Retirement Plan Newsletter

Quarterly Newsletter I Quarter Ending June 30, 2022

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Markets in Review

Global financial markets continued to sell off in the second quarter, with virtually all asset categories in the red. Global markets suffered their worst quarter since the pandemic lows in the first quarter of 2020. Market volatility continued to be a major talking point throughout the second quarter. Driving factors behind the volatility were the Federal Reserve's hawkish stance on inflation that continued to persist in the second quarter and quantitative tightening to slow down the economy.

All major market indices continued to contract during the quarter. Equity markets, as measured by the S&P 500 Index[1], fell by 16% with the median stock in the index falling by 40%.

With inflation persisting during the quarter, long term interest rates continued to surge. The 10-year U.S. Treasury started the quarter on April 1st at 2.39% and subsequently finished the quarter at 3%. The significant move in the bond market also contributed to volatility in the stock market, with all S&P 500 sectors finishing in negative territory.

A trend that persisted during the second quarter was the outperformance of large cap stocks relative to small and mid-cap with investors looking for higher quality, lower beta names during uncertain times.[2] By investment style, value stocks continued to outperform their growth counterparts with several of the value sectors such as energy, utilities, and consumer staples leading the market. Value indices still sit below historic forward P/E levels as measured by the Russell 1000 Value Index[3], which currently has a forward P/E[4] of 12.76x compared to its long-term historical average of 14.10x.

A major theme outside the U.S. was the outperformance of Chinese equities, mainly due to the Chinese Central Bank taking a much more dovish approach, cutting rates compared to other global central banks that are currently hiking rates aggressively to try to curb inflation. During the quarter the MSCI China Index[5] gained 3.4% compared to the MSCI ACWI Ex USA Index[6] that declined 13.5%.

Interest rate volatility continued during the quarter at both the short and long end of the yield curve. Yields of 2-, 10-, and 30-year Treasuries all increased, with the 30-year Treasury in particular gaining 0.74% during the quarter and 1.37% on a year-to-date basis. As a result of the significant rise in rates and investors' low appetite for risk, the dollar index saw new highs during the second quarter, hitting a 19-year high of $104.70. A strong dollar means U.S. exports are more expensive overseas which could drive down demand for goods produced domestically; however, a strong dollar can benefit U.S. travelers overseas and U.S.-based consumers purchasing foreign goods.

The U.S. economy contracted during the second quarter by

-0.9%, which was the second straight quarter of negative real economic growth. The U.S. economy continues to be hindered by relentless inflation, causing an unpleasant stagflationary environment, and persistent supply-chain bottlenecks.

Despite the negative economic growth, the labor market remained particularly strong. In the second quarter, 1.19 million jobs were added to the U.S. economy, with education and health services leading the way. The overall U.S. unemployment rate of 3.6% remains at historically low levels with the total number of unemployed people standing at 5.9 million.[8]

Inflation, as measured by the Consumer Price Index (CPI-U), grew at a pace of 9.1% for the past 12-month period ending June 30, 2022. The core inflation reading, which excludes food and energy, rose 5.9%. The energy index in particualr rose 41.6% over the last year, the largest 12-month increase since the period ending April 1980. The food index increased 10.4% for the 12-months ending in June, the largest 12-month increase since the period ending February 1981.[8]

Despite the elevated inflation levels, consumer finances remain relatively strong as of June 30, 2022. Debt payments as a percentage of disposable income are still relatively low at 9.5%, compared to past times of adversity, such as the fourth quarter 2007 when debt payments as a percentage of disposable personal income hit 13.2%. However, the personal savings rate has slowed considerably and credit card utlization has been on the rise, demonstrating consumers are feeling the impacts of higher prices across the economy.

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Form 5500 Insights

Every year, most employers file a Form 5500 for each qualified plan that they sponsor. The purpose of the Form 5500 is to provide required information to the Department of Labor (DOL), but it can also provide valuable insight to the plan sponsor.

The Form 5500 has several “types” and the type of form you file will vary based on the size of your plan. The Form 5500-SF is generally for small plans with under 100 participants and the Form 5500, which requires a number of attached schedules, is generally for large plans with 100 or more participants. Additionally, the full Form 5500 requires an accountant’s audit. In some cases, even small plans may be required to file a Form 5500 if the plan assets include employer securities or if the plan is considered a multi-employer or pooled employer plan.

There is an even briefer version of the 5500 series called the 5500-EZ. This version of the 5500 is typically filed by one-participant plans (usually the self-employed (and spouse) or one or more partners (and spouses)). The following are examples of the useful information provided on the Form 5500-SF or Form 5500:

Participant Count

Small plan vs large plan

- Whether your plan is considered a large or small plan depends on the number of eligible participants at the beginning of the plan year. This includes terminated participants with an account balance as well as active participants without a balance. As your count gets closer to 100 participants, you will need to plan for the additional work and expense of becoming a large plan, which is when your Form 5500 requires an accountant’s audit be attached when filed.

- If you file a Form 5500-SF as a small plan, the 80-120 rule will apply. This means that if your participant count remains under 120, you can continue to file Form 5500-SF as a small plan and do not require an audit. Once your beginning of the plan year count reaches 121, you will then be considered a large plan with an audit requirement.

- If you are a brand-new plan, though, and have over 100 participants on the first day of the first plan year, the 80-120 rule does not apply and you will require an audit. The 80-120 rule allows you to file as you did the prior year, and new plans do not have a filing for the prior year.

Eligible participants vs active participants with an account balance

- In addition to tracking eligible participants, the number of active participants with an account balance is also listed. This shows you how many of your eligible active participants have a $0 balance.

- If your plan provides for your participants to contribute 401k deferrals, automatic enrollment is an option to increase participation. In this case they must opt out, rather than opt in.

Terminated participants with an account balance

- As this number increases, it is a good time to review the list of terminated participants with account balances. If a participant has an account balance over $5,000, they generally must make a written election in order to withdraw the funds either as a cash distribution or rollover to an IRA or another qualified plan. However, smaller balances may be eligible for automatic payment without the participant’s election if the terms of the plan allow mandatory distributions (these may also be referred to as force-out distributions).

- If you are getting close to having 100 participants, distributions to terminated participants is one way to help lower the plan’s participant count and avoid the additional expense of being a large plan.

ERISA Fidelity bond coverage amount

- An ERISA fidelity bond is a type of insurance that protects the plan against losses caused by acts of fraud or dishonesty.

- The dollar amount of your bond in effect for the plan year is listed on the form. The required coverage amount is the greater of $1,000 or 10% of plan assets as of the first date of the plan year. If less, or listed as $0, it can be a red flag to the DOL.

- If it is the first year of the plan and the form shows a $0 balance at the start of the year, an estimated asset balance should be used for the 10% calculation when considering the level of coverage for your plan's bond.

- In the event you did not establish a bond by the close of the plan year, a bond provider may be able to assist you with a policy that provides retroactive coverage. Some policies can also include an inflation guard going forward so that as plan assets increase, the bond coverage automatically increases to the required amount.

- Not sure where to obtain a fidelity bond? Your property and casualty insurance agent may be able to add this as a rider to your current business policies or your TPA may be able to provide contact information for a vendor that they have seen in the industry.

- So, what happens if I don't have a bond? The correction for not having a bond is to get a bond put in place as soon as possible. However, having an insufficient bond amount noted on the Form 5500 could lead to an IRS or DOL audit where they may review more than just the bond amount.

Late deposits of employee contributions and loan repayments

- Another red flag to the DOL is the dollar amount of late deposits. There is a safe harbor deposit rule for small plans that states that deferrals and loan repayments must be deposited to the plan no later than the 7th business day following the paycheck date. Large plans have less time with contributions required to be remitted on the earliest date possible instead of within 7 business days.

- Late employee contributions or loan repayments for the plan year are reported on the Form 5500 or Form 5500-SF. In addition, if the correction for late deposits took place the following year, the amount is reported again on that year's Form 5500.

Your Form 5500 preparer, often your TPA, will prepare the form on your behalf for your review and signature. They will be able to help guide you through the information that is reported on the form and be sure you understand the information as it reflects on the plan year. The more you understand the Form 5500, the more proactive discussions you can have.

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New IRS Pre-Examination Compliance Program Announced

In June 2022, the IRS began piloting a pre-examination retirement plan compliance program. This is beneficial to plan sponsors because it provides an opportunity for plan sponsors to correct mistakes at a reduced cost and possibly avoid a full IRS examination. Anytime you receive a correspondence from the IRS or DOL, you should inform your TPA or service provider as soon as possible to determine if a response is needed. In some situations, no action is required. In this case, however, the letter opens a 90-day window. Within that time frame, you will need to:

- Review your plan document and operations.

- Determine if they meet current tax law requirements.

- Self-correct any mistakes that qualify under the Employee Plans Compliance Resolution System (EPCRS).

- Respond to the letter and provide your conclusion:
    - No mistakes were found.
    - Mistakes were found and self-corrected (provide the details of the error and correction).
    - Mistakes were found, but they do not qualify for self-correction. You may request a closing agreement. This means that the cost could be much less than if the IRS found the mistakes during an IRS examination.

Your TPA or service provider will be able to review the plan information with you to ensure that all necessary steps were previously taken to maintain compliance. If an issue is discovered as part of this review, they can discuss the correction options available. Of course, you don't have to wait until you receive a letter from the IRS to be sure your plan is compliant! Understanding the terms of the plan and operating the plan according to the document are very important actions to help avoid mistakes.

Once you submit your response, it is reviewed to see if they agree with your conclusion. The IRS will either issue a closing letter or conduct a limited or full scope examination. The intention is that this program will reduce taxpayer burden and the shorten the time spent on retirement plan examinations. The end date of this pilot program is not known, but the process may continue after the pilot period if they find it to be successful.

If you do not provide a response, you will be contacted to schedule the examination. Of course, this is the least favorable option. It is best not to ignore any letter from the IRS or DOL. It is in the best interest of your plan to take action when it is requested, and a 90-day window can close pretty fast!

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Q&A Corner

Q: I didn't file my 12/31/21 plan year end Form 5500 by 7/31/22, now what?

A: Contact your Form 5500 preparer! First, confirm whether or not an extension applies. This would occur with a Form 5558 filed before 7/31, or possibly a special extension or automatic extension. If so, you have until 10/15/22 to file the Form 5500. No extension? The Delinquent Filer Voluntary Compliance Program (DFVCP) is a DOL program designed for this purpose. Using this program, the maximum penalty is $750 for a small plan and $2,000 for a large plan. This is much lower than the

IRS late filing penalty ($250 a day, up to $150,000) and the DOL late filing penalty (up to $2,529 per day, with no maximum).

Q: What if I didn't sign the document restatement for my 401(k) Profit Sharing plan that was due by 7/31/22?

A: This plan document restatement (commonly referred to as Cycle 3, Tricycle or Post PPA) required signatures by 7/31/22. Contact your TPA as soon as possible, or your document provider if handled by someone other than your TPA. The steps to ensure your document remains in compliance will vary based on the type of plan document and provisions included, but the options are not as cut and dry as a late Form 5500. Be sure to act promptly!

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Upcoming Compliance Deadlines

September 2022

15th: Required contribution to Money Purchase Pension Plans, Target Benefit Pension Plans, and Defined Benefit Plans.

Contribution deadline for deducting 2021 employer contributions for those sponsors who filed a tax extension for Partnership or S-Corporation returns for the March 15, 2022 deadline.

30th: Deadline for certification of the Annual Funding Target Attainment Percentage (AFTAP) for Defined Benefit plans for the 2022 plan year.

October 2022

17th: Extended due date for the filing of Form 5500 and Form 8955 for plan years ending December 31, 2021.

Due date for 2022 PBGC Comprehensive Premium Filing for Defined Benefit plans.

Contribution deadline for deducting 2021 employer contributions for those sponsors who filed a tax extension for C-Corporation or Sole-Proprietor returns for the April 18, 2022 deadline.

Due date for non-participant-directed individual account plans to include Lifetime Income Illustrations on the annual participant statement for the plan year ending December 31, 2021.

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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. Beta is a way of measuring a stock's volatility compared with the overall market's volatility.
3. The Russell 1000 Value Index measures the performance of the large-cap value segment of the US equity universe.
4. The forward price-to-earnings (P/E) ratio is the ratio for valuing a company that measures its current share price relative to its next 12-months per-share earnings.
5. The MSCI China Index captures large and mid-cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings. With 717 constituents, the index covers about 85% of this China equity universe.
6. 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.
7. Source: Federal Reserve Bank of Atlanta GDPNow (https://www.atlantafed.org/cqer/research/gdpnow)
8. Source: U.S. Bureau of Labor Statistics (https://www.bls.gov/)
9. Source:BEA, J.P Morgan Asset Management, Guide to the Markets. Data as of June 30, 2022.