



# Retirement Plan Newsletter

Quarterly Newsletter | Quarter Ending March 31, 2023

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## Markets in Review

All major market indices finished the quarter with positive returns. Equity markets, as measured by the S&P 500 Index<sup>1</sup>, rose by 7.5% during the first quarter after finishing 2022 down 18.1%.

Seven of the eleven S&P 500 sectors finished the first quarter with a positive return. The three top performers during the quarter were the three worst performing sectors in 2022. Communication services was one of the best performing sectors in the first quarter due to strong gains from internet-focused tech stocks, as lower rates and the rotation to mega-cap tech companies pushed the sector higher. Consumer discretionary, which has larger weightings towards tech-based consumer companies such as Amazon, also posted positive gains as the labor market remained more resilient than expected, improving the prospects for consumer spending in the months ahead.

By market capitalization, large caps outperformed small caps, as they did throughout 2022. Concerns about sources of funding should the banking crisis worsen, and higher interest rates, weighed on small caps as smaller companies are historically more dependent on financing to maintain operations and spur growth.

From an investment style standpoint, growth outperformed value which was a reversal from 2022. Tech- heavy growth

funds benefited from the decline in bond yields and a late-quarter “flight to safety” amidst the regional banking crisis. Value funds, which tend to have larger weightings towards financials, were plagued by concerns about a potential broader banking crisis.

Foreign markets performed in line with domestic markets in the first quarter.<sup>2</sup> Foreign developed markets outperformed the S&P 500 Index during the quarter as economic data in Europe was better than expected and European banks were viewed as mostly insulated from the U.S. regional bank crisis, with the exception of Credit Suisse which was forced to sell to UBS. Emerging markets produced slightly positive returns during the quarter but underperformed the S&P 500 Index largely due to elevated geopolitical stressors (e.g., US - China tensions) and projected weaker global growth in 2023.

U.S. consumer inflation rates continued to slow after reaching a multi-decade peak of 9.1% in 2022.<sup>3</sup> Cooling inflation allowed the Federal Reserve to ease up on raising interest rates; however, the regional banking crisis raised concerns about a recession which fueled a broad bond market rally in the first quarter.

Inflation, as measured by the Consumer Price Index (CPI-U), grew at a pace of 5% for the past 12-month period ending March

31, 2023, marking the smallest 12-month increase since May 2021. The core inflation reading, which excludes food and energy, rose 5.6%. The energy index decreased 6.4% offsetting the increase in the food index of 8.5% over the last year.

Both the unemployment rate at 3.5% and the number of unemployed U.S. workers at 5.8 million remained basically the same in March, and have shown little movement since the beginning of 2022. The labor participation rate trended upward in March to 62.6%.<sup>3</sup>

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## Plan Participants: The More They Know, The Better

### As a plan sponsor, do you feel your employees have a clear understanding of the company's retirement plan?

Do most utilize it as a tool to save for retirement—and, if not, do they understand the benefit that they are missing? According to the 2022 PLANSPONSOR Participant Survey, 115 of 774 (14.9%) respondents opted not to participate in a workplace defined contribution plan for various reasons. 18.3% of those that declined to participate said it was because they need to better understand the benefits of participating. 15.7% said they needed their income for day-to-day expenses. 50.5% of the nonparticipating employees were between the age of 18 through 39, 44.3% were age 40 through 59. This means that participants of all ages would benefit from additional education and encouragement.

Getting started is a very important first step. Automatic enrollment provisions are popular and allow participants to begin their employee contribution deferral at a default rate (stated in the plan's document), such as 3%, unless they elect another amount or proactively opt out. Keep in mind that, since they do not have to make an active election to begin deferrals, they may not take advantage of the education materials available to them as part of the enrollment process. Education materials come in many forms, from simple informative handouts that explain the benefits of starting early, to more advanced retirement accumulation calculators that help the participant understand how the actions that they take now might affect them at retirement age. Websites are available that may help participants determine the appropriate amount to save for their retirement based on their current financial situation. The information shared with participants during the enrollment process will vary based on the recordkeeper or investment platform where the plan funds are held; further resources may be provided by the plan's investment advisor.

It is also quite common in today's employment arena to have employees who are focused on paying off student debt instead of contributing to a retirement plan. One can certainly understand their dilemma. If your plan currently offers an employer matching contribution, the optional matching contribution on student loan payments may be beneficial. This provision, offered through the Secure Act 2.0, would allow a participant to continue making loan repayments, while remaining eligible to receive a matching contribution funded to the plan on their behalf, helping them to begin building an account balance. This optional matching ability is new and will be available beginning January 1, 2024.

Some participants are hesitant to participate in an employer sponsored plan since it can be more difficult to access their account balance for hardships or other life events. To ensure that employees feel as though they will have access to the funds if they do contribute, you can choose to include several types of distributions in your plan document provisions, including the following:

- In-service distributions from your plan are not required to be made available but can be included if participants satisfy the requirements dictated by your plan's document. An example might be attainment of age 60 and 5 years of service.
- Hardship distributions:
  - Must be taken due to an immediate and heavy financial need.
  - Internal Revenue Service (IRS) regulations consider the following "safe harbor" reasons to meet the immediate and heavy financial need requirement.
    - Medical care expenses for the employee, the employee's spouse, dependents, or beneficiary.
    - Purchase of an employee's principal residence (excluding mortgage payments).
    - Tuition related educational expenses for the next 12 months of postsecondary education for the employee, the employee's spouse, children, dependents, or beneficiary.
    - Prevent eviction or foreclosure from the employee's principal residence.
    - Funeral expenses for the employee, the employee's spouse, children, dependents, or beneficiary.
    - Certain expenses to repair damage to the employee's principal residence.
  - The amount available is that of the financial need, which can include the amounts necessary to pay taxes resulting from the distribution. However, the participant must have the necessary amount available for withdrawal within their account. Your plan document can limit the money types available—such as employee contributions and earnings only—or balances from employer contributions can be made available for withdrawal as well.
- Qualified Birth and Adoption distributions:

- A distribution up to \$5,000 made during the one-year period beginning on the date on which the child of the individual is born, or the legal adoption by the individual is finalized.
- Each parent has a separate limit, and if there are multiple children, a distribution can be taken for each child.
- The 10% early withdrawal penalty is not waived for this distribution, but the amount can be repaid to the plan (no time limit applies).
- \$1,000 penalty-free emergency withdrawal will be available on or after January 1, 2024:
  - One distribution can be taken per year and can be repaid within three years.
  - The distribution amount is exempt from the 10% early withdrawal penalty.
  - No additional emergency distribution can be taken during the 3-year period if the original distribution was not repaid.
- Distributions to domestic abuse survivors will be available on or after January 1, 2024:
  - The distribution amount is exempt from the 10% early withdrawal penalty.

In conclusion, the more engaged participants are in the conversation about retirement and the more they understand the benefit being offered, the better chance they have for a successful retirement. Understanding the reasons why your participants opt out of plan participation may help you either determine if more education is needed or if there are plan provisions that could be considered that would encourage participation.

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## Beneficiary on File?

As part of the enrollment process, participants are asked to elect a beneficiary. However, this step is often not completed or kept up to date as time goes on, which can make death distributions more complicated than they need to be. When a participant names a beneficiary, it helps to ensure their account balance will be distributed to the person intended. However, updating the designation is also very important as life events occur.

When a plan includes automatic enrollment provisions, it does help participants begin saving for retirement. However, if they use the default deferral rate and the default investment option, they may neglect to elect a beneficiary at that time since they aren't filling out any other enrollment paperwork, or maybe they are married and assume the funds will automatically be paid to their spouse. What they need to factor in, though, is how their account balance will be paid if they do not make an election or if they fail to update it as time goes on.

If a current beneficiary election is not on record at the time of a participant's death, the default rules of the plan will determine the beneficiary, which may be the following order: surviving spouse, children in equal shares, surviving parents in equal shares, and lastly, estates. But what if the participant goes through a divorce and doesn't update their election? What if there are more children or stepchildren that are not added to the election? What if there is no spouse, parent, or child to benefit and no estate?

Having a beneficiary election on file makes the distribution process much smoother for all involved and requires less interpretation, which often involves engaging in the services of an attorney. When a participant is enrolled in the plan, it is best to have them designate a beneficiary even if it takes making the request several times until they do. Then, make the discussion part of a recurring process to have the participants review and update the information so that it's not an issue if the need to reference the beneficiary should arise.

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## News Flash!

### Defined Contribution plans: Form 5500 news!

Effective for plan years beginning on or after January 1, 2023, the determination of a large or small plan will be based on the number of participants with an account balance as of the beginning of the year, rather than the number of participants eligible for the plan.

This is welcome news for plans that required an accountant's audit as a large plan because there were more than 100 eligible participants but not all of those participants had balances. For new plans, the participant count will be based on the number of participants with an account balance as of the end of the year.

### Defined Benefit plans: Plan Document news!

The two-year Cycle 3 restatement window for pre-approved defined benefit plan documents opened April 1, 2023, and will end March 31, 2025. Check with your document provider to confirm when they intend to update your plan document for your review and signature during this restatement period.

### Reminders:

- **Required amendments for SECURE Act, CARES Act and Miners Act:** These were originally due as of the last day of the plan year beginning after January 1, 2022 (December 31, 2022, for calendar year plans). Due dates were extended as follows:
  - 401(k) plans, profit sharing plans, money purchase plans, defined benefit plans and 403(b) plans have until December 31, 2025.
  - Governmental plans (including governmental 457(b) plans) have until 90 days after the close of the third regular legislative session of the legislative body with the authority to

amend the plan that begins after December 31, 2023.

- The extension does not apply to tax-exempt 457(b) plans.

- **Form 5500 relief for retroactively adopted plans:** If a plan is adopted after the end of a plan year but before the employer's tax filing deadline (including extensions), the plan is considered to be adopted on the last day of the taxable year. No Form 5500 is due for the initial plan year, but the subsequent year form will have a box checked to indicate it is a retroactively adopted plan permitted by SECURE Act Section 201.

**31st:** Due date for calendar year end plans to file Form 5558 to request an automatic extension of time to file Form 5500.

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#### Clarification:

- In the last edition, the example of Required Minimum Distribution (RMD) age increases from 72 to 73 should have read as follows:
  - For participants who turn 73 in 2023, they were 72 in 2022 and subject to the age 72 RMD rule in effect for 2022.
  - For those who turn 72 in 2023, their 1st RMD will be due by December 31, 2024 or they may opt to delay it until April 1, 2025. If they choose the latter, they will take both their 1st and 2nd payment in 2025.

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## Upcoming Compliance Deadlines

### May 2023

**15th: Quarterly Benefit Statement** - Deadline for participant-directed plans to supply participants with the quarterly benefit/disclosure statement including a statement of plan fees and expenses charged to individual plan accounts during the first quarter of 2023.

### June 2023

**30th: EACA ADP/ACP Corrections** - Deadline for processing corrective distributions for failed ADP/ACP tests to avoid a 10% excise tax on the employer for plans that have elected to participate in an Eligible Automatic Enrollment Arrangement (EACA).

### July 2023

**29th: Summary of Material Modifications (SMM)** - An SMM is due to participants no later than 210 days after the end of the plan year in which a plan amendment was adopted.

**31st:** Due date for calendar year end plans to file Form 5500 and Form 8955-SSA (without extension).

**Sources:**

1. The S&P 500 is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market.
2. The MSCI ACWI ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 27 Emerging Markets (EM) countries. With 2,354 constituents, the index covers approximately 85% of the global equity opportunity set outside the US.
3. Source: U.S. Bureau of Labor Statistics (<https://www.bls.gov/>)

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