



Building Success. Together.

Trust Legislative & Regulatory Update

Highlights from Capitol Hill and the Federal Agencies

FIRMA 36th Annual Fiduciary Risk Management Conference

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Capitol Hill Highlights

- Retirement Reform (*Bipartisan*)
- Plan Investments (*Breakout*)
- Investment Duties (*Blustery Battle*)

Federal Agency Highlights

- **ESG Investing** *(DOL)*
- **Inherited IRA RMDs/Distributions** *(IRS)*
- **Trust Department Management** *(FDIC)*
- **Conflicts of Interest** *(SEC)*
- **Custody of Assets: Crypto/Advisory** *(SEC)*

SECURE 2.0 (Dec. 29, 2022)

- Broad, bipartisan retirement reforms
- Auto-enrollment in retirement plans (w/opt-out) (Sec. 101)
- Starter 401(k) plans for small businesses (121)
- Tax credits for small employer start-up costs (102)
- Employer incentives for workers to enroll (113)

Retirement Investor Gains

- RMD trigger phase-in: age 72 to 75 (2022-2032) (Sec. 107)
- Part-time employee upgrade (125)
- Emergency expense withdrawals (115)
- Emergency savings accounts (127)
- Student loan relief/matching contributions (110)
- Automatic portability (120)

SECURE 2.0 Shortfalls

- Annual paper statement once again required (Sec. 338)
- 403(b) plans still cannot invest in bank CIFs (128 - *tax only*)
- Legislation itself complex, technical, confusing
- Implementation challenge (SECURE 1.0 & 2.0; IRS rules)

SECURE 2.0 Provision Checklist

- Effective date?
- Mandatory or permissive?
- Self-executing, or is IRS action or rule required?
- Interaction with SECURE 1.0 and IRS Rules?
- Will IRS clarifications/revisions/help be forthcoming?

Retirement Savings Modernization Act

- Would codify non-exclusive list of prudent investments
- Plan fiduciary may select multi-asset investment options
- Includes ***private equity, real estate, digital assets***
- Protects fiduciary standard of prudent investing
- Intro'd in 2022; look for re-introduction in 2023

ESG: Congressional Conflict

- Dems: ***encourage*** plan investments in ESG (S 1762)
- Reps: ***discourage*** plan investments in ESG, focus instead on “pecuniary” factors (HR 7151), overturn DOL ESG rule (HJ Res 30)
- Dems: Sustainable Investment Caucus (Jan. 2023)
- Reps: (Anti-)ESG Working Group (Feb. 2023)

ESG: States' Scrum

- States following Congress' lead by legislating laws that either mandate or prohibit ESG, fossil-fuel investments
- 25-State AG lawsuit vs. DOL ESG investing rule (Jan. 26, 2023)
- Issue: are ESG considerations part of prudent investing?

DOL ESG Investing Rule (Effective Jan. 31, 2023)

- ESG factors *may* (not must) be considered in investments
- Principles-based approach to investment decision-making
- Cannot subordinate interests of participants in their retirement income or financial benefits
- Cannot sacrifice investment return or take on additional investment risk to promote benefits or goals unrelated to retirement income or financial benefits

Fiduciary Investing Considerations

- If fiduciary prudent investing requirements are otherwise met:
 - may select between two competing investments based on collateral benefits (*i.e.*, other than investment returns)
 - may consider participant preferences for DC plans
- Fiduciary is free to determine that an ESG-focused investment is *not* in fact prudent

Eliminated from Proposed Rule

- Mandate to consider ESG factors/climate change
- Identification/description of ESG factors:
 - Climate change-related factors
 - Governance factors (*e.g.*, compliance with labor laws)
 - Workplace practices (*e.g.*, progress on workforce diversity and inclusion)

DOL Deliverables for ESG Rule

- Dialogued with ABA and retirement industry
- Affirmed ERISA fiduciary requirements for investing
- Avoided most politically/ideologically charged language
- Left investment decision-making to the fiduciary

IRS Proposal on RMDs (Feb. 24, 2022)

- Reflects SECURE 1.0 changes to Internal Revenue Code
- For 2021, existing rules must be applied with a “reasonable, good faith interpretation” of the 10-year SECURE 1.0 requirement applicable to ineligible beneficiaries

Proposal Impact on Inherited IRAs

- Ineligible beneficiaries (*e.g.*, not spouse or minor child) must deplete inherited account “at least as rapidly” as account owner
- Means that such beneficiaries are subject to 10-year rule *and must also* take annual distributions based on single life expectancy (*latter requirement unexpected*)

ABA Response (May 25, 2022)

- Do *not* require annual distributions for inherited IRAs for years 1-9
- Retirement industry made reasonable interpretation of amended IRC section 401(a)(9)(H) for ineligible beneficiaries
- IRS Publication 590-B implies through examples that 10-year rule does not require RMDs for years 1-9

IRS Notice 2022-53 (Oct. 7, 2022)

- No penalties for non-distributions in 2021
- No penalties for non-distributions in 2022
- No excise tax will be asserted for non-distrib'ns
- IRS final rule will apply no earlier than 2023

FDIC Trust Exam Manual Updates

- July 2022 amendments/updates
- Trust Management (Section 1)
 - Management Capability (Section 1.D.)
 - Trust Policies (Section 1.G.)

Dominant Officials/Polycymakers

- Exert “material influence” over virtually all decisions involving bank policies and operations
- When coupled with ineffective risk management practices, bank may require enhanced supervision
- Not intended to capture persons who occupy multiple positions (small trust departments)

Incentive Compensation Policies

- Used for staff hiring, performance, retention
- Used also to vary comp with performance goals
- Poorly structured = exposure to material risk
- Balancing incentive \$ vs. risk “a complex task”

Sound Incentive Compensation Plan

- Balances risk-taking with amounts paid
- Strong trust dep't controls to monitor and document compensation
- Board approval, oversight, and assessment

SEC Staff Bulletin on Conflicts (Aug. 3, 2022)

- Applies to both broker-dealers and investment advisors
- Conflicts of interest not merely “check the box” exercise
- Not “set and forget” but robust, ongoing process
- Focus on compensation, fees, and charges

Q1: Do *All* Broker-Dealers and Investment Advisors Have Conflicts of Interest?

- Answer: Yes
- *Everyone* has at least *some* conflicts w/retail investors
- Economic incentive to recommend products/services/account types that provide more revenue or benefits
- Conflicts must be addressed to prevent firm & financial professionals from placing interest ahead of investor

Q4: What Are Some Steps My Firm Can Take to Identify Conflicts of Interest?

- Define conflicts relevant to firm's business
- Define conflicts that arise across scope of advice
- Establish ongoing process to identify conflicts
- Establish training programs, roles & responsibilities

Q5: Once Conflicts Are Disclosed, Are Reg BI/IA FS Obligations Satisfied?

- Answer: *No*
- Disclosure *alone* does *not* satisfy obligation to act in retail investor's best interest
- Certain conflicts must be addressed through mitigation, or elimination
- Where conflicts properly addressed, advice OK only when in retail investor's best interest

SEC Risk Alert: Reg BI Conflicts (Jan. 30, 2023)

- “Number of deficiencies” re Policies & Procedures
- Insufficient detail on the structure to identify and address conflicts
- Conflicts that were identified lacked specific descriptions
- Mitigation measures not established
- Improper reliance on disclosures to mitigate conflicts

SEC Examination Priorities (Feb. 7, 2023)

- Focus includes conflicts of interest (Reg BI, fid'y duty)
- Processes for identifying and addressing conflicts
- Whether disclosures contain material facts re conflicts
- Whether disclosures suffice for consent to conflict
- How conflicts are managed (includ'g mitigation/elim'n)

SAB-121 on Crypto Asset Custody

- Effective April 11, 2022
- Requires publicly traded entities, including banks, that “safeguard” digital assets to record the value of these investor-owned assets on the balance sheet at fair value
- Questions about application to various accounts and relationships and scope of “digital assets”
- Chilling effect on bank custody of crypto assets

SEC Custody Proposal (Feb. 15, 2023)

- “Safeguarding Advisory Client Assets” (new rule 223-1)
- Goal: to boost protections of RIA-managed cust’r assets
- Includes *all* client assets, not just funds and securities
- Heightened standards/duties for qualified custodians
- Expanded recordkeeping & reporting requirements

“Qualified Custodians” Include:

- Federal- and state-chartered banks and thrifts
- Certain trust companies
- Registered broker-dealers & futures comm’n merchants
- Certain foreign financial institutions
- Proposal: QC must hold client assets in account designed to protect assets from QC’s creditors in the event of QC’s insolvency or failure

Issues for Qualified Custodians

- RIA must enter into written agreement with QC
- QC must provide assurances on asset protection/custody
- QC must obtain/furnish annual internal control report
- QC subject to mere “negligence” liability standard
- QC must provide client records to SEC on request
- Query: Is SEC regulating bank QCs indirectly?

Challenges for Trust/Wealth Management

- Agency coordination, consistency, coherency
- Targeted rules and compliance certainty
- Clarity in customer relationship and expectations
- Avoiding entanglement in climate, ESG, and crypto-asset turf battles (Congress, agencies, states)

Trust/Wealth Management Forward Look

- DOL Fiduciary Rule reboot: advice and IRA rollovers
- SEC swing pricing proposal: “hard close” requirement
- SEC advisor outsourcing proposal: bank SP burdens
- Joint supervisory guidance (Fed, OCC, FDIC) on climate-related financial principles

Question-&-Answer/Discussion

