USI CONSULTING GROUP

Market & Legal Update

JULY 2023 REVIEW

Stay on top of the latest market developments and legal and regulatory updates that may affect your business.

MARKET UPDATE | Rate Hikes Resume, But So Does Economic Growth

July was an encouraging start to the second half of 2023, as there were positive results in both markets and the economy. Inflation continued to cool while economic output exceeded expectations, although the Fed continued their hawkish path by restarting rate hikes. Markets reacted positively to the economic news, with the Dow Jones Industrial Average rising 3.4%, the S&P 500 gaining 3.2%, and the tech-heavy NASDAQ jumping 4.0% in July, with the positive year-to-date returns of all three indexes surpassing their losses from 2022. Foreign stocks also rose in July as the MSCI EAFE Index gained 3.2% and the MSCI Emerging Market Index returned 6.2% for the month. The Bloomberg U.S. Aggregate Index dropped -0.1% as interest rates rose and bond prices fell.

Market Return Indexes	July 2023	YTD 2023	2022
Dow Jones Industrial Average	3.4%	8.6%	-6.9%
S&P 500	3.2%	20.7%	-18.1%
NASDAQ (price change)	4.1%	37.1%	-33.1%
MSCI Eur. Australasia Far East (EAFE)	3.2%	15.3%	-14.5%
MSCI Emerging Markets	6.2%	11.4%	-20.1%
Bloomberg High Yield	1.4%	6.8%	-11.2%
Bloomberg U.S. Aggregate Bond	-0.1%	2.0%	-13.0%
Yield Data	**July 2023**	**June 2023**	**May 2023**
U.S. 10-Year Treasury Yield	3.96%	3.81%	3.64%

The June inflation report revealed another welcoming drop in headline inflation (CPI) from the previous month of 4.0% to 3.0% annually, which was the smallest 12-month reading since March of 2021. The Consumer Price Index (CPI) for all goods rose 0.2% in June on a seasonally adjusted basis from the prior month. The index for shelter continues to be the largest contributor to inflation, accounting for over 70% of the monthly increase. Although we have seen some recent relief within the housing market, economists predict that it can take anywhere from six to twelve months for a decline in current housing prices to be fully represented in inflation data, which is a positive sign for future readings. Meanwhile, energy prices have continued to decline over the last few months, detracting from the overall headline inflation reading. Removing volatile food and energy prices, Core CPI rose 4.8% on an annual basis, down from 5.3% in May. Personal Consumption Expenditures (PCE) is the Fed's preferred measure of inflation over CPI, as PCE accounts for a broader range of source data, revises the weights of expenditures following consumer trends, and includes a more comprehensive coverage of goods and services. While PCE and CPI both increased 3.0% on an annual basis in June, Core PCE fell to 4.1%, down from 4.6% in May, which is the lowest reading since September of 2021 but still well above the Fed's 2% target.

The FOMC met at the end of July and cited the elevated levels of core inflation as one of their reasons for enacting an expected 0.25% rate hike, bringing the target range to 5.25% - 5.50%, the highest level in over 20 years. This put the Fed back on their rate hiking path following a brief pause from their June meeting. In addition to elevated inflation, Fed Chair Powell noted that labor conditions remain very tight, as the unemployment rate continues to sit near record lows at 3.6%. Powell articulated that the Fed is looking for broader moderate growth, as well as better balance of supply and demand throughout the economy when considering ending the rate hiking cycle. With another rate hike, the U.S. increasingly faces the risk of the Fed over-tightening in their attempt to temper inflation, which Powell acknowledged as the "risk of doing too much or too little" in this situation, as the Fed continues to walk on a tightrope towards a hopeful "soft landing". Data from the Fed's June projections suggest that rates will finish the year a quarter percentage point higher than now, with three FOMC meetings left on the calendar in 2023.

Expanding economic conditions have sent mixed signals to the Fed on the impact of their monetary tightening. In July, the advanced estimate released by the Bureau of Economic Analysis revealed that real gross domestic product (GDP) increased at an annual rate of 2.4% in the second quarter of 2023, exceeding expectations. This positive economic data followed shortly on the heels of an upward revision of Q1 GDP from 1.3% to 2.0%. The increase in Q2 GDP reflected increases in consumer spending and nonresidential fixed investment, which were partly offset by decreases in exports and residential fixed investment. The report revealed the U.S. economy's resilience despite the Fed's ongoing tightening, which continues to push recession fears further into the future.

Although consumers have held up remarkably well in the first half of 2023, tighter credit conditions, the resumption of student loan payments, and depletion of savings are expected to shift consumers to a more conservative spending approach, which threatens the longevity of the current economic expansion. Markets and the Fed will be watching closely to see the impact of these conditions as well as the results of two more job reports and two additional CPI releases before the next Fed meeting in late September.

IRS ISSUES SECURE 2.0 GUIDANCE: PLAN CORRECTIONS AND REQUIRED MINIMUM DISTRIBUTIONS

The December 29, 2022 enactment of the SECURE 2.0 Act (SECURE 2.0) left many plan sponsors and service providers with both opportunities and challenges. In recent weeks, the Internal Revenue Service has issued two pieces of guidance on two provisions of SECURE 2.0, as follows:

- **Notice 2023-43,** May 25, 2023, Expansion of the Employee Plans Compliance Resolution System; and
- **Notice 2023-54,** July 14, 2023, Transition Relief and Guidance Relating to Certain Required Minimum Distributions.

The following summarizes these two new pieces of SECURE 2.0 guidance.

EXPANDED PLAN CORRECTION

The tax Code subjects employer plans and individual retirement accounts to a host of technical requirements to maintain tax-deferred or tax-qualified status, including administering such plans according to their written terms. Unfortunately, retirement plan errors are common. Administrators make mistakes that may result in plan qualification failures. Common errors include excluding eligible participants, miscalculating contributions, improperly crediting plan compensation, and failing to enroll participants automatically in elective deferrals.

The IRS has established the Employee Plans Compliance Resolution System (EPCRS) to enable administrators (and the IRS) to correct plan failures and to encourage voluntary compliance with applicable rules. EPCRS (most recently set forth in IRS Revenue Procedure 2021-30) contains three distinct programs for correcting plan errors:

- **Self-Correction Program (SCP)** – the administrator corrects the error following a method detailed in the Revenue Procedure but does not file with the IRS;
- **Voluntary Correction Program (VCP)** – the administrator corrects the error but files for a compliance statement with the IRS and pays a fee; and
- **Audit Closing Agreement Program** – the IRS finds the error during a plan audit, and the administrator corrects the error under a closing agreement and pays a sanction (more significant than the VCP application fee).

Plan administrators obviously prefer correcting under the SCP rather than filing a VCP application with the IRS. Historically, EPCRS imposed significant limitations on the types and timing of plan errors an administrator could self-correct.

SECURE 2.0 has now broadened the ability to use the SCP by allowing self-correction for any "eligible inadvertent failure," which the Act defines to include any failure to meet the requirements of the tax Code despite the existence of the plan sponsor's practices and procedures that are designed to promote regulatory compliance. An inadvertent failure does not include any failure that is egregious, relates to the diversion or misuse of plan assets, or is directly or indirectly related to an abusive tax avoidance transaction.

In order to self-correct an eligible inadvertent failure under SCP, the plan sponsor must correct the error within a reasonable period after the plan sponsor identifies the error, and the error must not have been identified by the IRS prior to plan sponsor's efforts to self-correct the error.

In addition, SECURE 2.0 allows plan sponsors to self-correct for eligible inadvertent plan loan failures. Previously, most plan loan errors had to be corrected through VCP.

The new provision for the self-correction of eligible inadvertent failures was effective as of the date of enactment, December 29, 2022. Although the provision is currently in effect, the IRS has a two-year period to update the Revenue Procedures for EPCRS and to provide additional guidance regarding this statutory change to the retirement plan correction rules.

On May 25th the IRS issued Notice 2023-43 which gives plan sponsors and administrators interim reliable guidance on SECURE 2.0's expansion of EPCRS. The most significant changes or clarifications in Notice 2023-43 are as follows:

- Administrators may now self-correct eligible inadvertent failures found **at any time**, provided they substantially start the correction prior to any IRS plan audit, and they complete the correction **within 18 months of the error's discovery.**
- Administrators are only permitted to self-correct before an IRS plan audit, unless they can demonstrate, based on the facts and circumstances, that they were actively pursuing to correct the failure prior to the audit.
- Administrators remain unable to self-correct certain inadvertent failures, such as failure to adopt a written plan document, certain demographic failures, and certain ESOP failures. Although SECURE 2.0 intends the IRS eventually to expand EPCRS to **individual retirement accounts and annuities** (presently, EPCRS only applies to SEPs and SIMPLE IRAs), Notice 2023-43 determined that IRA holders would have to wait to begin correcting IRA errors under EPCRS.

Notice 2023-43 contains further details and limitations. Administrators still must correct certain "significant" failures by filing a VCP application.

REQUIRED MINIMUM DISTRIBUTIONS – TRANSITION RELIEF.

Employer retirement plans and individual retirement accounts generally permit participants to defer income taxation on benefits accrued or account balances accumulated in such plans. (Special rules apply to after-tax contributions and Roth accounts.) Because Congress intended such plans or IRAs to be for retirement, the law requires that plans and IRAs begin distributing benefits to participants (or to their beneficiaries) in set minimum amounts as of a particular date. Practitioners refer to these requirements as the "required minimum distribution" (RMD) rules. These rules set the **date** on which benefits must commence and the **period** over which a plan or IRA must distribute a participant's entire benefit to the participant or the participant's beneficiary. A participant or IRA holder may not roll over (*i.e.*, continue to defer income taxation) any portion of a distribution that is a minimum amount.

In the 2019 SECURE Act, Congress raised the age for required minimum distributions from **70½ to 72**, effective with the 2020 distribution calendar year. (Please note that, with respect to employer plans, the law does not require such plans to make minimum distributions to participants until their employment terminates, unless a participant is a more than 5% owner.)

The 2022 SECURE 2.0 Act raised the applicable age from age **72 to age 73**, effective for the 2023 distribution calendar year. (By the 2033 distribution calendar year, this applicable age will increase to age 75.) Because Congress enacted SECURE 2.0 in late December, some administrators and service providers made distributions to 72-year-old participants or IRA holders (*i.e.*, born in 1951) in early 2022 that the amended law did not require and that the law otherwise would treat as eligible for tax deferred rollover.

Given the circumstances and the very recent changes wrought by SECURE 2.0 regarding required minimum distributions, on July 14th, the IRS issued Notice 2023-54, containing important transition relief as follows:

- With respect to distributions made between January 1, 2023 and July 31, 2023 to participants at age 72 (*i.e.*, born in 1951), the IRS will not treat plan administrators as having failed to comply with the **eligible rollover rules**.
- With respect to participants at age 72 who received such distributions between January 1, 2023 and July 31, 2023, the IRS has **extended the 60-day rollover deadline** to September 30, 2023; participants who mistakenly received distributions originally intended as required minimum distributions have until **September 30, 2023** to roll such distributions into an employer plan or IRA.
- Regarding participants or IRA holders who died after their required beginning date in 2020, 2021 or 2022, the IRS will not treat an employer plan or IRA as having failed to meet the RMD rules (nor assess the excise tax on participants or IRA holders) with respect to the 2023 distribution calendar year for **not making a 2023 minimum life expectancy distribution** (under the Proposed Regulation) to a designated beneficiary. (This relief also applies to successor beneficiaries of a participant's spouse, minor child, disabled beneficiary, chronically ill beneficiary, or other beneficiary not more than ten years younger than the participant if such person dies in 2020, 2021 or 2022.)
- The IRS issued proposed RMD regulations prior to the passage of SECURE 2.0. These proposed regulations now need to be updated for the subsequent SECURE 2.0 changes.

The IRS intends to issue Final RMD Regulations that will apply for distribution calendar years beginning no earlier than 2024.

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How USI Consulting Group (USICG) Can Assist

The USICG team can help answer any questions that you have regarding SECURE 2.0. Both the IRS and the DOL are expected to issue additional guidance regarding the SECURE 2.0 provisions and as soon as additional information becomes available, we will provide updates to inform you about such guidance and its impact on plan compliance and administration. The USICG team is always available to help plan sponsors with documents, compliance, and other matters, including those discussed here.

Retirement Resources for You

The USICG team is happy to assist employers with all retirement plan compliance matters and changes in the market, including those discussed here, to help you mitigate risk and financial impact to your organization.

To learn more, please contact your local USICG representative, visit our Contact Us page or reach out to us at information@usicg.com.

Find the address and telephone number of your local USI Consulting Group office here.

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An index is a measure of value changes in a representative grouping of stocks, bonds, or other securities. Indexes are used primarily for comparative performance measurement and as a gauge of movements in financial markets. You can not invest directly in an index and, for comparative purposes; they do not reflect the effect of the various fees inherent in actual investment vehicles.

The S&P 500 Index is a market value weighted index showing the change in the aggregate market value of 500 U.S. stocks. It is a commonly used measure of stock market total return performance.

The Dow Jones Industrial Average is a price weighted index comprised of 30 actively traded blue chip stocks; primarily industrial companies, but including some service oriented firms.

The NASDAQ Composite Index is a market-value weighted index that measures all domestic and non-U.S. based securities listed on the NASDAQ Stock Market.

Gross Domestic Product (GDP) is the market value of the goods and services produced by labor and property in the U.S. It is comprised of consumer and government purchases, net exports of goods and services, and private domestic investments. The Commerce Department releases figures for GDP on a quarterly basis. Inflation adjusted GDP (or real GDP) is used to measure growth of the U.S. economy.

The MSCI Europe and Australasia, Far East Equity Index (EAFE) is a market capitalization weighted unmanaged index developed by Morgan Stanley Capital International to measure approximately 1,100 securities in 21 major overseas stock markets. It is a commonly used measure for foreign stock market performance.

The Barclays Capital U.S. Aggregate Index covers the U.S. Dollar denominated investment grade, fixed-rate, taxable bond market of SEC-registered securities.

The Barclays Capital U.S. Corporate High Yield Index covers the U.S. Dollar denominated, non-investment grade, fixed income, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's Fitch, and S&P is Ba1/BB+/BB+ or below.

The MSCI Emerging Markets Index (EM) is a free-float-adjusted market-capitalization index developed by Morgan Stanley Capital International. It is designed to measure the equity market performance of 26 emerging market countries.

The 10 Year Treasury Yield is the interest rate the U.S. government pays to borrow money for a 10-year period. In addition to influencing how much the government pays to borrow over this time-frame, the 10-year Treasury Yields also determines how much investors earn by investing in this debt and it is a good indicator of investor sentiment

The higher the yield, the better the economic outlook.

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