform other available investments?** Each plan investment must be prudent. Plans should consider whether a potential investment is likely to be more financially beneficial for plan participants than other available investments (regard-

less of ESG-status), and should be able to explain the reasons for its conclusion. The current DOL administration appears to believe that ESG factors can contribute to performance, but that does not alleviate the fiduciary from engaging in a robust analysis comparing the investment to other non-ESG alternatives.

- **What makes the investment "ESG"?**  If the fiduciary believes ESG factors contribute to performance, the fiduciary should evaluate whether the investment under consideration focus on environmental factors? Social issues? Corporate governance policies? Plans should understand an investment's focus so that it can evaluate the investment in the selection process.

- **Is the investment's ESG focus genuine?** Commentators and regulators have raised concerns about "greenwashing" by some ESG-labeled investments (i.e., funds claiming to be more environmentally focused than they are). To the extent the plan fiduciaries place value on ESG factors, they should take steps to ensure an investment will deliver the ESG benefits it advertises.



- **How would the investment fit within the plan's overall investment lineup?** Individual plan investments typically are intended to serve a specific role as part of an overall investment lineup (e.g., providing participants exposure to U.S. large-cap growth equity). Plans should consider how any new investment would fit into the overall lineup.

While the DOL's guidance on ESG investing has shifted several times in recent years (and might shift again in the future), ERISA's basic requirement that plan investment decisions be made prudently and solely in the financial interests of participants has not changed. Plan administrators should ensure that their plan fiduciaries are continuing to follow a prudent process to ensure that any plan investment (ESG or otherwise) serves that goal.

WHAT'S NEW IN WASHINGTON

Senate Finance Committee Introduces the EARN Act; Next Step in SECURE 2.0

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In September, the Senate Finance Committee introduced the formal text for of the Enhancing American Retirement Now (EARN) Act. This is now one of three major bills aimed at expanding Americans' access to retirement plans and improving retirement outcomes. The EARN Act has a number of provisions that are similar to the house version of SECURE 2.0 — the Securing a Strong Retirement Act — but there are some significant differences. A number of the proposed provisions would be effective January 1, 2023 — mere months away — so plan sponsors and their service providers should watch this closely in order to be prepared to make fast adjustments.

The provisions of EARN would include the following:

- **New Stretch Match QACA Safe Harbor.** Currently a QACA safe harbor must match 100% of the first 1% of deferrals and 50% of the next 5% of an employee's deferrals. Under the proposal, a new option for QACAs would allow employers to match 100% of the first 2%, 50% of the next 4%, and 20% of the next 4% of deferrals. While this new match requires a potentially higher total match, it permits employers to match above 6% and still maintain exemption from the ACP safe harbor *and* small employers choosing the new QACA would be eligible for a tax credit of up to 2% of compensation for each non-highly compensated employee for the first 5 years of participation.

- **Federal Match for Savers Credit.** Similar to the SSRA, the EARN Act would increase the eligibility thresholds for the Saver's Credit. However, *significantly*, the EARN Act would also make the credit refundable, provided that the refund is sent to an IRA or employer plan. The credit for eligible employees would



be 50% of an individual's contribution to an IRA or employer plan up to \$2,000 (and phased out based on income).

- **Long-term Part-time Workers.** Employees with at least 500 hours of service in three consecutive years must be permitted to defer income to the plan per the SECURE Act, generally effective in 2024. EARN Act lowers the requirement to two consecutive years *and* accelerates the entry date to 2023 — requiring potentially swift action if this passes late in 2022.
- **Student Loan Matching Program.** While employers are allowed to match student loan payments with employer contributions now, the current nondiscrimination rules create practical barriers to adoption. EARN Act, like SSRA, would revise the nondiscrimination rules to potentially remove barriers to adopting these matching programs.
- **Catch-up Contributions.** Participants with over \$100,000 in wages in the previous year will only be allowed to make catch-up contributions on a Roth basis. SSRA contained a similar requirement, but it applied to all participants without regard to income. The EARN Act would also prevent deferrals from being recharacterized as Roth — which could be significantly detrimental for highly compensated employees in non-safe harbor plans.
- **Roth Program Enhancements.** Employers that offer employees the opportunity to make Roth contributions may be required to also offer employees the opportunity to elect to have their employer contributions (Roth or nonelective) to be made on a Roth basis as well — effective for contributions in 2023.



No action is required at this time because EARN is not yet law. Congressional offices will be working now to meld the various bills into a final version of SECURE 2.0 that could pass later this year. The final version will almost certainly be different in some details. Regardless, now is still a great time to familiarize yourself with the provisions. You may also want to broach plan design issues (such as Roth features and part-time employees) with your TPA and plan vendors now, as these provisions may take effect quickly if approved.

BEST PRACTICES FOR PLAN SPONSORS

Best Practices for Year-End Preparation

It is hard to believe, but the end of the year is rapidly approaching! To avoid costly errors that can arise from inadvertent errors in the year-end crush, plan sponsors should begin talking with their service providers now about what must be done before December 31, 2022.



Retirement Plan Disclosures. There are a host of notices and disclosures that need to be made throughout the year. However, there are several notices generally given at the end of the year. The following is a list of common year-end disclosure requirements for retirement plans:

- **Safe harbor notice** — For plans utilizing a safe harbor plan design, this notice must be distributed to participants 30-90 days prior to the beginning of each plan year for plans relying on safe harbor rules; by December 1, 2022, for calendar-year plans.
- **Automatic contribution arrangement (ACA) notice** — Plans utilizing an automatic contribution feature must provide a notice to participants 30-90 days prior to the beginning of each plan year; by December 1, 2022, for calendar year plans.
- **Qualified default investment arrangement (QDIA) notice** — Plans availing themselves of the fiduciary protections of using a QDIA must provide a notice to participants 30-90 days prior to the beginning of each plan year; by December 1, 2022, for calendar year plans.
- **Annual participant fee disclosure documents** — ERISA plans must provide an annual fee disclosure at least once in each 14-month period. If you distributed

the fee notice with your other notices toward the end of last year, plan to do so again this year.

- **Summary annual report (SAR)** — ERISA-covered defined contribution plans must provide the SAR to participants within nine months of the end of the plan year or two months after the Form 5500 filing deadline. For calendar year plans, this generally means the SAR is due September 30 if the Form 5500 was not extended or December 15 if the Form 5500 was extended.

These notices should be carefully reviewed to ensure all provisions are included and accurate and reflect all updates made in the past year. Keep in mind that vendor-prepared and distributed notices are often computer-generated and may not accurately reflect special features of a plan (particularly if you use an individually designed plan or have any special addenda or special effective dates for your preapproved plan).



For a retirement plan, ineffective or incorrect notices may result in confusion among participants as well as errors and penalties. Be sure you know what notices are required, review all notices carefully, and address any concerns or questions with your trusted team of service providers.



Kelsey Mayo's practice is focused in the areas of Employee Benefits and Executive Compensation. She works with business owners and HR executives to understand and manage employee benefits and executive compensation arrangements. She routinely represents clients before the Internal Revenue Service, Department of Labor, and Pension Benefit Guarantee Corporation and has extensive experience in virtually all aspects of employee benefit plans and executive compensation arrangements.