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USI CONSULTING GROUP

Market & Legal Update

MARCH 2023 REVIEW

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

MARKET UPDATE | March Volatility Ends with Positive Returns Despite Banking Crisis

March was an extremely eventful month for markets following two public addresses from the Federal Reserve, a modest inflation report, and a frightening but contained to-date banking crisis, all of which are intricately connected events. Markets experienced extreme volatility subsequent to each of these events, with the S&P 500 finishing up 3.7% for the month, while experiencing a 7.9% recovery from its intra-month low. The Dow Jones Industrial Average finished March up 2.1%, while the NASDAQ soared 6.7%, bringing its year-to-date return to 16.8% so far in 2023. Overseas, the MSCI EAFE Index gained 2.5%, while the MSCI Emerging Market Index finished the month up 3.0%. Within fixed income, the Bloomberg U.S. Aggregate Index increased 2.5%.

Market Return Indexes	March 2023	YTD 2023	2022
Dow Jones Industrial Average	2.1%	0.9%	-6.9%
S&P 500	3.7%	7.5%	-18.1%
NASDAQ (price change)	6.7%	16.8%	-33.1%
MSCI Eur. Australasia Far East (EAFE)	2.5%	8.5%	-14.5%
MSCI Emerging Markets	3.0%	4.0%	-20.1%
Bloomberg High Yield	1.1%	3.6%	-11.2%
Bloomberg U.S. Aggregate Bond	2.5%	3.0%	-13.0%
Yield Data	**March 2023**	**Feb. 2023**	**Jan. 2023**
U.S. 10-Year Treasury Yield	3.48%	3.94%	3.52%

March began on a hawkish note, as Federal Reserve Chair Jerome Powell told Congress on March 7th that the Fed would likely need to raise rates higher and faster than anticipated, citing the recent surge in job growth as one of the surprisingly strong economic data measures that will keep the Fed relatively aggressive. Following Powell's testimony, policy-sensitive yields continued to shift upward, with the yield on the two-year Treasury note reaching 5% for the first time since 2007. As interest rates rise, the prices of existing bonds fall, resulting in negative performance within fixed income markets over the past year.

On March 8th Silicon Valley Bank (or "SVB") announced that it would book a $1.8 billion loss on the sale of fixed income securities, including Treasury and mortgage bonds, to meet its elevated withdrawal demand, as its largely startup customer base continued to burn cash with the lack of venture capital support that continued to dwindle through 2022. The bank also announced that it needed to raise an additional $2.25 billion by selling common and preferred stock, which resulted in Moody's credit rating agency downgrading Silicon Valley Bank a few hours later. As the bank's stock crashed with the news, venture capital firms and their portfolio companies began to withdraw their cash accounts in a panic, attempting to withdrawal a total of $42 billion that day. On March 10th, SVB's stock was halted, and federal regulators announced that they took control of the bank, marking the second biggest bank failure in U.S. history following Washington Mutual in 2008.

The panic continued to ripple across regional banks, with New York-based Signature Bank failing only a few days later. In an attempt to contain the spread of the fear surrounding banks, the U.S. government announced that customers of both failed banks would be eligible to receive all of their deposits back, not just those under the FDIC insured limit of $250,000. The Federal Reserved followed with a new lending program for banks, The Bank Term Funding Program, which allows banks to borrow from the Fed against their debt holdings at par value, not accounting for the large market value losses on these assets. The Treasury Department is also providing $25 billion of credit protection to the Fed in case any of the banks cannot repay their advances. The government continued to ease public panic as Treasury Secretary Janet Yellen assured that the government could step in to protect depositors at additional banks if needed.

Other banks also took matters into their own hands to stop the contagion, as eleven U.S. banks deposited $30 billion into First Republic bank, another regional bank that began to experience a large run of withdrawals following Silicon Valley Bank. First Citizens Bank recently entered a deal to acquire the bulk of Silicon Valley Bank's assets and globally, UBS announced a takeover of competitor Credit Suisse, which has also faltered in the wake of the banking panic.

With the swift intervention of regulators and other banks, the banking crisis has temporarily eased, with no new bank failures announced within the United States. Banks, both regional and national, still face endangerment due to the significant market value losses associated with their debt holdings. Larger institutions such as Charles Schwab have reassured the public that they would not have to sell any of their assets at these losses to meet liquidity demands. Investors and the American public will look to signs that the banking system is as strong as it is portrayed and hope that no more cracks are exposed in the system as markets begin to stabilize.

February's inflation report released on March 14th revealed that inflation for all items increased 6.0% on an annual basis, which was the smallest 12-month increase since September 2021. The all items less food and energy index rose 5.5% over the last 12 months, its smallest 12-month increase since December 2021. Powell spoke again on March 22nd, where he announced the Fed's additional rate hike of one quarter of a percentage point, bringing the federal funds target rate range to 4.75% to 5.00%. Despite the delicate situation within the banking sector, the Fed adhered to their commitment to reduce inflation by not halting their rate hikes, noting that the banking system is "sound and resilient". The next FOMC meeting is in the beginning of May, and all eyes are on the labor market, inflation data, and banking sector to determine if the Fed might pivot from further increases.

LEGAL UPDATE

Legislative Support of Roth Continues with SECURE 2.0

By now most retirement plan sponsors and participants have become familiar with the after-tax Roth concept which can simply be described as pre-paying taxes on retirement savings contributions in exchange for tax avoidance on the future earnings when the benefit is distributed. Encouraging Roth contributions has proven to be a favorite legislative strategy largely because Roth contributions are a short-term revenue raiser when compared with traditional tax-deferred contributions. Additionally, Roth savings vehicles have proven to be popular with many savvy tax and financial planners.

The concept of Roth was first introduced in IRAs in 1997 and later extended to qualified plans in 2006. Since then, Congress has taken several opportunities to expand the concept and the recently enacted SECURE 2.0 Act ("SECURE 2.0") further extends the Roth concept in three ways.

1 Mandatory Roth Catch-Up Contributions for Certain High-Paid Participants

For tax years beginning after 2023 catch-up contributions for "High-Paid Participants" must be made as a Roth contribution. For this purpose, a "High-Paid Participant" is defined as an employee who earned more than $145,000 (indexed annually) from the plan sponsor in the previous year. It will be important for plan sponsors and recordkeepers to be able to identify the impacted participants at the beginning of the year to properly handle the payroll and plan recordkeeping aspects of this change.

The technical aspect of determining a "High-Paid Participant" might result in some unexpected results, for example if a company hires a new highly paid executive in 2024 that person would not be impacted by the Roth catch-up rule in 2024, because they had no pay from the plan sponsor in 2023. This executive would not be required to make catch-up contributions as Roth and could make a full catch-up contribution as a pre-tax contribution. Additionally, if they did not make $145,000 from the employer in 2024 (presumably because they started work for the employer late in the year), then they could get that same pre-tax treatment in 2025 for catch-up contributions.

To the extent the plan sponsor permits catch-up contributions, this mandatory Roth treatment for highly paid participants will apply to both regular catch-up contributions and to the new special increased catch-up contributions that will be permitted under SECURE 2.0 beginning in 2025 for participants who are within the age window of 60 to 63 years old.

Although this new provision is mandatory, the change impacts two plan provisions that have always been and remain optional, Roth contributions and catch-up contributions. After 2023 if a plan offers catch-up contributions that plan will need to offer designated Roth contributions well; therefore, plan amendments for Roth contributions will be necessary for any plans that currently do not permit Roth contributions. It is possible that some plan sponsors might consider eliminating catch-up contributions or requiring that all catch-up contributions, regardless of the participant's compensation level be made as a Roth contribution to simplify the plan administration.

2 Optional Roth Treatment for Employer Contributions to the Plan

Effective immediately, employers may permit employees to elect to treat employer non-elective and matching contributions as Roth contributions. This means that these contributions would be taxable to the employee at the time the contributions were made. An employee would need to be 100% vested in the contribution to make this election. Although this optional provision is currently in place under the code, IRS guidance is expected since there are several taxation and administrative issues relating to this concept that still need to be worked out before this provision can be implemented, such as:

- **How a participant will make this election**
- **How to program this treatment in the employer's payroll system and plan's recordkeeping system**
- **How the participant will pay the taxes**
- **How the tax is reported on the employee's W-2**

USICG COMMENTARY

Plan sponsors should not rush into providing this option until some of these issues are better understood, keeping in mind that if the plan already permits an in-plan Roth conversion of existing accounts, then participants might be able to accomplish the same end goal without the additional payroll complexities.

3 Required Minimum Distributions (RMDs) No Longer Necessary for Roth

Beginning with the 2024 calendar year RMDs will no longer be required to be made from designated Roth accounts within qualified plans. This change in the law fixes a discrepancy that has long existed between Roth IRAs and Roth 401(k)s (and other qualified plan Roth designated accounts). Participants who have an RMD for 2023 will continue to be required to take an RMD from their Roth account for 2023 but will not have to do so starting in 2024.

How USI Consulting Group (USICG) Can Assist

The USICG team can help answer any questions that you have regarding SECURE 2.0 and its discretionary and required changes to your plan. Both the IRS and the DOL will be issuing 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.

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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