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# **Pensions and Individual Retirement Accounts (IRAs): Investment Issues**

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## **Pensions and Individual Retirement Accounts (IRAs): Investment Issues**

Employer-sponsored pensions and individual retirement accounts (IRAs) are important sources of income security in retirement for American households. Recent congressional interest in retirement policy has focused on several aspects of pension investments. Some of this interest involves pension investment policy spanning the state and local, federal, and private sectors. For example, several hearings in the 118<sup>th</sup> Congress have examined the role of environmental, social, and governance (ESG) investing in pension plans with regard to investment managers and retirement policy generally. Some other recent developments in pension investment policy have focused on a particular sector. For instance, recent regulatory and congressional responses to private sector pension issues have addressed investment advice and investment fees. Similarly, the investment practices of the Thrift Savings Plan (TSP), a retirement plan covering the civilian federal workforce and the uniformed services, have been legislatively active over recent Congresses, including the 118<sup>th</sup> Congress.

This report provides an overview of pension investment issues across state and local pensions, federal pensions (with a focus on TSP), private sector pension plans, and IRAs. For each of these types of pensions or retirement accounts, this report explains relevant federal authorities (if any), relevant federal oversight (if any), and administrative issues. For example, while current TSP investment options are set out specifically under federal law (5 U.S.C. §8438), state and local pension plans are generally governed by state laws, contract law, and/or state constitutions. Moreover, state and local pension plans are exempt from many, but not all, requirements under the Employee Retirement Income Security Act of 1974 (ERISA; P.L. 93-406), the federal law that covers most private sector pension plans. Understanding the relevant authorities and administration of different types of pension plans and retirement accounts is crucial to untangling policy proposals to address pension investment issues.

This report also identifies and synthesizes key pension investment issues for Congress, many of which have received regulatory and congressional responses or have involved legislative activity in the 118<sup>th</sup> Congress. Specifically, lawmakers have expressed interest in the following policy issues related to pension investments, by sector:

- State and local pensions: ESG investing, alternative investments, geopolitical considerations, and diverse asset managers;
- Federal pensions, specifically with regard to TSP: the International “I” Fund benchmark and investments in Chinese companies, ESG investment issues, the mutual fund window, diverse asset managers, and the exercise of shareholder rights;
- Private sector pensions: investments based on non-pecuniary factors, exercise of shareholder rights, alternative investments, collective investment trusts in 403(b) plans, investment advice, investment fees, and qualified professional asset managers; and
- IRAs: investment restrictions and prohibited transactions.

For background on other aspects of these pension plans and retirement accounts, see CRS Report R47119, *Pensions and Individual Retirement Accounts (IRAs): An Overview*.

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## Introduction

A pension is a benefit offered by employers to assist employees in providing for their financial security in retirement.<sup>1</sup> Pensions are a type of deferred compensation intended to replace income when individuals separate from the paid labor force at older ages. Employers in the public sector—state and local governments as well as the federal government—and in the private sector may provide pensions to their employees.<sup>2</sup>

Pension plans can be classified along several dimensions. In defined benefit (DB) plans (sometimes referred to as traditional pension plans), participants typically receive monthly payments in retirement based on a formula that uses either (1) a combination of length of service, accrual rate, and average of final years' salary or (2) a flat dollar amount times the number of months or years in the plan. Some plans offer participants the option to receive their benefits as a lump-sum amount.

In defined contribution (DC) plans, workers are provided individual accounts funded by their own contributions, contributions from their employers, or both. The funds in the account may accrue investment earnings, which can then be used as a source of income in retirement. The type of DC plan that an employer may offer depends on the type of employer (for example, the types of plans offered by public sector employers are typically different from those offered by private sector employers), as well as the employer's choices regarding plan features (for example, private sector employers have a number of types of DC plans they can offer). Examples of DC plans include profit-sharing plans, money purchase plans, 401(k) plans, 403(b) plans, and employee stock ownership plans (ESOPs).

Individual retirement accounts (IRAs) are tax-advantaged accounts that allow individuals to save for retirement outside of employer-sponsored plans or to roll over savings from employer-sponsored plans.<sup>3</sup> Traditional and Roth IRAs differ based on their tax treatment. Contributions to traditional IRAs may be deductible from taxable income, while withdrawals are included in taxable income. Contributions to Roth IRAs are not deductible and are limited by income, but qualified withdrawals are not included in taxable income; investment earnings grow tax free. Most inflows to IRAs come from *rollovers* of savings in workplace pension plans (such as 401(k) plans) at job change or retirement.<sup>4</sup>

In March 2023, nearly three-quarters (72%) of U.S. civilian workers had access to, and more than half (56%) participated in, DB or DC pension plans at their workplaces.<sup>5</sup> Additionally, in 2019, about 25% of U.S. households owned IRAs.<sup>6</sup> Pensions and retirement policy is an area of ongoing congressional interest as lawmakers seek ways to improve the retirement system for both employers and employees. Congress may be interested in a number of issues related to pensions,

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<sup>1</sup> For a discussion of retirement income security more generally, see CRS In Focus IF12330, *Retirement Income Security: Issues and Policies*.

<sup>2</sup> For background on the various types of pension plans, see CRS Report R47119, *Pensions and Individual Retirement Accounts (IRAs): An Overview*.

<sup>3</sup> For background on IRAs, see CRS Report R46635, *Individual Retirement Account (IRA) Ownership: Data and Policy Issues*, and CRS Report RL34397, *Traditional and Roth Individual Retirement Accounts (IRAs): A Primer*.

<sup>4</sup> For example, in 2020 (the latest year for which data is available), over 96% of the inflows to traditional IRAs came from rollovers. More inflows to Roth IRAs came from contributions rather than rollovers, but Roth IRA inflows (\$85.0 billion) were much smaller than traditional IRA inflows (\$616.9 billion) in 2020. See Investment Company Institute, "The U.S. Retirement Market, Third Quarter 2023," <https://www.ici.org/research/stats/retirement>.

<sup>5</sup> See Bureau of Labor Statistics, National Compensation Survey, March 2023, <https://www.bls.gov/ebs/publications/employee-benefits-in-the-united-states-march-2023.htm>.

<sup>6</sup> See CRS Report R47213, *Ownership of Retirement Assets: Data in Brief*.

such as proposals to expand pension coverage or the tax treatment of retirement plans. One pension policy issue that has received considerable attention recently is the investment practices of different types of retirement plans. For example, in May and June of 2023, the House Committee on Oversight and Accountability held two joint subcommittee hearings to examine the role of environmental, social, and governance (ESG) investing,<sup>7</sup> including with regard to investment managers and retirement policy.<sup>8</sup> On November 7, 2023, the House Committee on Ways and Means held a hearing on “Ensuring That ‘Woke’ Doesn’t Leave Americans Broke: Protecting Seniors and Savers from ESG Activism,”<sup>9</sup> which also focused on the role of ESG investments in retirement policy. Additionally, legislation to make changes to the investment practices of the Thrift Savings Plan (TSP), a defined contribution retirement plan for the civilian federal workforce and the uniformed services, has been introduced in recent Congresses.<sup>10</sup>

This report synthesizes information on selected pension investment issues so Congress can understand existing legislative proposals as well as develop new legislative proposals. This report provides background information on pension investment issues generally, including differences across sectors and types of pension plans.

## Overview of Pension Plans

Pensions vary across a number of dimensions that are relevant for the purposes of investment policy considerations. First, and most significantly, the sector of the employer that sponsors the pensions matters for the purposes of pension investments. Therefore, this report considers public sector pension plans sponsored by governments at the (1) state and local level and (2) federal level and discusses (3) private sector pensions, all on their own terms. Pensions sponsored by employers across these three sectors differ meaningfully for the purposes of investment policy, including the role of federal laws (if any), the role of federal oversight (if any), and plan administration. Similarly, IRAs are subject to their own federal authorities, federal oversight, and account administration.

Second, as previously mentioned, there are two types of pension plans based on benefit structure: (1) DB plans, in which participants typically receive their benefits as monthly payments in retirement, and (2) DC plans, in which participants’ benefits accrue in individual savings accounts. The different features of these two types of pension plans lend themselves to different policy issues with regard to investment practices. In addition, DB plan investment decisions may be influenced by plans’ funded statuses, which differ by sector.<sup>11</sup> For example, both private sector

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<sup>7</sup> For background on ESG investing, see CRS In Focus IF11716, *Introduction to Financial Services: Environmental, Social, and Governance (ESG) Issues*.

<sup>8</sup> See U.S. Congress, House Committee on Oversight and Accountability, *ESG Part I: An Examination of Environmental, Social, and Governance Practices with Attorneys General*, May 10, 2023, <https://oversight.house.gov/hearing/esg-part-i-an-examination-of-environmental-social-and-governance-practices-with-attorneys-general/>; and *ESG Part II: The Cascading Impacts of ESG Compliance*, June 6, 2023, <https://oversight.house.gov/hearing/esg-part-ii-the-cascading-impacts-of-esg-compliance/>.

<sup>9</sup> See U.S. Congress, House Committee on Ways and Means, *Hearing on Ensuring That “Woke” Doesn’t Leave Americans Broke: Protecting Seniors and Savers from ESG Activism*, November 7, 2023, <https://waysandmeans.house.gov/event/hearing-on-ensuring-that-woke-doesnt-leave-americans-broke-protecting-seniors-and-savers-from-esg-activism/>.

<sup>10</sup> For examples of legislation that would have made changes to TSP investments in the 117<sup>th</sup> Congress, see CRS In Focus IF12110, *Thrift Savings Plan: Investment Issues*.

<sup>11</sup> Plans’ funded statuses, which differ by sector, may be a result of different funding rules between private and public sector plans. Private sector DB plans are subject to funding rules in federal law—ERISA sets out requirements for the minimum required contribution, which is the amount of money that must be contributed each year to a DB pension plan (continued...)

and state and local DB plans have historically been underfunded, although in recent years, private sector plans' funding status has improved, in part due to changes in law that affect the discount rate used by plans.<sup>12</sup> State and local DB plans continue to be underfunded.<sup>13</sup> Federal DB pensions are not underfunded because they are generally invested in risk-free Treasury securities.<sup>14</sup>

Pension plans hold a variety of investments.<sup>15</sup> The Federal Reserve publishes quarterly data on the holdings of pension plans in the Financial Accounts of the United States.<sup>16</sup> These holdings include short-term securities (such as checking and savings deposits), corporate equities (such as company stock), debt (such as mortgages and bonds issued by governments and companies), mutual funds (such as investment companies that pool money from investors in securities such as stocks and bonds), and, for DB plans, the claims of the pension funds on plan sponsors (plans' unfunded benefits).<sup>17</sup> Not every pension plan holds every type of asset.<sup>18</sup> For example, the DB pension plans for nearly all federal employees hold only U.S. Treasury securities.

Total assets held in DB retirement plans, DC accounts, and IRAs totaled \$40.0 trillion as of June 30, 2023.<sup>19</sup> Because assets in pension plans and IRAs comprise a significant portion of U.S. households' wealth, changes to pension investment policies could affect both the amount and the distribution of household wealth.<sup>20</sup> **Figure 1** shows (1) the amount of financial assets (in trillions of dollars) in pension plans sponsored by private sector employers, state and local governments, and the federal government; (2) the amount of assets in IRAs; and (3) the components of these assets.

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(see CRS Report R46366, *Single-Employer Defined Benefit Pension Plans: Funding Relief and Modifications to Funding Rules*). State and local pension plans are not subject to federal pension funding requirements and generally follow pension accounting standards set by the Governmental Accounting Standards Board. In some cases, state and local plans may not make their full required contributions to the pension plans each year, which contributes to plan underfunding.

<sup>12</sup> See CRS Report R46366, *Single-Employer Defined Benefit Pension Plans: Funding Relief and Modifications to Funding Rules*.

<sup>13</sup> See Public Plans Data, "Actuarial Funded Ratio for State and Local Pensions, 2001-," <https://publicplansdata.org/quick-facts/national/#>.

<sup>14</sup> See "Federal Pension Plans" later in this report.

<sup>15</sup> For additional information, see CRS Report R47699, *U.S. Retirement Assets: Data in Brief*.

<sup>16</sup> The Financial Accounts of the United States are available at <https://www.federalreserve.gov/releases/z1/>.

<sup>17</sup> DB plan underfunding is in plan assets because the plans expect to receive the funds that are owed by plan sponsors.

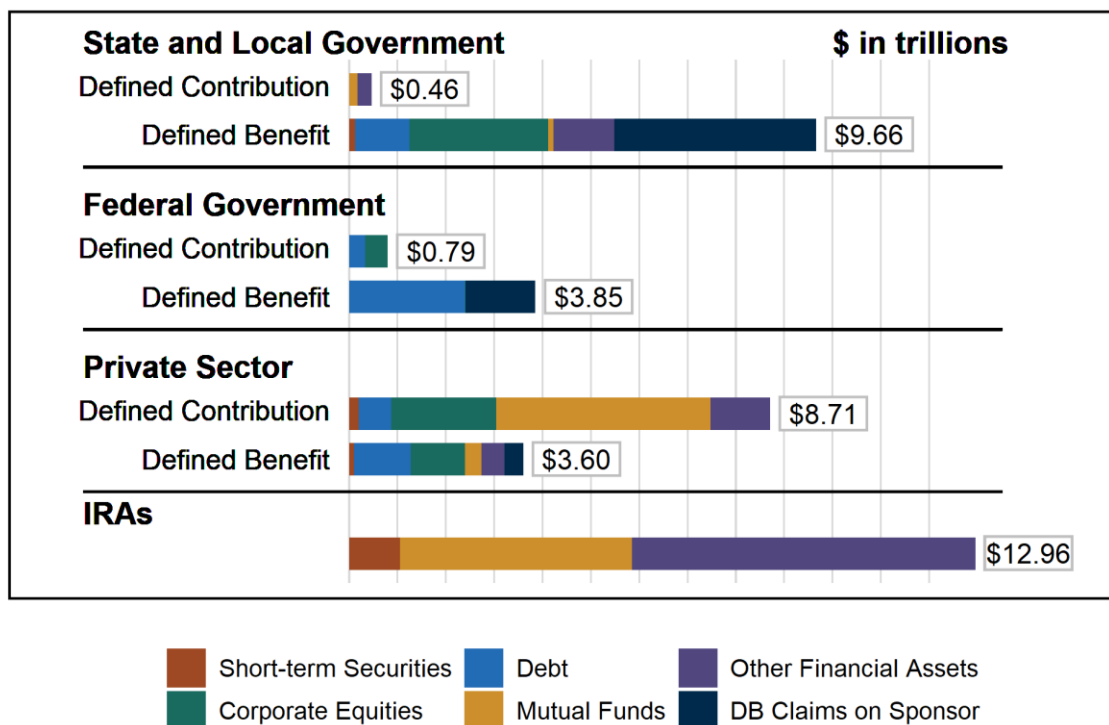
<sup>18</sup> The financial accounts data does not have a separate category for international holdings. International holdings are included in their respective categories. (For example, the sovereign debt of a foreign nation would be under "debt.")

<sup>19</sup> See CRS Report R47699, *U.S. Retirement Assets: Data in Brief*.

<sup>20</sup> In Q3 2023, household net worth totaled \$142.4 trillion. See Board of Governors of the Federal Reserve System (US), "Households; Net Worth, Level [BOGZ1FL192090005Q]," retrieved from Federal Reserve Bank of St. Louis, <https://fred.stlouisfed.org/series/BOGZ1FL192090005Q>, January 7, 2024.

**Figure I. Total Holdings and Components of Financial Assets in U.S. Pension Plans and Individual Retirement Accounts (IRAs)**

In Trillions of Dollars, as of June 30, 2023



**Source:** Figure constructed by CRS from Board of Governors of the Federal Reserve System, *Financial Accounts of the United States*, <https://www.federalreserve.gov/apps/fof/FOFTables.aspx>. See tables L.118.b, L.118.c, L.119.b, L.119.c, L.120.b, L.120.c, and L.229.

**Notes:** IRAs include employer-sponsored IRAs and state-administered IRA programs. Mutual funds invest in a variety of assets, including corporate equities and debt. As a result, the total amount of corporate equities and debt held by pension plans likely exceeds the values presented in the Corporate Equities and Debt categories in the figure. DB claims on sponsors are funds owed but unpaid by plan sponsors to the plans. Unpaid funds are treated as financial assets. Short-term securities include checkable deposits, savings deposits, money market funds, and security repurchase agreements. Debt is composed of securities such as commercial paper, U.S. Treasury securities, U.S. government agency and government-sponsored-enterprise-backed securities, foreign bonds, and corporate bonds. Corporate equities include publicly traded shares and private equity. Mutual funds pool money from investors and invest the money in securities such as stocks, bonds, and debt. DB claims on sponsors are funds owed but unpaid by plan sponsors to the plan. Unpaid funds are treated as financial assets. Other financial assets include, but are not exclusively composed of, insurance contracts and contributions receivable.

## State and Local Government Pension Plans

Most state and local employees (such as police officers, firefighters, teachers, and other state and local government employees) are covered by pension plans and, among those with plans, they are more likely to be covered by DB plans than by DC plans. In March 2023, 91% of all state and local government workers had access to pension plans, with 86% having access to DB plans and 39% having access to DC plans. In the same month, 81% of state and local government workers



participated in pension plans (75% DB, 18% DC; some workers participated in both types of plans).<sup>21</sup>

## Authority and Administration

State and local pension plans are not covered by the Employee Retirement Income Security Act of 1974 (ERISA; P.L. 93-406), which covers most private sector pension plans and is included in the *U.S. Code* in both Title 26 (the Internal Revenue Code, or IRC) and in Title 29 (often called the Labor Code). Relatedly, state and local pension plans are not covered by the Pension Benefit Guaranty Corporation (PBGC), which is a government corporation established by ERISA that insures private sector DB plans.<sup>22</sup> Finally, state and local pension plans are exempt from many, but not all, IRC requirements (such as minimum funding requirements). Instead, these plans are governed by state laws, contract law, and/or state constitutions.

Many (if not nearly all) state and local government plans follow the accounting and financial standards set by the Governmental Accounting Standards Board (GASB).<sup>23</sup> GASB publishes accounting and financial reporting standards for state and local governmental pension plans using U.S. Generally Accepted Accounting Principles. These standards govern how public pensions calculate and report their assets and liabilities and are intended to promote transparency, consistency, and comparability across state and local pension plans.

In FY2020, 14.7 million active (working) members and 11.5 million total beneficiaries were covered by 5,340 DB plans administered by state and local government entities, including municipalities, townships, counties, school districts, and special districts.<sup>24</sup> The Center for Retirement Research indicated that the 219 largest state and local DB plans (121 state, 108 local) in its Public Plans Data accounted for 95% of state and local DB pension assets and members in the United States.<sup>25</sup>

Most public sector employees are covered by DB plans, but DC plans are becoming more common.<sup>26</sup> Some states have shifted to a hybrid system that combines DB and DC plans. Others, such as Alaska, have closed their DB plans and instead offer a DC plan to new hires.<sup>27</sup> Depending on the employer, state and local DC plan types include 401(a), 401(k), 403(b), and 457(b) plans. Employee participation and contributions may be mandatory or optional, depending on the structure of the plan as determined by the employer. A **401(a)** plan may be available to state and local government workers as part of a DB-DC combination plan or a hybrid cash balance plan. A **403(b)** plan may be offered to employees of public schools, churches, and certain charitable tax-

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<sup>21</sup> Bureau of Labor Statistics, “National Compensation Survey: Employee Benefits in the United States,” March 2023, September 2023, <https://www.bls.gov/ebs/publications/employee-benefits-in-the-united-states-march-2023.htm>.

<sup>22</sup> For background on the PBGC, see CRS Report 95-118, *Pension Benefit Guaranty Corporation (PBGC): A Primer*.

<sup>23</sup> See Governmental Accounting Standards Board, “About the GASB,” <https://gasb.org/about-us/about-the-gasb>.

<sup>24</sup> U.S. Census Bureau, *2020 Annual Survey of Public Pensions: State and Local Tables*, <https://www.census.gov/data/tables/2020/econ/aspp/aspp-historical-tables.html>. Fiscal year dates vary by state. Between 25% and 30% of state and local DB plan members and beneficiaries are not covered by Social Security. See National Conference on Public Employee Retirement Systems and Cobalt Community Research, *2019 NCPERS Public Retirement Systems Study*, January 21, 2020, <https://www.ncpers.org/files/2019%20NCPERS%20Public%20Retirement%20Systems%20Study%20Report%20Final.pdf>.

<sup>25</sup> Center for Retirement Research at Boston College, “Public Plans Data,” <https://publicplansdata.org/public-plans-database>. Data retrieved from website on February 16, 2024.

<sup>26</sup> See CRS Report R43439, *Worker Participation in Employer-Sponsored Pensions: Data in Brief*.

<sup>27</sup> See American Society of Pension Professionals and Actuaries, “Snapshot: The Effect of the DB to DC Shift in Alaska,” June 5, 2023, <https://www.asppa-net.org/news/snapshot-effect-db-dc-shift-alaska>.

exempt entities. A **457(b)** plan is a voluntary, supplementary DC savings vehicle, often offered to state and local government employees in conjunction with a traditional DB pension.

## State and Local Pension Plan Investment Issues

Investment issues for state and local pensions include those related to:

- ESG investing,
- geopolitical concerns,
- alternative investments, and
- diverse asset managers.

Most state and local pension investment issues have been focused on DB plans.<sup>28</sup> In comparison with private sector pensions, which use company resources to make up for DB plan underfunding, state and local pension plans could have different investment risk tolerances because plan underfunding is generally made up through increased taxation or reductions in other public spending.<sup>29</sup>

Congress has expressed interest in issues affecting state and local pension plan investments—particularly those related to ESG investing. However, because state and local plans are not subject to the part of federal pensions law governing plan investments, Congress may have fewer options to influence state and local pension plan investments.<sup>30</sup>

## ESG Investment Issues

There is no universally agreed-upon definition of what constitutes ESG.<sup>31</sup> In addition, inconsistent disclosure standards make it harder for investors to measure a firm’s performance on ESG issues. In general, the *E* means that investors and stakeholders may examine a firm’s impact on the environment, the *S* refers to the consideration of a firm’s effects on its various stakeholders, such as consumers, employees, suppliers, contractors, and the local and broader communities; and *G* refers to the consideration of policies, processes, and controls implemented by a firm.<sup>32</sup>

State and local pension plans are taking different approaches to ESG issues. Some plans specifically incorporate ESG factors into their investment choices; others limit the consideration of ESG factors in the investment process, such as by requiring plan fiduciaries to choose

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<sup>28</sup> This might be because DC plan assets comprise a small portion of state and local pension assets (less than \$500 billion compared to \$9.5 trillion for DB).

<sup>29</sup> For a discussion of the different incentives of participants and stakeholders in the public pension plan system, see American Academy of Actuaries, *Risk Management and Public Plan Retirement Systems*, [https://www.actuary.org/sites/default/files/files/PPPTF\\_Final\\_Report\\_c\\_0.pdf](https://www.actuary.org/sites/default/files/files/PPPTF_Final_Report_c_0.pdf).

<sup>30</sup> One example of federal legislation that would have affected public sector pensions is the Public Employee Pension Transparency Act, first introduced by Representative Devin Nunes in the 111<sup>th</sup> Congress (see H.R. 6484) and later introduced in subsequent Congresses. This bill would have required state and local pension plans to file annual reports with the Department of the Treasury disclosing pension liabilities based on a specified (typically lower) interest rate. State and local governments not in compliance with the reporting requirements would lose their ability to issue tax-exempt bonds.

<sup>31</sup> For information about ESG, see CRS In Focus IF11716, *Introduction to Financial Services: Environmental, Social, and Governance (ESG) Issues*.

<sup>32</sup> For more details on what ESG investment factors might include, see Securities and Exchange Commission, “Environmental, Social, and Governance (ESG) Funds—Investor Bulletin,” February 26, 2021, <https://www.sec.gov/oiea/investor-alerts-and-bulletins/environmental-social-and-governance-esg-funds-investor-bulletin>.

investments solely based on factors that balance risk and return or to divest from companies or asset managers as state law might dictate. Some examples include New York, which integrates ESG considerations in its investment decisions;<sup>33</sup> Texas, which barred state governmental entities (which include public pension funds) from contracting with companies that boycott fossil fuel companies;<sup>34</sup> and Kansas, which passed a law that prevents the use of ESG considerations in state contracts and investments.<sup>35</sup>

*Pensions and Investments 1000 Summary Report* includes data on DB plans among the top 200 funds that use ESG factors. Public sector plans included in this list include those based in Alabama, California, Illinois, Iowa, Maryland, New Jersey, New York, Ohio, Washington, and Wisconsin.<sup>36</sup>

Advocates of ESG investing note that portfolios that consider ESG factors may lead to greater portfolio diversification and improved corporate performance and can align with investors' goals.<sup>37</sup> Opponents of ESG investment point out the higher costs associated with ESG investing, lower returns, and misalignment with the goal of maximizing investment returns instead of pursuing social policy.<sup>38</sup>

## Geopolitical Considerations

Related to ESG issues are geopolitical issues, on which some plans base investment decisions.<sup>39</sup> In recent years, two general trends in state and local pension investment policies have been to (1) divest from certain countries (e.g., Russia, Belarus, China) and entities based in those countries and (2) bar investments in companies that support the Boycott, Divestment and Sanctions (BDS)

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<sup>33</sup> See New York Common Retirement Fund, *Environmental, Social and Governance (ESG) Strategy*, <https://www.osc.ny.gov/files/common-retirement-fund/2020/pdf/ESG-strategy-report-2020.pdf>. In addition, California's CalPERS plan, which has nearly 2.2 million participants, operates a Sustainable Investments Program, which assists the investment office by integrating ESG risks and opportunity consideration into investment decisionmaking and engages with companies and managers to manage ESG risks. See CalPERS, *2021-22 Annual Comprehensive Financial Report*, <https://www.calpers.ca.gov/docs/forms-publications/acfr-2022.pdf>, and CalPERS, "Sustainable Investments Program," <https://www.calpers.ca.gov/page/investments/sustainable-investments-program>.

<sup>34</sup> See Texas Comptroller of Public Accounts, "Texas Comptroller Glenn Hegar Announces List of Financial Companies That Boycott Energy Companies," August 24, 2022, <https://comptroller.texas.gov/about/media-center/news/20220824-texas-comptroller-glenn-hegar-announces-list-of-financial-companies-that-boycott-energy-companies-1661267815099>; and Oklahoma State Treasurer, "Financial Institutions Remain on Oklahoma Treasurer's List of Restricted Companies," August 15, 2023, <https://oklahoma.gov/treasurer/news-releases/financial-institutions-remain-on-oklahoma-treasurers-list-of-restricted-companies.html>.

<sup>35</sup> See Kansas legislature, HB 2100, [https://www.kslegislature.org/li/b2023\\_24/measures/hb2100/](https://www.kslegislature.org/li/b2023_24/measures/hb2100/).

<sup>36</sup> See Pensions and Investments, *The P&I 1000 Summary Report*, <https://www.pionline.com/pi1000>.

<sup>37</sup> See, for example, Tensie Whelan et al., "ESG and Financial Performance: Uncovering the Relationship by Aggregating Evidence from 1,000 Plus Studies Published Between 2015-2020," New York University Stern Center for Sustainable Business, August 2021, <https://www.stern.nyu.edu/sites/default/files/assets/documents/ESG%20Paper%20Aug%202021.pdf>.

<sup>38</sup> See, for example, testimony of the Hon. Jason Isaac, in *Ensuring That "Woke" Doesn't Leave Americans Broke*, <https://gop-waysandmeans.house.gov/wp-content/uploads/2023/11/Isaac-Testimony.pdf>, and testimony of the Hon. Marlo M. Oaks, in *Ensuring That "Woke" Doesn't Leave Americans Broke*, <https://gop-waysandmeans.house.gov/wp-content/uploads/2023/11/Oaks-Testimony.pdf>.

<sup>39</sup> There is no universally agreed-upon definition of what constitutes ESG. Investors and other stakeholders consider a wide-ranging array of topics as part of ESG. Some might categorize geopolitical concerns as an ESG issue; this report discusses them separately.

movement.<sup>40</sup> In the past, there have been efforts to divest from Sudan, Northern Ireland, and Iran.<sup>41</sup>

For example, Indiana, New Jersey, and New York have introduced legislation and/or undertaken executive actions to divest from Russia.<sup>42</sup> In 2023, Indiana's public pension system divested from investments controlled by the People's Republic of China or the Chinese Community Party.<sup>43</sup> In 2015, Illinois was the first state to divest its public pensions from companies that participate in the BDS movement.<sup>44</sup> In some cases, the pension plans are making divestment decisions. In other cases, sanctions in state laws require all public funds, including pension funds, to divest from certain countries or entities in specified countries.

## **Alternative Investments**

In the past 30 years, many state and local DB pension plans have increased the allocation of alternative investments (i.e., financial assets that are not stocks, bonds, or cash, including assets such as private equity, hedge funds, real estate, and commodities) in their investment portfolios. Alternative investments might be perceived as being less regulated and transparent or having higher fees compared to traditional investments. On the other hand, advocates note that alternative investments' low correlation with traditional investments could strengthen diversification of investment portfolios.<sup>45</sup> The CRR indicated that the plans in the Public Plans database had about 9% of their assets invested in alternatives in 2001 and that the percentage increased to 34% in 2022.<sup>46</sup> State and local pension plans typically have a greater percentage of their investments allocated to private equity than do private sector plans.<sup>47</sup> It is unclear why state and local and private sector DB plans differ in the percentages of plan assets allocated to alternatives, but it might be related to plan sponsors' different risk tolerances due to a variety of factors.<sup>48</sup>

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<sup>40</sup> The BDS movement, according to its website, is a global movement made up of unions, academic associations, churches, and grassroots movements that seeks to employ boycotts, divestment, and sanctions against Israel. See BDS, <https://bdsmovement.net/>.

<sup>41</sup> See National Association of State Retirement Administrators, "Divestment," <https://www.nasra.org/files/Topical%20Reports/Governance%20and%20Legislation/Pension%20Reform/divestment.pdf>.

<sup>42</sup> In general, news reports suggest that state plan holdings in Russia account for approximately 1% or less of total pension assets.

<sup>43</sup> See Indiana Senate Bill 268, <https://iga.in.gov/legislative/2023/bills/senate/268/details>.

<sup>44</sup> See Illinois.gov, "Governor Signs Historic Anti-BDS Law in Illinois," press release, July 23, 2015, <https://www.illinois.gov/news/press-release.13202.html>.

<sup>45</sup> See CFA Institute, "Introduction to Alternative Investments," <https://www.cfainstitute.org/en/membership/professional-development/refresher-readings/introduction-alternative-investments>.

<sup>46</sup> See Jean-Pierre Aubry, "Public Pension Investment Update: Have Alternatives Helped or Hurt?," Center for Retirement Research at Boston College, November 22, 2022, <https://crr.bc.edu/public-pension-investment-update-have-alternatives-helped-or-hurt/>.

<sup>47</sup> For example, WTW indicated that at the end of 2021, the 100 largest private sector DB plans that are sponsored by publicly traded corporations had about 9.5% of their investments allocated to alternative investments. See Brendan McFarland, "WTW Pension 100: Year-End 2021 Disclosures of Funding, Discount Rates, Asset Allocations and Contributions," WTW, May 4, 2022, <https://www.wtwco.com/en-us/insights/2022/05/wtw-pension-100-year-end-2021-disclosures-of-funding-discount-rates-asset-allocations>.

<sup>48</sup> Some note that one reason may be that public pension plans "have become optimistic about the so-called alpha of alternatives relative to public equities." See Juliane Begenau, Pauline Liang, and Emil Siriwardane, "The Rise of Alternatives," January 18, 2024, Stanford University Graduate School of Business Research Paper, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=4105813](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4105813).

## Diverse Asset Managers

Some policymakers have expressed interest in growing the diversity of professional asset managers in the public pension investment space, including minority- and women-owned business enterprises. Several states have enacted laws, implemented programs, or established goals to encourage the utilization of diverse asset managers under the notion that diversity among asset managers can enhance financial outcomes and lead to better risk-adjusted returns on plan assets. For example, Maryland's State Retirement and Pension System operates a program that "seeks to identify promising smaller or developing managers."<sup>49</sup> At the local level, the Chicago Teachers' Pension Fund's annual financial report noted that, during the year ending June 30, 2019, "approximately 44% (\$4.8 billion) of the Fund's investment portfolio was managed by qualified minority, women, and disabled-person owned investment managers."<sup>50</sup>

These actions at the state and local level have also been a model for interest in diverse asset managers at the federal pension level, especially as a consideration for TSP (see the discussion in the federal pension section below on "Diverse Asset Managers").<sup>51</sup>

## Federal Pension Plans

Most of the civilian federal workforce is covered by one of two DB retirement plans: the Civil Service Retirement System (CSRS) for employees first hired prior to 1984, or the Federal Employees' Retirement System (FERS) for employees first hired in 1984 or later.<sup>52</sup> Both CSRS and FERS are financed through the Civil Service Retirement and Disability Fund (CSRDF). The CSRDF is similar to the Social Security trust funds in that, by law, 100% of its assets are invested in special-issue U.S. Treasury bonds or other bonds backed by the full faith and credit of the U.S. government.<sup>53</sup> When the trust fund needs cash to pay retirement benefits, it redeems the bonds and the Treasury disburses an equivalent dollar value of payments to CSRS and FERS beneficiaries.<sup>54</sup>

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<sup>49</sup> See Maryland State Retirement and Pension System, *Terra Maria: Developing Manager Program in Public Markets and Private Equity*, updated February 2011, <https://sra.maryland.gov/sites/main/files/file-attachments/terramariadevelopingmanagerprogram-description.pdf>.

<sup>50</sup> See Chicago Teachers' Pension Fund, *124<sup>th</sup> Comprehensive Annual Financial Report, 2019*, p. 12, [https://www.ctpf.org/sites/files/2020-10/2019\\_ctpf\\_cafr\\_final\\_post.pdf](https://www.ctpf.org/sites/files/2020-10/2019_ctpf_cafr_final_post.pdf).

<sup>51</sup> At the federal level, the House Financial Services Committee held a hearing in 2019 about challenges, solutions, and opportunities for inclusion of diverse asset managers. See U.S. Congress, House Committee on Financial Services, *Diverse Asset Managers: Challenges, Solutions and Opportunities for Inclusion*, 117<sup>th</sup> Cong., 1<sup>st</sup> Sess., June 25, 2019, <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=407321>.

<sup>52</sup> Military servicemembers are covered by a separate retirement system, which is not discussed in this report. For details on retirement benefits for military servicemembers, see CRS Report RL34751, *Military Retirement: Background and Recent Developments*. A number of smaller DB and DC plans have been established for certain civilian federal employees within various agencies. There are a few additional plans that provide federal pensions to a non-trivial number of civilian federal employees. For example, the Foreign Service Retirement and Disability System (FSRDS) and the Foreign Service Pension System (FSPS) are DB plans that cover Foreign Service Officers (FSOs) based on their dates of hire in a similar way to CSRS and FERS. The Federal Reserve also operates its own DB and DC plans on behalf of its bank and board employees and certain other employees. For more information all of these federal pension plans, including CSRS and FERS, see CRS Report R47084, *Federal Retirement Plans: Frequently Asked Questions*.

<sup>53</sup> See 5 U.S.C. §8348(c). For information on the investment practices of the Social Security trust funds, see CRS In Focus IF10564, *Social Security Trust Fund Investment Practices*.

<sup>54</sup> For more information on the CSRDF, see CRS Report RL30023, *Federal Employees' Retirement System: Budget and Trust Fund Issues*.

Federal employees enrolled in either CSRS or FERS may also contribute to the TSP, a DC pension plan similar to the 401(k) plans provided by many private sector employers.<sup>55</sup> However, only employees enrolled in FERS are eligible for employer matching contributions under TSP. Newly hired FERS employees are automatically enrolled in TSP and contribute 5% of their pay, though they have the option to decline participation or change the amount of their contributions. TSP participants may contribute from their salaries up to the current contribution limits.<sup>56</sup> An employee covered by FERS receives an automatic 1% agency contribution and an agency match equal to 100% of the worker's first 3% of basic pay and 50% of the next 2% of basic pay.<sup>57</sup>

Because the CSRDF investments are restricted to Treasury securities, the remaining discussion about federal pension plans focuses on TSP investment issues. Below is an explanation of the authority for and administration of TSP investments as well as an explanation of current TSP investment options.

## **TSP Investments: Authority and Administration**

The Thrift Savings Plan (TSP) was created under the Federal Employees' Retirement System Act (FERSA; P.L. 99-335; June 6, 1986). The Federal Retirement Thrift Investment Board (FRTIB) administers TSP.<sup>58</sup> FRTIB is an independent agency that receives no appropriations from Congress. Instead, administrative expenses for FRTIB are paid through TSP loan fees, 1% agency automatic contributions forfeited by certain employees who leave federal service before they have vested, and administrative charges against participant accounts.<sup>59</sup>

FRTIB is composed of five board members chosen by the President and confirmed by the Senate. The Board also selects an Executive Director who manages daily operations.<sup>60</sup> Under current law, members of the FRTIB and the Executive Director serve as fiduciaries, legally obligated to act "solely in the interest of the [TSP] participants and beneficiaries ... and for the exclusive purpose of providing benefits to participants and their beneficiaries."<sup>61</sup>

All TSP investment options are set out under current law.<sup>62</sup> In order to offer these investment options to participants, FRTIB develops specific investment policies—for example, selecting benchmarks for the index fund investment options—that provide for "prudent investments suitable for accumulating funds for payment of retirement income; and low administrative costs."<sup>63</sup> Thus, in addition to its fiduciary responsibilities, FRTIB must adhere to its statutory mandates to keep administrative costs low and prudently manage returns for TSP account holders.

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<sup>55</sup> Military servicemembers and FSOs may also contribute to the TSP.

<sup>56</sup> Contribution limits are available at TSP.gov, "Contribution Limits," <https://www.tsp.gov/making-contributions/contribution-limits/>.

<sup>57</sup> Participants are fully vested in the 1% agency automatic contributions to the TSP after three years (two years for congressional employees and certain senior political appointees). There is no vesting requirement for other contributions (i.e., employee or agency matching contributions). See 5 U.S.C. §8432(g). (*Vesting* refers to ownership, or amounts not being subject to forfeiture.)

<sup>58</sup> For more information on FRTIB, see <https://www.frtib.gov/>.

<sup>59</sup> For more information on TSP administrative expenses, see TSP.gov, "Expenses and Fees," <https://www.tsp.gov/tsp-basics/expenses-and-fees/>.

<sup>60</sup> For information on current FRTIB board members as well as the Executive Director, see <https://www.frtib.gov/board-members/>. The FRTIB currently has one vacancy.

<sup>61</sup> 5 U.S.C. §8477(b)(1)).

<sup>62</sup> 5 U.S.C. §8438.

<sup>63</sup> 5 U.S.C. §8475.

At its creation in 1986, the TSP was designed to be passively managed in order to avoid political manipulation—in particular, using the large pool of assets managed by FRTIB for political purposes.<sup>64</sup> Thus, TSP index funds are all passively managed by professional fund managers, each with an investment objective of matching the performance of a specific, benchmark index fund. TSP fund managers do not actively select a fund’s portfolio assets. Currently, BlackRock and State Street Global Advisors both hold fund manager contracts for all TSP index funds.<sup>65</sup>

Three investment options—the “C” Fund (a common stock index fund), the “F” Fund (a fixed income index fund), and the “G” Fund (a government security fund)—were authorized at TSP’s creation under FERSA. Two additional index funds, the “S” Fund (a small cap stock index fund) and the “I” Fund (an international stock index fund), were added in 2001 in accordance with the Thrift Savings Plan Act of 1996 (P.L. 104-208; September 30, 1996).

In 2005, FRTIB introduced “Lifecycle Funds” (L Funds), which are invested in various combinations of the five core TSP funds with allocations based on the year that the participant expects to begin withdrawing money from the TSP. The Smart Savings Act (P.L. 113-255; December 18, 2014) changed the default investment option to the age-appropriate Lifecycle Fund for automatic contributions to TSP. Prior to P.L. 113-255, TSP default contributions were automatically invested in the “G” Fund of the TSP. (The default contribution rate for most employees is 5% if enrolled in TSP after October 1, 2020, or 3% if enrolled between August 1, 2010, and September 30, 2020.)

Title I of Division B of P.L. 111-31, the Thrift Savings Plan Enhancement Act (June 22, 2009), provided FRTIB with the authority to set up a mutual fund window (MFW) “if the Board determines that such addition would be in the best interests of participants.”<sup>66</sup> The TSP mutual fund window opened to eligible participants in June 2022.<sup>67</sup> (Additional details on this TSP investment option are provided below in the “Current TSP Investment Options” and “Mutual Fund Window” sections.)

## **Current TSP Investment Options**

Participants in the TSP may currently choose among five core funds in which they can invest their TSP contributions:

- The “C” Fund replicates the Standard and Poor’s 500 Index of 500 large to medium-sized U.S. companies.<sup>68</sup>
- The “F” Fund invests in bonds in the same proportion as they are represented by the Barclays Capital U.S. Aggregate Bond Index.<sup>69</sup>

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<sup>64</sup> House Conference Report 99-906 (May 16, 1986).

<sup>65</sup> For the announcement of the most recent BlackRock fund manager contract, see FRTIB, “Federal Retirement Thrift Investment Board Awards the First of Two Fund Manager Contracts,” press release, February 24, 2020, [https://www.frtib.gov/pdf/reading-room/PressRel/PR\\_2020-02-26\\_Fund\\_Manager\\_Contract.pdf](https://www.frtib.gov/pdf/reading-room/PressRel/PR_2020-02-26_Fund_Manager_Contract.pdf). For the announcement of the State Street Global Advisors fund manager contract, see FRTIB, “Federal Retirement Thrift Investment Board Awards the Second of Two Fund Manager Contracts,” press release, October 22, 2020, [https://www.frtib.gov/pdf/reading-room/PressRel/PR\\_2020-10-27\\_Multi\\_Manager\\_Selection.pdf](https://www.frtib.gov/pdf/reading-room/PressRel/PR_2020-10-27_Multi_Manager_Selection.pdf).

<sup>66</sup> 5 U.S.C. §8438(b)(5)(A)).

<sup>67</sup> See TSP.gov, “Mutual Fund Window,” at <https://www.tsp.gov/mutual-fund-window/>.

<sup>68</sup> For additional details, see TSP.gov, “C Fund,” <https://www.tsp.gov/funds-individual/c-fund/>.

<sup>69</sup> For additional details, see TSP.gov, “F Fund,” <https://www.tsp.gov/funds-individual/f-fund/>.

- The “G” Fund invests in U.S. government securities and pays interest equal to the average rate of return on government securities with maturities of four years or more.<sup>70</sup>
- The “S” Fund tracks the Dow Jones U.S. Completion Total Stock Market Index of small to medium-sized U.S. companies not included in the “C” Fund.<sup>71</sup>
- The “I” Fund currently replicates the Morgan Stanley Capital International (MSCI) EAFE (Europe, Australasia, Far East) Index.<sup>72</sup>
  - On November 14, 2023, FRTIB announced that it had voted to change the I Fund benchmark to replicate the MSCI All Country World ex USA ex China ex Hong Kong Investable Market Index.<sup>73</sup> (Implementation of this change is scheduled for 2024 but has not occurred as of the date of this report.<sup>74</sup>)

Additionally, the L Funds are composed of the five core TSP funds and consist of L2025 through L2065 in five-year increments and the L Income Fund, which is a low-risk option designed to achieve asset preservation for participants making withdrawals or nearing retirement.<sup>75</sup> As the participant approaches retirement, the proportion of contributions invested in the C, I, and S funds—which invest in stocks—is reduced. The proportion invested in the G and F funds—which invest in bonds—is increased. This helps to protect participants who are nearing retirement from investment losses that would occur from a sharp decline in stock prices.

Finally, eligible TSP participants may invest in the mutual fund window (MFW). According to the final rule implementing the TSP MFW:

A mutual fund window is a type of brokerage window. A brokerage window is a retirement plan feature that allows participants to open a brokerage account to put some of their retirement savings in investments that are not curated by their retirement plan’s fiduciaries.<sup>76</sup>

FRTIB set out the following terms and conditions for MFW participation:<sup>77</sup> (1) a minimum initial transfer of \$10,000 into the MFW; (2) a limit of no more than 25% of a TSP account holder’s balance into the MFW (thus, a minimum balance of \$40,000 is required); and (3) inclusion of transfers to and from the MFW in the overall limit on interfund transfers (two per month). FRTIB also specified fees for TSP participants who choose to invest in the MFW: an annual \$55 administrative fee, an annual \$95 maintenance fee, a per-trade fee of \$28.75, and any fees and expenses imposed by the specific mutual fund(s). According to the FRTIB, “The MFW offers roughly 5,000 mutual funds in roughly 300 mutual fund families, including those offered by

<sup>70</sup> For additional details, see TSP.gov, “G Fund,” <https://www.tsp.gov/funds-individual/g-fund/>.

<sup>71</sup> For additional details, see TSP.gov, “S Fund,” <https://www.tsp.gov/funds-individual/s-fund/>.

<sup>72</sup> For additional details, see TSP.gov, “I Fund,” <https://www.tsp.gov/funds-individual/i-fund/>.

<sup>73</sup> FRTIB, “Federal Retirement Thrift Investment Board Approves a New Benchmark Index for the I Fund,” press release, November 14, 2023, [https://www.frtib.gov/pdf/reading-room/PressRel/PR\\_2023-11-14\\_I-Fund-Benchmark-Change.pdf](https://www.frtib.gov/pdf/reading-room/PressRel/PR_2023-11-14_I-Fund-Benchmark-Change.pdf). *Ex* means “excluding.”

<sup>74</sup> FRTIB has stated that it plans to announce when the I Fund benchmark transition is complete no later than December 31, 2024. See FRTIB, “I Fund Benchmark Change in 2024,” February 5, 2024, <https://www.tsp.gov/plan-news/2024-02-05-I-Fund-benchmark-index-change-in-2024/>.

<sup>75</sup> For additional details, see TSP.gov, “Lifecycle Funds,” <https://www.tsp.gov/funds-lifecycle/>.

<sup>76</sup> FRTIB, “Mutual Fund Window,” 87 *Federal Register* 27917, May 10, 2022, <https://www.govinfo.gov/content/pkg/FR-2022-05-10/pdf/2022-09972.pdf>.

<sup>77</sup> FRTIB, “Mutual Fund Window,” 87 *Federal Register* 27917-27923, May 10, 2022, <https://www.govinfo.gov/content/pkg/FR-2022-05-10/pdf/2022-09972.pdf>.



Fidelity, T. Rowe Price, and Vanguard. For funds with multiple classes, the lowest expense ratio class is offered.”<sup>78</sup>

## **TSP Investment Issues**

Several TSP investment-related policy issues have been legislatively active in recent Congresses. Below is a discussion of key TSP investment issues, including:

- the TSP “I” Fund benchmark and investments in Chinese companies,
- ESG investment issues,
- the TSP mutual fund window (MFW),
- diverse asset managers, and
- the exercise of shareholder rights and proxy voting on behalf of TSP assets.

Examples of relevant legislation from the 118<sup>th</sup> Congress are also provided.

### **“I” (International) Fund Benchmark and Investments in Chinese Companies**

TSP I Fund investment practices have drawn attention from policymakers over recent years. Specifically, there has been FRTIB deliberation surrounding changes to the I Fund benchmark, including concerns from policymakers about potential investments in Chinese companies. In November 2017, after consulting with experts,<sup>79</sup> FRTIB made the decision to move from the current I Fund benchmark—the Morgan Stanley Capital International (MSCI) EAFE (Europe, Australasia, Far East) Index—to a new benchmark: the MSCI ACWI ex U.S. IMI (All Country World ex USA Investable Market Index).<sup>80</sup> FRTIB justified this decision using the following arguments: (1) the MSCI ACWI ex. U.S. IMI represents 99% of the international equity market (vs. the MSCI EAFE Index, which represents only 58%) and, thus, is a more representative benchmark that better fulfills the statutory requirement of a complete representation of the international equity markets; and (2) the MSCI ACWI ex. U.S. IMI would be more in line with the investment policies of other large retirement plans in the private and public sectors, which offer the ability to invest in Canada and emerging markets.

Before the change to the I Fund benchmark could be implemented, however, this FRTIB decision received attention from policymakers. This interest focused on issues raised by investments in certain Chinese companies. For example, in August 2019, Senators Rubio and Shaheen sent a letter to FRTIB outlining concerns with the proposed I Fund benchmark change as:

a decision to invest in China-based companies, including many firms that are involved in the Chinese government’s military, espionage, human rights abuses and ‘Made in China 2025’ industrial policy, and therefore poses fundamental questions about the board’s statutory and fiduciary responsibilities to American public servants who invest in federal retirement plans.<sup>81</sup>

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<sup>78</sup> FRTIB, “Facts About the TSP’s Mutual Fund Window,” press release, June 2022, [https://www.frtib.gov/pdf/reading-room/FactSheets/FS\\_2022-06-01\\_MFW\\_Fact\\_Sheet\\_June\\_2022.pdf](https://www.frtib.gov/pdf/reading-room/FactSheets/FS_2022-06-01_MFW_Fact_Sheet_June_2022.pdf).

<sup>79</sup> See Aon Hewitt, “Benchmark Study: Federal Retirement Thrift Investment Board, Thrift Savings Plan,” November 2017, [https://www.frtib.gov/pdf/reading-room/InvBMarks/2017Oct\\_Benchmark-Evaluation-Report.pdf](https://www.frtib.gov/pdf/reading-room/InvBMarks/2017Oct_Benchmark-Evaluation-Report.pdf).

<sup>80</sup> See TSP.gov, “Investment Benchmark Update,” November 13, 2019, <https://www.tsp.gov/plan-news/2024-02-05-I-Fund-benchmark-index-change-in-2024/>.

<sup>81</sup> Office of Sen. Rubio, “Rubio, Shaheen Urge TSP Board to Reverse Decision to Steer Federal Retirement Savings to China,” press release, August 26, 2019, <https://www.rubio.senate.gov/rubio-shaheen-urge-tsp-board-to-reverse-decision-to-steer-federal-retirement-savings-to-china/>.

In November 2019, FRTIB reviewed its decision and announced that it was moving ahead to finalize the I Fund benchmark change.<sup>82</sup> In May 2020, however, FRTIB announced that it was deferring any action on the I Fund benchmark due to (1) the “meaningfully different economic environment related in large part to the impact of the global COVID-19 pandemic” and (2) the nominations of new FRTIB members.<sup>83</sup> The current I Fund benchmark, the MSCI EAFE Index, does include investments in Hong Kong, which FRTIB claims has been less than 4% of the I Fund since its creation in 2001.<sup>84</sup> But the current I Fund benchmark (the MSCI EAFE Index) does not, nor has it ever, included investments in mainland China.<sup>85</sup> Among the dynamic offering of more than 5,000 mutual funds available through the TSP MFW, however, there is likely exposure to investments in Chinese companies (for additional details on this issue, see “Mutual Fund Window,” below).

Most recently, in November 2023, FRTIB announced that it had voted to change the I Fund benchmark to replicate the MSCI All Country World ex USA ex China ex Hong Kong Investable Market Index (MSCI ACWI IMI ex USA ex China ex Hong Kong Index).<sup>86</sup> According to FRTIB, this new index represents 90% of non-U.S. market capitalization and is expected to outperform the current I Fund benchmark on a “risk-adjusted basis over the long term.”<sup>87</sup> Thus, the MSCI ACWI IMI ex USA ex China ex Hong Kong Index will provide a more representative benchmark that better fulfills the statutory requirement for the I Fund of a complete representation of the international equity markets. At the same time, this new benchmark will exclude China and Hong Kong, thus addressing concerns related to Chinese investments. Implementation for the new I Fund benchmark is scheduled for 2024. (As of the publication of this report, it has not yet occurred.<sup>88</sup>)

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<sup>82</sup> See TSP.gov, “Investment Benchmark Update.”

<sup>83</sup> FRTIB, “Federal Retirement Thrift Investment Board Defers Action on I Fund Transition,” press release, May 13, 2020, [https://www.frtib.gov/pdf/reading-room/PressRel/PR\\_2020-05-13\\_Defer\\_I\\_Fund\\_Implementation.pdf](https://www.frtib.gov/pdf/reading-room/PressRel/PR_2020-05-13_Defer_I_Fund_Implementation.pdf).

On June 9, 2022, the Senate confirmed four nominees to the FRTIB, including three new Board Members (Leona Bridges, Michael Gerber, and Stacie Olivares) and one Board Member who received another term (Dana Bilyeu). See FRTIB, “Federal Retirement Thrift Investment Board Announces the Confirmation of Dana Bilyeu, Leona Bridges, Michael Gerber and Stacie Olivares as New Members of the Board,” press release, June 28, 2022, [https://www.frtib.gov/pdf/reading-room/PressRel/PR\\_2022-06-28\\_Board\\_Members\\_Bilyeu\\_Bridges\\_Gerber\\_Olivares.pdf](https://www.frtib.gov/pdf/reading-room/PressRel/PR_2022-06-28_Board_Members_Bilyeu_Bridges_Gerber_Olivares.pdf).

On September 1, 2022, David Jones announced his resignation from the FRTIB, effective September 15, 2023. See FRTIB, “Federal Retirement Thrift Investment Board Announces Resignation of Board Member David A. Jones,” press release, September 1, 2022, [https://www.frtib.gov/pdf/reading-room/PressRel/PR\\_2022-08-01\\_DAJ\\_Resignation.pdf](https://www.frtib.gov/pdf/reading-room/PressRel/PR_2022-08-01_DAJ_Resignation.pdf).

For more information on current Board Members, see <https://www.frtib.gov/board-members/>.

<sup>84</sup> FRTIB, “TSP Fact Sheet—Investment in China,” press release, August 2023, [https://www.frtib.gov/pdf/reading-room/FactSheets/FS\\_2023-08-04\\_TSP\\_Investment\\_in\\_China.pdf](https://www.frtib.gov/pdf/reading-room/FactSheets/FS_2023-08-04_TSP_Investment_in_China.pdf).

<sup>85</sup> FRTIB, “TSP Fact Sheet—Investment in China.”

<sup>86</sup> FRTIB, “Federal Retirement Thrift Investment Board Approves a New Benchmark Index for the I Fund,” press release, November 14, 2023, [https://www.frtib.gov/pdf/reading-room/PressRel/PR\\_2023-11-14\\_I-Fund-Benchmark-Change.pdf](https://www.frtib.gov/pdf/reading-room/PressRel/PR_2023-11-14_I-Fund-Benchmark-Change.pdf).

<sup>87</sup> FRTIB, “Federal Retirement Thrift Investment Board Approves a New Benchmark Index for the I Fund,” p. 1.

<sup>88</sup> For more information, see FRTIB, “I Fund Benchmark Change in 2024.”

### ***Examples of Legislation in the 118<sup>th</sup> Congress***<sup>89</sup>

Several pieces of legislation have been introduced in the 118<sup>th</sup> Congress that would have the effect of prohibiting any TSP investment in Chinese firms. For example, S. 1650, the TSP Act of 2023 (introduced by Senator Rubio), and H.R. 3455, the TSP Act (introduced by Representative Waltz), would both amend TSP law to prohibit any investments in “countries of concern,” defined as a country identified as a threat to the national security of the United States in the most recent Annual Threat Assessment report submitted to Congress by the Director of National Intelligence.<sup>90</sup> In addition, S. 149, the TSP Fiduciary Security Act of 2023 (introduced by Senator Rubio), would amend FRTIB fiduciary duties under current law to include national security concerns and would prohibit TSP investments in entities on certain lists maintained by the Department of Defense and the Department of Commerce (e.g., Chinese military companies).

This type of legislation would have prevented the I Fund benchmark change to the MSCI ACWI ex USA (i.e., due to its exposure to Chinese investments). However, it is not clear that it would prevent the proposed I Fund benchmark change to the MSCI ACWI IMI ex USA ex China ex Hong Kong, as it does not have exposure to Chinese companies. These bills would, however, likely require FRTIB to make changes to the TSP mutual fund window, which does currently have exposure to Chinese companies. (For additional discussion on this issue, see the section on “Mutual Fund Window.”)

### **ESG Investment Issues**

Policymakers have also been interested in ESG issues with regard to TSP investments.<sup>91</sup> For example, in a May 2021 report, the Government Accountability Office (GAO) recommended that FRTIB evaluate TSP investment risks with regard to climate change:

Investment risks associated with climate change are expected to impact the global economy and cause unprecedented disruption to the financial markets, and investors, including retirement plans, are considering how their portfolios may be exposed to these risks. Passive investment strategies, like those used by TSP, are generally seen as providing the important benefits of broad diversification and low costs, leading to greater risk-adjusted returns when compared to active investment strategies. However, even passive investment strategies are exposed to financial risks from climate change as the impacts are expected to be widespread across all economic sectors. Climate and financial experts urge passive investors and others to consider the unique and systemic risks posed by climate change.<sup>92</sup>

In its comments responding to this GAO report, FRTIB did not agree or disagree with GAO’s recommendation—although it did provide a response that challenged some of GAO’s conclusions and asserted that its current investment strategy already prices in risk:

The draft report states that the FRTIB “does not currently have any knowledge” of the risks of climate change. We disagree with that characterization. As we discussed several times with the GAO representatives and as is mentioned in the report, the FRTIB subscribes to a strict indexing discipline using the broadest possible market opportunity set. As such,

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<sup>89</sup> Examples of TSP-related legislation here and below are provided for illustrative purposes and should not be considered exhaustive.

<sup>90</sup> The legislative text in these bills was also offered as S.Amdt. 523 to S. 2226, the National Defense Authorization Act for Fiscal Year 2024, but this amendment was not agreed to in the Senate.

<sup>91</sup> For background on ESG, see CRS In Focus IF11716, *Introduction to Financial Services: Environmental, Social, and Governance (ESG) Issues*.

<sup>92</sup> GAO, *Retirement Savings: Federal Workers’ Portfolios Should Be Evaluated for Possible Financial Risks Related to Climate Change*, GAO-21-327, May 25, 2021, p. 39, <https://www.gao.gov/assets/gao-21-327.pdf>.

individual companies are held in the TSP index funds at their market weights, in line with the theory that markets are generally efficient and that the market portfolio is the most efficient from a risk and return perspective. The theory has proven to hold true over decades of empirical studies. Indeed, we build our 10 Lifecycle Funds using that analysis. The efficient market theory concludes that the market is pricing all risks into its valuation in an on-going basis. It also posits that a broad index fund with all assets held at market weight provides the highest return to risk ratio.<sup>93</sup>

Prior to the opening of the TSP MFW in June 2022, there were no ESG investment options available to TSP participants, as the core funds are all passively managed with the investment objective of matching the performance of a specific, benchmark index fund selected by the FRTIB. In authorizing the MFW in 2009, Congress acknowledged that some TSP participants may wish to access “socially responsible funds” as part of their investment options.<sup>94</sup> In TSP annual reports from 2020 and 2021, FRTIB acknowledged that offering ESG investment would be part of the MFW: “Of the more than 5,000 mutual funds available through the MFW, there will be funds that are designed for ESG investment (however a participant may define that), as well as commodity specific funds, actively managed funds, and emerging manager funds.”<sup>95</sup> Thus, with the current availability of the MFW, eligible TSP participants have access to ESG investment options (for additional information on the TSP MFW, see “Mutual Fund Window,” below).

### *Examples of Legislation in the 118<sup>th</sup> Congress*

There has been legislation introduced in the 118<sup>th</sup> Congress that would both expand and prohibit ESG investing through TSP. For example, Representative Schiff introduced H.R. 1261, the Federal Employees Sustainable Investment Act, which would create a new TSP index fund, the Corporate Responsibility Stock Index Fund. This new index fund would be invested in a stock portfolio designed to replicate the performance of a commonly-recognized, passively-managed index comprised of stocks that meet certain minimum criteria related to corporate responsibility. In terms of anti-ESG legislation, Representative Roy introduced H.R. 3612, the No ESG in TSP Act, which would prohibit any ESG mutual funds from being offered as part of the TSP MFW. Senator Lee introduced S. 2147, the Senate companion bill. Additionally, a policy rider (Section 754) in H.R. 4664, the Financial Services and General Government Appropriations Act, 2024, would prevent any funding to be used “to make investments under the Thrift Savings Plan in certain mutual funds that make investment decisions based primarily on environmental, social, or governance criteria.”

### **Mutual Fund Window**

In a 2008 TSP participant survey, 39% of participants—and 46% of TSP participants who were military servicemembers—reported that the addition of a self-directed mutual fund window would improve TSP.<sup>96</sup> In 2009, P.L. 111-31 provided the FRTIB with an authority to set up an MFW “if the Board determines that such addition would be in the best interests of participants.”<sup>97</sup>

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<sup>93</sup> GAO, *Retirement Savings*, p. 50.

<sup>94</sup> See H.Rept. 111-58 Part 2, P.L. 111-31, Division B, Thrift Savings Plan Enhancement Act of 2009, p. 5.

<sup>95</sup> FRTIB, “TSP Annual Report 2020,” p. 2, [https://www.frtib.gov/pdf/reading-room/congress/annual/TSP-Annual-Report\\_2020.pdf](https://www.frtib.gov/pdf/reading-room/congress/annual/TSP-Annual-Report_2020.pdf); and FRTIB, “TSP Annual Report 2021, p. 2, [https://www.frtib.gov/pdf/reading-room/congress/annual/TSP-Annual-Report\\_2021.pdf](https://www.frtib.gov/pdf/reading-room/congress/annual/TSP-Annual-Report_2021.pdf).

<sup>96</sup> FRTIB, “2008 TSP Participant Survey Results,” pp. 57-58, <https://www.frtib.gov/pdf/reading-room/SurveysPart/satisfaction/TSP-Survey-Results-2008.pdf>.

<sup>97</sup> 5 U.S.C. §8438(b)(5)(A)).

In providing this authority, the House Committee on Oversight and Government Reform noted that:

The Committee recognizes some investors today have sophisticated or specialized investment needs. Participants may want added diversity by investing in funds comprised of real estate investment trusts, emerging markets, or inflation-protected bonds. Other participants may want to align their portfolio with their personal convictions by investing in socially responsible funds. The self-directed investment options are intended to provide a vehicle for meeting these needs of plan participants without complicating the basic structure of the Thrift Savings Plan.<sup>98</sup>

From 2009 until its decision to offer an MFW in April 2015, FRTIB deliberation about this issue included consultations with relevant subject matter experts and the Employee Thrift Advisory Council (ETAC).<sup>99</sup> In November 2020, FRTIB announced that the recordkeeping contract to implement the MFW, along with other TSP service delivery features, was awarded to Accenture Federal Services.<sup>100</sup> FRTIB published the final regulations for the MFW on May 10, 2022.<sup>101</sup> The TSP MFW opened to eligible participants in June 2022.<sup>102</sup>

With regard to the mutuals funds offered through the TSP MFW, FRTIB has explained that:

All the mutual funds on the platform comply with all applicable U.S. laws and regulations, including those promulgated by the Securities and Exchange Commission (SEC) and the Office of Foreign Assets Control (OFAC). The mutual funds on the TSP MFW platform will follow the same rules applicable to any other mutual fund offered in any other public or private retirement plan in the United States.<sup>103</sup>

Additionally, FRTIB is not providing fiduciary oversight over the MFW, which it noted mirrors the practice of private sector retirement plans<sup>104</sup> and could “place unreasonable cost and resource

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<sup>98</sup> H.Rept. 111-58 Part 2, P.L. 111-31, Division B, Thrift Savings Plan Enhancement Act of 2009, p. 5.

<sup>99</sup> For a legislative and program history of the TSP MFW, see FRTIB, “Mutual Fund Window,” 87 *Federal Register* 3940-3943, January 26, 2022, <https://www.govinfo.gov/content/pkg/FR-2022-01-26/pdf/2022-01312.pdf>.

As explained at <https://www.frtib.gov/board-members/>: “The Employee Thrift Advisory Council (ETAC) is comprised of representatives from Federal and Postal unions and management associations, as well as a representative from the Department of Defense on behalf of uniformed service members. ETAC provides advice on matters relating to TSP investment policies and plan administration. The Board and the Executive Director meet with ETAC at least annually.”

<sup>100</sup> FRTIB, “Federal Retirement Thrift Investment Boards Awards Recordkeeping Contract,” press release, November 16, 2020, [https://www.frtib.gov/pdf/reading-room/PressRel/PR\\_2020-11-17\\_RKSA\\_Award\\_Announcement\\_FINAL.pdf](https://www.frtib.gov/pdf/reading-room/PressRel/PR_2020-11-17_RKSA_Award_Announcement_FINAL.pdf).

<sup>101</sup> FRTIB, “Mutual Fund Window,” 87 *Federal Register* 27917-27923, May 10, 2022, <https://www.govinfo.gov/content/pkg/FR-2022-05-10/pdf/2022-09972.pdf>.

<sup>102</sup> See TSP.gov, “Mutual Fund Window,” <https://www.tsp.gov/mutual-fund-window/>. As of December 2023, out of a total of 6,997,017 TSP accounts, FRTIB reports that there were slightly over 4,000 MFW accounts with funds in them (i.e., approximately 0.06% of all TSP accounts). See FRTIB, “Thrift Fund Statistics: December 2023,” <https://www.frtib.gov/pdf/minutes/2024/Jan/Att1-Participant-Activity-Report-December-2023.pdf>. More generally, FRTIB estimates that 2%-3% of TSP account holders will be using the MFW two to three years after implementation (see FEDweek Staff, “TSP Projects Just 2-3% of Investors Will Use Mutual Fund Window,” *FEDweek*, March 22, 2024, <https://www.fedweek.com/fedweek/tsp-projects-just-2-3-of-investors-will-use-mutual-fund-window/>).

<sup>103</sup> FRTIB, “Facts about the TSP’s Mutual Fund Window,” p. 1.

<sup>104</sup> See, for example, Department of Labor, *Understanding Brokerage Windows in Self-Directed Retirement Plans*, report to Honorable Martin Walsh, Secretary of the Department of Labor, Advisory Council on Employee Welfare and Pension Benefit Plans (2021), p. 47, <https://www.dol.gov/sites/dolgov/files/EBSA/about-ehsa/about-us/erisa-advisory-council/2021-understanding-brokerage-windows-in-self-directed-retirement-plans.pdf> (“Investments accessible through a brokerage window are not routinely monitored by plan fiduciaries, and most experts conclude that, except perhaps in extraordinary circumstances, plan fiduciaries are not obligated to monitor brokerage window investments nor do their fiduciary duties apply with respect to those investments.”).

burdens on the FRTIB.”<sup>105</sup> Instead, eligible TSP participants may create MFW accounts to view the complete list of available mutual funds and use a Morningstar tool to sort and review funds.<sup>106</sup> According to the FRTIB, the TSP MFW

provides TSP participants with access to roughly 4,700 commercially available mutual funds, including funds from Berkshire, BNY Mellon, Calvert, Cohen & Steers, Fidelity, Franklin Templeton, Goldman Sachs, John Hancock, JPMorgan, Morgan Stanley, Schwab, T Rowe Price, TIAA, Vanguard, and Voya, among many others.<sup>107</sup>

### ***Examples of Relevant Legislation in the 118<sup>th</sup> Congress***

In general, any legislation that would require major investment changes, including divestment for any reason (e.g., from Chinese companies [S. 149, S. 1650, and H.R. 3455]), would affect the TSP mutual fund window. Additionally, as described above, there are three bills that would prohibit ESG investments specifically in the mutual fund window: H.R. 3612 and S. 2147, the No ESG in TSP Act, as well as Section 754 in H.R. 4664, the Financial Services and General Government Appropriations Act, 2024.

### **Diverse Asset Managers**

Some policymakers have also expressed interest in expanding professional services contracts to minority- and women-owned business enterprises in the arena of public pension investment, including TSP investment. At a July 2008 hearing held by the House Oversight and Government Reform Committee’s Subcommittee on the Federal Workforce, Postal Service, and the District of Columbia on “Investing in the Future: Minority Opportunities and the Thrift Savings Plan,” Representative Danny Davis stated:

The debate over minorities participating in the TSP funds has been a concern for quite some time; yet, the issue came to the forefront during last year’s Congressional Black Caucus legislative conference. The executive director of the Federal Retirement Thrift Investment Board revealed that there are minority firms with talent in long-term financial management. However, most of these firms gravitate toward the active fund management business, which is not an investment strategy of the TSP. Research by the TSP indicates that there may be only one minority-owned firm that deals with passive-management of index funds.<sup>108</sup>

After this hearing, Section 105 of the Thrift Savings Plan Enhancement Act of 2009 (enacted as part of P.L. 111-31) created annual reporting requirements for FRTIB, which included reporting on “the diversity demographics of any company, investment adviser, or other entity retained to invest and manage the assets of the Thrift Savings Fund.”<sup>109</sup>

A September 2017 GAO report, *Investment Management: Key Practices Could Provide More Options for Federal Entities and Opportunities for Minority- and Women-Owned Asset Managers*, examined how federal entities, including TSP, were using minority- and women-

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<sup>105</sup> FRTIB, “Mutual Fund Window,” 87 *Federal Register* 27920, May 10, 2022, <https://www.govinfo.gov/content/pkg/FR-2022-05-10/pdf/2022-09972.pdf>.

<sup>106</sup> FRTIB, “Facts About the TSP’s Mutual Fund Window,” p. 1.

<sup>107</sup> FRTIB, “TSP Fact Sheet—Investment in China,” p. 2.

<sup>108</sup> U.S. Congress, House Committee on Oversight and Government Reform, Subcommittee on the Federal Workforce, Postal Service, and the District of Columbia, *Investing in the Future: Minority Opportunities and the Thrift Savings Plan*, 110<sup>th</sup> Cong., 2<sup>nd</sup> sess., July 10, 2008, Serial No. 110-133, p. 2.

<sup>109</sup> See, for example, Appendix A (BlackRock) and Appendix B (State Street) in FRTIB, *TSP Annual Report 2022*, [https://www.frtib.gov/pdf/reading-room/congress/annual/TSP-Annual-Report\\_2022.pdf](https://www.frtib.gov/pdf/reading-room/congress/annual/TSP-Annual-Report_2022.pdf).

owned asset managers and identified key practices to increase opportunities for these asset managers: (1) “top leadership commitment,” (2) “remove potential barriers,” (3) “outreach,” and (4) “communicate priorities and expectations.”<sup>110</sup> This report concluded that FRTIB did not intend to use any of these best practices in setting up the TSP MFW.<sup>111</sup>

In October 2021, Senators Menendez, Padilla, Luján, Brown, Merkley, Kaine, and Booker sent a letter urging the FRTIB “to create opportunities for federal workers to invest in funds run by racially, ethnically, and gender diverse asset managers. When it comes to their retirement investments, federal workers deserve the chance to make the strategic and values-driven choice to prioritize diversity.”<sup>112</sup> The signatories of this letter highlighted the opportunity for diverse asset managers in the MFW.<sup>113</sup>

There has been legislation introduced in prior Congresses related to the use of diverse asset managers by federal institutional investors, including FRTIB (e.g., S. 4097 and H.R. 7594 in the 117<sup>th</sup> Congress). At this time, no such legislation has been introduced in the 118<sup>th</sup> Congress.

## **Exercise of Shareholder Rights**

Under current law, FRTIB, the Executive Director, and TSP participants are all prohibited from exercising shareholder voting rights associated with TSP assets.<sup>114</sup> Therefore, TSP fund managers (i.e., BlackRock and State Street Global Advisors) are the only parties currently exercising voting rights, with oversight provided by the FRTIB. According to the FRTIB:

[T]he FRTIB does not set proxy voting policy for its Fund managers. The FRTIB does, however, require that the Fund managers conform to their stated proxy voting policy. The FRTIB receives quarterly reports from an independent organization hired by the money manager to audit that their proxy voting complies with their policy. Those reports are sent

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<sup>110</sup> GAO, *Investment Management: Key Practices Could Provide More Options for Federal Entities and Opportunities for Minority- and Women-Owned Asset Managers*, GAO-17-726, September 13, 2017, <https://www.gao.gov/products/gao-17-726>.

<sup>111</sup> See also Appendix V in GAO-17-726 for FRTIB’s response to GAO.

<sup>112</sup> See Office of Sen. Menendez, “Menendez, Booker, Colleagues Urge for Diversity Among Federal Retirement Asset Managers,” press release, October 21, 2021, <https://www.menendez.senate.gov/newsroom/press/menendez-booker-colleagues-urge-for-diversity-among-federal-retirement-asset-managers>.

<sup>113</sup> In terms of the contracting rules, including for professional services such as asset managers, FRTIB states:

FRTIB is a self-funded federal agency with independent budgetary authority that receives no annual appropriations from Congress. Due to our unique status, FRTIB is not strictly bound to adhere to the Federal Acquisition Regulation (FAR). While subject to many of the same procurement laws as other government agencies, FRTIB also works under the mandate of its enabling statute, the Federal Employees’ Retirement System Act (FERSA), which requires that FRTIB fiduciaries manage Thrift Savings Fund (TSF) assets in the sole interest of the TSF participants and beneficiaries, and expend funds for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the TSP. To that end, FRTIB procurements will largely adhere to the FAR, unless doing so might infringe upon the Agency’s fiduciary obligations under FERSA. FRTIB has adopted the FAR as its primary contracting policy and procedures for procuring its goods and services.

FRTIB designed the Thrift Federal Acquisition Supplement (T-FAS) as a supplement to the FAR, which specifies when the Agency’s policies and practices deviate from the FAR. See link to T-FAS below. The T-FAS provides an efficient blend of the FAR and federal procurement law while allowing the Agency to be more flexible to accomplish its mission under FERSA (FRTIB, “Doing Business with FRTIB,” <https://www.frtib.gov/procurement/>).

<sup>114</sup> See 5 U.S.C. §8438(f): “The Board, other Government agencies, the Executive Director, an employee, a Member, a former employee and a former Member may not exercise voting rights associated with the ownership of securities by the Thrift Savings Fund.”

to the FRTIB by the money manager. Our Chief Investment Officer reports on this issue quarterly to the Board in our monthly, public Board meetings.<sup>115</sup>

It should be noted that there is additional federal oversight over TSP fiduciary duties. The U.S. Department of Labor’s (DOL’s) Employee Benefits Security Administration (EBSA) is responsible for establishing a program to carry out audits to determine the level of compliance with the requirements related to TSP fiduciary responsibilities and prohibited activities of TSP fiduciaries.<sup>116</sup> EBSA provides regular fiduciary audits of TSP.<sup>117</sup>

Some policymakers have expressed concerns about proxy voting by TSP asset managers—particularly with regard to ESG issues. For example, in July 2021, Senators Toomey and Johnson wrote a letter to FRTIB expressing their concerns:

Specifically, recent statements by the CEOs of BlackRock and State Street Global Advisors (SSGA) indicate they are using their control of proxy votes for federal employees’ Thrift Savings Plan (“the Plan”) investments to pressure other companies to adhere to their own environmental and social policy views. We are concerned that BlackRock and SSGA may be prioritizing their CEOs’ personal policy views over retirees’ financial security. Federal law explicitly requires all fiduciaries of the [TSP], including BlackRock and SSGA, to discharge their responsibilities “solely in the interest of the participants and beneficiaries and for the *exclusive* purpose of providing benefits to participants and their beneficiaries.”<sup>118</sup>

### *Examples of Relevant Legislation in the 118<sup>th</sup> Congress*

In the 118<sup>th</sup> Congress, for example, Representative Buck introduced H.R. 3406, the Stop TSP ESG Act, which would add “a qualified professional asset manager” to the entities and individuals prohibited from exercising shareholder voting rights associated with securities held by TSP. Senator Rubio introduced the Senate companion bill as S. 1891. This proposal would effectively prevent any TSP proxy voting.

## **Private Sector Pension Plans**

Pension plans can be classified along several dimensions, such as whether the employee receives a monthly payment in retirement (DB pensions) or accrues funds in an individual account (DC pensions), and whether the plan sponsor is a private-sector or public-sector employer. To protect the interests of pension plan participants and beneficiaries, ERISA was enacted (P.L. 93-406). ERISA covers most private-sector pension plans and is included in the *U.S. Code* in both Title 26 (the Internal Revenue Code, or IRC) and in Title 29 (often called the Labor Code).<sup>119</sup>

Nearly all private sector pension plans are required to file Form 5500 with the Internal Revenue Service (IRS), DOL, and the PBGC. The Form 5500 includes breakdowns on the number of plan

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<sup>115</sup> Email communication with FRTIB, January 14, 2021. For FRTIB’s quarterly reporting on the proxy voting by asset managers, see “Meeting Minutes,” available at <http://www.frtib.gov> for the month after each quarter (i.e., January, April, July, and October). See, for example, FRTIB, “Monthly Meeting,” October 2020, Attachment 4, pp. 10-13, <https://minutes.frtib.gov/>.

<sup>116</sup> This authority is provided by the statutory reference to the Secretary of Labor; see 5 U.S.C. §8477(g).

<sup>117</sup> See, for example, EBSA, “FY2022 Thrift Savings Plan Fiduciary Oversight Program,” April 26, 2022, <https://www.frtib.gov/pdf/minutes/2022/Apr/MM-2022Apr-Att7.pdf>.

<sup>118</sup> Sens. Pat Toomey and Ron Johnson, letter to David A. Jones, Acting Chairman, Federal Retirement Thrift Investment Board, June 30, 2021, [https://www.banking.senate.gov/imo/media/doc/toomey\\_johnson\\_letter\\_to\\_frtib.pdf](https://www.banking.senate.gov/imo/media/doc/toomey_johnson_letter_to_frtib.pdf).

<sup>119</sup> For an overview of ERISA, see CRS Report RL34443, *Summary of the Employee Retirement Income Security Act (ERISA)*.



participants, financial information about the plan, and details of companies providing services to the plan. Though information on plan investments is included in the Form 5500, this information is not aggregated into downloadable Form 5500 datasets nor presented in a standardized manner. To see information on an individual plan's investments, individuals must download the plan's Form 5500 and examine the corresponding schedule.<sup>120</sup>

## **Duties of Plan Sponsors Regarding Plan Investments Under ERISA**

ERISA contains provisions governing many aspects of pension plans (e.g., reporting and disclosure requirements, participation standards, funding requirements). ERISA also contains fiduciary standards, which require that individuals who make decisions in and for private sector pension plans and their participants (referred to as *fiduciaries*) adhere to specified standards of conduct, including:

- The duty of loyalty, which requires fiduciaries to discharge their duties “solely in the interest of the participants and beneficiaries” and for the “exclusive purpose” of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan;
- The duty of prudence, which requires fiduciaries to also act “with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man would use in the conduct of an enterprise of a like character with like aims;”
- The duty to diversify investments, which requires fiduciaries to diversify the investments of plans “so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so;” and
- The duty to act in accordance with plan documents, which requires fiduciaries to discharge their duties “in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with” ERISA.<sup>121</sup>

ERISA also prohibits fiduciaries from engaging in transactions deemed likely to injure pension plans, referred to as *prohibited transactions*. ERISA bars certain transactions between a plan and a party in interest with respect to a plan, and between a plan and a plan fiduciary.<sup>122</sup> In order to facilitate transactions between pension plans and service providers that would otherwise be prohibited by ERISA, a number of *prohibited transaction exemptions (PTEs)* exist, either in statute or as issued by DOL.<sup>123</sup>

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<sup>120</sup> Schedule H of the Form 5500 provides financial information for the plan. A plan must provide details on plan investments as an attachment to Schedule H.

<sup>121</sup> See ERISA §404 and 29 C.F.R. §2550.404a-1.

<sup>122</sup> These transactions include sale, exchange, or leasing of any property; lending of money or other extension of credit; furnishing of goods, services, or facilities; transfer or use of any plan assets; and acquisition, on behalf of the plan, of any employer security or employer real property in violation of ERISA Section 407, which limits the amount of employer securities and property that may be held by a plan. A fiduciary may not deal with the assets of the plan in his own interest or for his own account; act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan. See 29 U.S.C. §1106.

<sup>123</sup> A list of class exemptions is available at <https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/exemptions/class>.

## Private Sector Pension Plan Investment Considerations

Few explicit restrictions on private sector pension plan investments exist.<sup>124</sup> Because the fiduciary duty is such a high standard (and fiduciaries can be held personally liable for violating their duties), plan sponsors tend to be cautious about which types of investments are included in their plans. Among those who are fiduciaries are individuals who choose plan investments. The roles of fiduciaries in DB plans and DC plans are described in more detail below.

### Defined Benefit Plans

Private sector DB plan sponsors are responsible for choosing how plans' assets are invested. While DB plan participants can file claims for breach of fiduciary duty, because participants have a claim on their monthly benefits they receive and not on the assets on the plans, they generally cannot take action for fiduciaries' investment choices unless they experience loss of benefits.

### Defined Contribution Plans

Most private sector DC plans are those in which participants have individual accounts and choose their investments from among the options provided by the plan sponsors, referred to as 404(c) plans.<sup>125</sup>

DC plan sponsors make various decisions about plan features, including which investment options to include in the plans (referred to *designated investment alternatives*).<sup>126</sup> The investment options usually include mutual funds with varying characteristics such as index funds (which mirror the performance of a stock market index such as the S&P 500), small and large cap funds (which invest in small or large firms as measured by market capitalization), bond funds (which invest in debt obligations), real estate funds (which invest in real estate), and target date funds (which change the investment mix between bonds and stocks as an individual gets closer to retirement). DC plans may also offer participants collective investment trusts (CITs), which are pooled investment vehicles managed by bank and trust companies, and annuities, which provide a monthly payment in retirement that lasts until the death of the participant or, if married, the surviving spouse.

In addition to mutual fund investments, less than one-third of private sector DC plans allow participants to invest via *brokerage windows*.<sup>127</sup> A brokerage window allows plan participants to

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<sup>124</sup> One investment restriction that exists for DC plans and IRAs is collectibles, such as artwork, rugs and antiques, metals, gems, stamps, alcoholic beverages, and most coins. Amounts invested in collectibles are treated as distributions and may be subject to income tax and a 10% penalty (26 U.S.C. §408(m)). Gold, silver, and platinum coins issued by the U.S. Treasury and gold, silver, palladium, and platinum bullion are permissible. Nonfungible tokens, or NFTs, are digital certificates of ownership that represent digital or physical assets. In March 2023, Treasury and the IRS announced that they were soliciting feedback for upcoming guidance regarding the tax treatment of an NFT as a collectible. Certain plans, such as DC plans in which participants direct the investments of their accounts, may be subject to other restrictions, such as limitations on the amount of employer stock held in a plan.

<sup>125</sup> See ERISA 404(c).

<sup>126</sup> See 29 C.F.R. §2550.404a-5.

<sup>127</sup> Although one-quarter to one-third of DC plans offer brokerage windows, a small fraction of participants use them. Plan Sponsor Council of America found that 31.2% of plans in its survey offered brokerage windows. See Plan Sponsor Council of America, "65<sup>th</sup> Annual Survey of Profit Sharing and 401(k) Plans," <https://www.pasca.org/research/401k/65thAR>. An ERISA advisory report on brokerage windows cited data from various financial services firms. In that report, brokerage window offer rates varied by firm: Fidelity (17.4% in 2016), Vanguard (20% of all plans; 38% of plans with 5,000 or more participants), and Alight Solutions (46%). Vanguard's data stated that while 33% of all participants had access to brokerage windows, less than 0.5% of all participants used them. Alight's data stated that (continued...)

invest in options beyond those provided by the plan, such as individual stocks and a wide variety of mutual funds. Some plans place restrictions on participants' investments within brokerage windows, such as limiting the percentage of an individual's account balance that can be invested in the brokerage window or prohibiting investments in the stock of the employee's company.<sup>128</sup>

At job change or retirement, many individuals with DC plans roll over their savings into IRAs. IRA investment restrictions and policy issues are described later in this report.

## **Private Sector Pension Plan Investment Issues**

This section describes several issues related to private sector pension plan investments that have been topics of discussion in recent Congresses. Each issue is comprised of two parts: an overview and a discussion of relevant regulatory or congressional responses, if any. The following issues are discussed:

- Investments based on non-pecuniary factors,
- Exercise of shareholder rights,
- Investment advice,
- Alternative investments in retirement plans,
- Collective investment trusts in 403(b) plans,
- Investment fees, and
- Qualified professional asset managers (QPAMs).

## **ESG Investment Issues**

Over the years, investors—including pension plan sponsors and participants—have taken an interest in investment features beyond the standard risk and return relationship. Examples of such investments include those that consider the effects of climate change (e.g., preferring renewable energy companies to fossil fuel companies), a firm's supply chain practices (e.g., ensuring that seafood is not caught with forced labor), faith-based approaches (e.g., investing based on the Bible or Sharia law), corporate governance structures (e.g., considering the diversity of a corporation's board of directors), or geopolitical circumstances (e.g., avoiding countries that are perceived to be hostile to U.S. interests). These investments have been referred to with various names, such as economically targeted investments, socially responsible investments, and ESG investing. Policymakers' opinions vary as to the appropriateness of these types of investments within pension plans. Some Members of Congress are interested in facilitating these investments; others are interested in limiting them.

In 1994, 2008, and 2015, DOL issued guidance in the form of Interpretive Bulletins and, in 2018, a Field Assistance Bulletin on the extent to which pension plan fiduciaries can consider factors

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2.4% of participants used brokerage windows. See Advisory Council on Employee Welfare and Pension Benefit Plans, *Understanding Brokerage Windows in Self-Directed Retirement Plans*, December 2021, <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebbsa/about-us/erisa-advisory-council/2021-understanding-brokerage-windows-in-self-directed-retirement-plans.pdf>.

<sup>128</sup> DOL regulations state that a brokerage window is *not* a designated investment alternative. See 29 C.F.R. §2550.404a-5(h)(4). In "Field Assistance Bulletin (FAB) 2012-02," DOL clarified that investments in a brokerage window could be considered a designated investment alternative if chosen by a significant number of participants (see Q30 at <https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2012-02>). However, DOL subsequently removed that in an update to the FAB (see Q39 at <https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2012-02r>).

beyond an investment's risk and return relationship.<sup>129</sup> The guidance generally emphasized that investment decisions must be made with the objective to provide economic benefits to plan participants. The guidance also described scenarios in which consideration of investments that have goals beyond providing income to participants could be consistent with a fiduciary's duties. For example, if a plan found that two investments were equal on an economic basis, then the plan could—but would not be required to—choose based on noneconomic factors. DOL, in Interpretive Bulletin (IB) 2015-01, construed that ERISA prohibits “a fiduciary from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives.”<sup>130</sup>

### ***Regulatory and Congressional Responses***

On November 13, 2020, under the Trump Administration, DOL issued a final rule relating to the selection of investments by a pension plan fiduciary.<sup>131</sup> The DOL rule said that the evaluation of an investment by a pension plan fiduciary must be based on economic factors only—what the regulation called pecuniary factors—and that a pension plan could not subordinate the interests of participants and their retirement income to non-pecuniary objectives.

On December 1, 2022, under the Biden Administration, DOL issued a final rule that it said would clarify the application of fiduciary duty when selecting plan investments.<sup>132</sup> DOL said that the November 2020 regulation had a “chilling effect and other potential negative consequences” on the appropriate use of ESG factors in investment decisions in pension plans. While the regulation removed some of the barriers from the 2020 regulation to make it easier to consider factors beyond the risk-return relationship, the 2022 regulation retains what it calls “the core principle” that the duties of prudence and loyalty require ERISA plan fiduciaries to focus on relevant risk-return factors. It stated that ERISA fiduciaries cannot subordinate the interests of participants and beneficiaries (such as by sacrificing investment returns or taking on additional investment risk) to objectives unrelated to the provision of benefits under the plan.

In the 118<sup>th</sup> Congress, H.J.Res. 30, which would use the Congressional Review Act (CRA; enacted in P.L. 104-121) to nullify the 2022 regulation, was passed by the House and Senate and vetoed by President Biden on March 20, 2023.<sup>133</sup>

H.R. 4008, the Protecting Americans' Retirement Savings Act, introduced by Representative Jim Banks on June 12, 2023, would prohibit private sector pension plans from making new

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<sup>129</sup> See Pension and Welfare Benefits Administration, “Interpretive Bulletin Relating to the Employee Retirement Income Security Act of 1974,” <https://www.govinfo.gov/content/pkg/FR-1994-06-23/html/94-15162.htm>; EBSA, “Interpretive Bulletin Relating to Economically Targeted Investments,” 73 *Federal Register* 61734-61736, October 17, 2008, <https://www.govinfo.gov/content/pkg/FR-2008-10-17/pdf/E8-24551.pdf>; EBSA, “Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments,” 80 *Federal Register* 65135-61736, October 26, 2015, <https://www.govinfo.gov/content/pkg/FR-2015-10-26/pdf/2015-27146.pdf>; and EBSA, “Interpretive Bulletins 2016-01 and 2015-01,” <https://www.dol.gov/sites/dolgov/files/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01.pdf>.

<sup>130</sup> EBSA, “Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments,” 80 *Federal Register* 65135-61736, October 26, 2015, <https://www.govinfo.gov/content/pkg/FR-2015-10-26/pdf/2015-27146.pdf>.

<sup>131</sup> See EBSA, “Financial Factors in Selecting Plan Investments,” 85 *Federal Register* 72846-72885, November 13, 2020, <https://www.federalregister.gov/documents/2020/11/13/2020-24515/financial-factors-in-selecting-plan-investments>.

<sup>132</sup> See EBSA, “Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights,” 87 *Federal Register* 73882-73886, December 1, 2022.

<sup>133</sup> The House failed to override the veto. For more information, see CRS In Focus IF12328, *Department of Labor Guidance and Regulations on Selecting Private-Sector Pension Plan Investments*.

investments in specified countries (China, Russia, North Korea, and Iran) or in entities operated by individuals or organizations in these specified countries.<sup>134</sup>

## **Exercise of Shareholder Rights**

Among other responsibilities, pension plan fiduciaries must manage plan assets that involve shares of corporate stock and, thus, may be required to make and monitor decisions about voting proxies and exercising shareholder rights. DOL has published guidance over the past few decades outlining these responsibilities.

Pension plans typically hold stocks as part of their investment portfolios. Ownership of a company's stock confers partial ownership and grants the investor certain rights. One of these rights may include the right to vote on matters such as electing the board of directors and the approval of mergers and acquisitions. Shareholders can exercise their votes in person. However, most shareholders do not attend corporate annual meetings. Typically, shareholders have the right to appoint proxies. A proxy is a written authorization that delegates the shareholder's voting power to another person or, more typically, an institution.

DOL's long-standing position is that plan fiduciaries should engage in proxy voting activities in discharging their fiduciary obligation to prudently manage plan investments. A pension plan fiduciary is subject to fiduciary responsibility when deciding whether to vote or not to vote (via proxy or in person) and when deciding how to vote. The details of how fiduciaries determine whether and how to vote have been the subject of various regulations.

Due to the large number and diverse array of issues that shareholders may vote on, institutional investors, such as mutual funds and pension plans, frequently use proxy advisory firms for proposal voting recommendations. Proxy advisory firms provide institutional investors with research and recommendations on management and shareholder proposals that are voted on at annual corporate meetings. Two firms—Institutional Shareholder Services (ISS) and Glass Lewis—control much of the proxy advisory business. Pension plan fiduciaries are subject to fiduciary responsibility in the selection and monitoring of proxy advisory firms and ensuring that any proxy advisory firm votes in the best interest of plan participants.

## ***Regulatory and Congressional Responses***

In the 118<sup>th</sup> Congress, H.J.Res. 30, which would use the CRA (enacted in P.L. 104-121) to nullify the 2022 regulation, was passed by the House and Senate and vetoed by President Biden on March 20, 2023.<sup>135</sup>

## **Investment Advice**

Retirement plans are complex, and individuals often rely on financial services professionals to assist them with their decisionmaking. For example, an employer might seek assistance in determining what investments to offer in a 401(k) plan it has established, participants in a 401(k) plan might seek assistance in choosing their investments from among the options offered by the plan, or a worker who participates in an employer-sponsored 401(k) plan might seek assistance

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<sup>134</sup> Pension plans would not be required to divest current investments in these specified countries or entities but would be subject to disclosure requirements.

<sup>135</sup> The House failed to override the veto. For more information, see CRS In Focus IF12362, *Department of Labor Guidance and Regulations on the Exercise of Shareholder Rights by Private-Sector Pension Plans*.

on whether to leave his or her 401(k) account balance in the plan or roll it over into an IRA or into another employer's DC plan either upon job change or at retirement.

The compensation structure of some financial services professionals may give rise to conflicts of interest, particularly if these professionals' recommendations result in larger commissions or otherwise benefit them. These potential conflicts could lead to recommendations that are not in the interests of their clients. By contrast, some financial services professionals have compensation structures that do not vary based on which products clients choose. This type of compensation structure could mitigate any conflicts of interest.

Individuals who transact with a pension plan may be required to meet certain standards. The standard that applies depends on the individuals' roles and the actions they are taking. For example, an individual providing investment advice is subject to the high fiduciary standard, whereas an individual who is acting on the direction of the plan participant to buy or sell a particular security or mutual fund may have a lower standard of duty.

Following the passage of ERISA, DOL issued regulations in 1975 that created a five-part test to determine whether an individual provided investment advice and thus was subject to the fiduciary standard.<sup>136</sup> In addition, DOL issued a PTE to ensure that fiduciaries can continue to engage in practices that would otherwise be prohibited (such as brokers receiving commissions).

To be held to the 1975 fiduciary standard with respect to his or her advice, an individual must (1) make recommendations on investing in, purchasing, or selling securities or other property or give advice as to the value (2) on a regular basis, (3) pursuant to a mutual understanding that the advice (4) serves as a primary basis for investment decisions and (5) is individualized to the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments. An investment adviser is not treated as a fiduciary unless each of the five elements of the test is satisfied for each instance of advice.

In October 2010, DOL proposed, and subsequently withdrew in September 2011, an expansion of the definition of *fiduciary advice* that would have made more individuals and their actions subject to the fiduciary advice regulation. In April 2015, DOL issued a revised proposal to broaden the definition of *investment advice* and in April 2016 issued a final rule and PTE. In March 2017, DOL issued a Temporary Enforcement Policy that indicated it would not initiate enforcement actions against financial advisers or financial institutions that failed to satisfy the conditions of the regulation or PTE.<sup>137</sup>

In March 2018, a U.S. district court ruled that the 2016 rule was improperly promulgated, and in March 2018, the U.S. Court of Appeals for the Fifth Circuit vacated the 2016 rule. This meant that the five-part test was reinstated.<sup>138</sup>

In October 2020, DOL issued PTE 2020-02 which, as with previous PTEs, allows fiduciaries to conduct transactions that are otherwise prohibited.<sup>139</sup> Investment advice fiduciaries who rely on PTE 2020-02 must comply with Impartial Conduct Standards, which require them to provide

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<sup>136</sup> See 29 C.F.R. §2510.3-21.

<sup>137</sup> See DOL, "Temporary Enforcement Policy on Fiduciary Duty," March 10, 2017, <https://www.dol.gov/sites/dolgov/files/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2017-01.pdf>.

<sup>138</sup> See EBSA, "Conflict of Interest Rule—Retirement Investment Advice: Notice of Court Vacatur," 85 *Federal Register* 40589-40594, July 20, 2020.

<sup>139</sup> EBSA, "Prohibited Transaction Exemption 2020-02, Improving Investment Advice for Workers and Retirees," 85 *Federal Register* 82798-82866, December 18, 2020, <https://www.govinfo.gov/content/pkg/FR-2020-12-18/pdf/2020-27825.pdf>.

advice that is in the best interest of the retirement investor, charge no more than reasonable compensation, and make no misleading statements about investment transactions. In addition, PTE 2020-02 noted that rollover recommendations from an employer plan to an IRA could be considered investment advice if specified conditions are met—for example, if the investment recommendation is expected to be part of an ongoing relationship.<sup>140</sup> On February 13, 2023, a federal district court struck down the portion of PTE 2020-02 related to the rollover recommendations, and on June 30, 2023, in a different federal district court, a magistrate judge recommended that the guidance related to rollover advice be vacated.<sup>141</sup>

### ***Regulatory and Congressional Responses***

In November 2023, DOL issued a proposed rule that would change the definition of an investment advice fiduciary under ERISA.<sup>142</sup> The rule was accompanied by several other amendments to existing PTEs, including PTE 2020-02.<sup>143</sup> A public hearing on the rule and associated PTE amendments was held in December 2023.<sup>144</sup> Comments on the proposed rule and amendments were due January 2, 2024.

As of the date of this report, congressional responses include:

- separate letters opposing the proposed regulation from Dr. Virginia Foxx, the chairwoman, and 10 members of the majority on the House Education and Workforce Committee;<sup>145</sup> a bipartisan group of 50 members of the House of Representatives; Representative Roger Williams, Chairman, and three members of the House Committee on Small Business Committee;<sup>146</sup> and Senator Roger Marshall and 10 other Senators,<sup>147</sup>

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<sup>140</sup> See EBSA, *New Fiduciary Advice Exemption: PTE 2020-02 Improving Investment Advice for Workers and Retirees Frequently Asked Questions*, April 2021, <https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/faqs/new-fiduciary-advice-exemption.pdf>.

<sup>141</sup> See <https://www.bloomberglaw.com/product/blaw/document/X1VIAADDLGV944QLQJHAF66N3JO/download>.

<sup>142</sup> See EBSA, “Retirement Security Rule: Definition of an Investment Advice Fiduciary,” 88 *Federal Register* 75890-75979, November 3, 2023, <https://www.federalregister.gov/documents/2023/11/03/2023-23779/retirement-security-rule-definition-of-an-investment-advice-fiduciary>.

<sup>143</sup> See EBSA, “Proposed Amendment to Prohibited Transaction Exemption 84-24,” 88 *Federal Register* 76004-76032, November 3, 2023, <https://www.federalregister.gov/documents/2023/11/03/2023-23781/proposed-amendment-to-prohibited-transaction-exemption-84-24>; EBSA, “Proposed Amendment to Prohibited Transaction Exemptions 75-1, 77-4, 80-83, 83-1, and 86-128,” 88 *Federal Register* 76032-76045, November 3, 2023, <https://www.federalregister.gov/documents/2023/11/03/2023-23782/proposed-amendment-to-prohibited-transaction-exemptions-75-1-77-4-80-83-83-1-and-86-128>; and EBSA, “Proposed Amendment to Prohibited Transaction Exemption 2020-02,” 88 *Federal Register* 75979-76003, November 3, 2023, <https://www.federalregister.gov/documents/2023/11/03/2023-23780/proposed-amendment-to-prohibited-transaction-exemption-2020-02>.

<sup>144</sup> For unofficial transcripts of the hearing, see DOL, “US Department of Labor Publishes Transcripts of Online Hearing on Proposed Retirement Security Rule, Related Proposed Exemption Amendments,” press release, December 22, 2023, <https://www.dol.gov/newsroom/releases/ebsa/ebsa20231222>.

<sup>145</sup> See letter to Acting Secretary Su from Reps. Foxx, Good, Walberg, Grothman, Stefanik, Allen, Banks, Smucker, McClain, Bean, and Houchin, December 21, 2023, at [https://edworkforce.house.gov/uploadedfiles/12.21.23\\_final\\_comment\\_ltr\\_house\\_committee\\_on\\_education\\_and\\_the\\_workforce.pdf](https://edworkforce.house.gov/uploadedfiles/12.21.23_final_comment_ltr_house_committee_on_education_and_the_workforce.pdf).

<sup>146</sup> See letter to Acting Secretary Su from Senators Marshall, Barrasso, Braun, Collins, Cornyn, Ernst, Grassley, Hagerty, Hyde-Smith, Rounds, and Thune, December 18, 2023, at <https://www.marshall.senate.gov/wp-content/uploads/Letter-to-DOL-Fiduciary-Rule-12.18.23.pdf>.

<sup>147</sup> See letter to Acting Secretary Su and Assistant Secretary Gomez from multiple Members of Congress, January 8, 2024, at [https://si-interactive.s3.amazonaws.com/prod/planadviser-com/wp-content/uploads/2024/01/08165414/2024.1.8\\_Bipartisan\\_Hill\\_DScott\\_DOL\\_Retirement\\_Security\\_Proposed\\_Rule\\_Comment\\_Letter-FINAL-SIGNED.pdf](https://si-interactive.s3.amazonaws.com/prod/planadviser-com/wp-content/uploads/2024/01/08165414/2024.1.8_Bipartisan_Hill_DScott_DOL_Retirement_Security_Proposed_Rule_Comment_Letter-FINAL-SIGNED.pdf).

- a letter supporting the proposed regulation from Senator Bernie Sanders, chair of the Senate Committee on Health, Education, Labor, and Pensions; and Representative Bobby Scott, ranking member of the House Education and Workforce Committee;<sup>148</sup>
- press releases opposing the proposed regulation from Representative Ann Wagner, chair of the House Financial Services Subcommittee on Capital Markets, and supporting the proposed regulation from Representative Scott, ranking member of the House Committee on Education and the Workforce, and Representative Maxine Waters, ranking member of the House Financial Services Committee;<sup>149</sup>
- a hearing from the House Financial Services committee on January 10, 2024, entitled *Examining the DOL Fiduciary Rule: Implications for Retirement Savings and Access*;<sup>150</sup> and
- a hearing from the Subcommittee on Health, Employment, Labor, and Pensions of the House Education and Workforce committee on February 15, 2024, entitled *Protecting American Savers and Retirees from DOL's Regulatory Overreach*.<sup>151</sup>

## Investment Fees

Retirement plans pay a variety of fees and expenses, such as for plan administration and recordkeeping, services to the plan and participants, and investment expenses. Fees are a particular concern in DC plans, because small differences in fees can ultimately have a large effect on participants' account balances.<sup>152</sup> The complexity of 401(k) plan arrangements may provide opportunities for fees to be higher than they otherwise might be, particularly if plan sponsors and participants are not fully informed of the fees they pay.<sup>153</sup> Among the fiduciary

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<sup>148</sup> See Sen. Sanders and Rep. Scott, letter to Acting Secretary Su, January 2, 2024, [https://democrats-edworkforce.house.gov/imo/media/doc/scott\\_sanders\\_comment\\_letter\\_to\\_dol\\_re\\_retirement\\_security\\_rule.pdf](https://democrats-edworkforce.house.gov/imo/media/doc/scott_sanders_comment_letter_to_dol_re_retirement_security_rule.pdf).

<sup>149</sup> See Office of Rep. Ann Wagner, "Wagner Blasts Misguided, Irresponsible Fiduciary Rule," press release, October 31, 2023, <https://wagner.house.gov/media-center/press-releases/wagner-blasts-misguided-irresponsible-fiduciary-rule>; and Office of Rep. Bobby Scott, "Scott Applauds Proposed Rule to Strengthen America's Retirement Security," October 31, 2023, <https://bobbyscott.house.gov/media-center/press-releases/scott-applauds-proposed-rule-strengthen-americas-retirement-security>; and Office of Rep. Maxine Waters, "Ranking Member Maxine Waters Applauds Biden Administration's 'Retirement Security' Rule Proposal," October 31, 2023, <https://democrats-financialservices.house.gov/news/documentsingle.aspx?DocumentID=410916>.

<sup>150</sup> See U.S. Congress, House Committee on Financial Services, *Examining the DOL Fiduciary Rule: Implications for Retirement Savings and Access*, January 10, 2024, <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=409088>.

<sup>151</sup> See U.S. Congress, House Committee on Education and the Workforce, Subcommittee on Health, Employment, Labor, and Pensions, *Protecting American Savers and Retirees from DOL's Regulatory Overreach*, <https://edworkforce.house.gov/calendar/eventsingle.aspx?EventID=410108>.

<sup>152</sup> For example, a starting account balance of \$20,000 that earned 7% in returns each year would have about \$77,000 after 20 years if no fee is charged, whereas the account would have about \$70,000 if a 0.5% fee is charged. The same account would have a balance of about \$58,000 after 20 years if a 1.5% fee is charged (17% less than the account that charged a 0.5% fee). If a 1.5% annual fee is charged, over the course of 30 years the account holder in this example would pay more than \$52,000 in fees. For more information on the fees in private sector DC plans, see EBSA, *A Look at 401(k) Fees*, September 2019, <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebbsa/our-activities/resource-center/publications/a-look-at-401k-plan-fees.pdf>; and EBSA, *Understanding Your Retirement Plan Fees*, September 2021, <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebbsa/our-activities/resource-center/publications/understanding-retirement-plan-fees-and-expenses.pdf>.

<sup>153</sup> GAO, *401(k) Retirement Plans: Many Participants Do Not Understand Fee Information, but DOL Could Take Additional Steps to Help Them*, GAO-21-357, August 26, 2021, <https://www.gao.gov/products/gao-21-357>. Fees are (continued...)



duties of plan sponsors is a duty to ensure that the fees paid for services to the retirement plans are reasonable.

DC plan participants receive information about plan fees from several sources, including Summary Plan Descriptions (SPDs), Form 5500 filings, and benefit statements. SPDs describe how plans operate. Plan sponsors are required to automatically provide copies of these documents to plan participants upon enrollment and upon written request of plan participants. SPDs are required to disclose a summary of provisions that may result in a fee charged to a participant, the payment of which is a condition to the receipt of benefits under the plan.<sup>154</sup>

The Form 5500 was jointly developed by DOL, the IRS, and PBGC and is required to be submitted annually by ERISA-covered plans.<sup>155</sup> This annual report contains various schedules with information on the financial condition, investments, and operations of the plans. Plans with more than 100 participants are required to disclose the identity of service providers that receive direct or indirect compensation of \$5,000 or greater in connection with services rendered to the plans.<sup>156</sup>

Plan sponsors must provide participants in DC plans with regular benefit statements. If the investments in a DC plan are participant directed (which includes most 401(k) plans), then benefit statement must be provided quarterly and contain information about the fees charged to the participant.<sup>157</sup>

In recent years, plan participants have brought a large number of lawsuits alleging that recordkeeping and investment management fees in their plans were excessive.<sup>158</sup> This was expected to continue after a January 2022 Supreme Court of the United States ruling.<sup>159</sup>

### ***Regulatory and Congressional Responses***

In response to a request by Senator Patty Murray and Representative Bobby Scott, a 2021 GAO report assessed the extent to which 401(k) plan participants understood the fee information in retirement plan disclosures and suggested steps that DOL could take to improve participant understanding of fee disclosures.<sup>160</sup> A provision in the SECURE 2.0 Act of 2022 (“SECURE 2.0,” enacted as Division T of P.L. 117-328; December 29, 2022) requires DOL to review regulations relating to disclosure requirements for participant-directed individual account plans and explore (through a public request for information) how the contents and design may be improved to better

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not typically a concern in DB plans. Because employers are responsible for funding the plans via their contributions, they have an incentive to ensure that fees are kept to a minimum.

<sup>154</sup> An EBSA Field Assistance Bulletin notes that charges for hardship withdrawals, if a plan allows hardship withdrawals, might be an example of such a charge. See Field Assistance Bulletin 2003-3 issued by EBSA on May 19, 2003, at <https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2003-03>.

<sup>155</sup> Form 5500s are available at <https://www.efast.dol.gov/5500Search/>.

<sup>156</sup> See DOL, “Annual Reporting and Disclosure,” 72 *Federal Register* 64710-64857, November 16, 2007.

<sup>157</sup> As part of regulations related to fee disclosures issued in 2010, DOL published a model disclosure statement that plan sponsors and administrators could rely on. See <https://www.dol.gov/sites/dolgov/files/ebsa/employers-and-advisers/plan-administration-and-compliance/fiduciary-responsibilities/401k-plan-fee-disclosure-tool.pdf>.

<sup>158</sup> See CRS Legal Sidebar LSB10636, *Supreme Court Rules on Retirement Plan Fiduciary Duty in Hughes v. Northwestern University*; and Ilana Polyak, “401(k) Lawsuits on the Rise as Participants Target Fees, Conflicts of Interest and Data Privacy,” *BenefitsPro*, January 21, 2021, <https://www.benefitspro.com/2021/01/21/401k-lawsuits-on-the-rise-as-participants-target-fees-conflicts-of-interest-and-data-privacy/?slreturn=20210718150301>.

<sup>159</sup> Gregg Greenberg, “Will 2023 Be Another Banner Year for 401(k) Fee Litigation?,” *InvestmentNews*, February 2, 2023, <https://www.investmentnews.com/will-2023-be-another-banner-year-for-401k-fee-litigation-233242>.

<sup>160</sup> GAO, *401(k) Retirement Plans*.

help participants understand DC plan fees.<sup>161</sup> The provision also requires DOL to issue a report to the House Committee on Education and the Workforce and the Senate Health, Education, Labor, and Pensions Committee with findings and legislative recommendations related to the findings.

In the 117<sup>th</sup> Congress, H.R. 7284 would have directed the Secretary of Labor to improve DC plan fee disclosures, and S. 4361 would have required DOL to study and report on retirement account disclosure requirements, including ways to improve participants' understanding of fees.

## **Alternative Investments in Retirement Plans**

Though stocks, bonds, and mutual funds are common plan investments, pension plan fiduciaries may invest in nearly any asset class provided they adhere to fiduciary duty in the selection and monitoring of such investments. Several alternative investments, including cryptocurrency and private equity, have been topics of increasing congressional attention in recent years regarding their appropriateness for retirement plan participants.

### ***Cryptocurrency***

**In DC plans**, until recently, cryptocurrency was not available as an investment option. In 2021, FORUSALL announced that it would be the first financial services company to offer plan sponsors the option to adopt cryptocurrency as an investment for participants.<sup>162</sup> In April 2022, Fidelity announced its intention to allow 401(k) participants whose plan sponsors adopt it as an investment option to invest up to 20% of their account balances in Bitcoin.<sup>163</sup>

**In DB plans**, while plan sponsors may invest in cryptocurrencies, current use appears to be minimal. DOL outlined its concerns with cryptocurrencies in a March 2022 Compliance Release. The concerns included the potentially speculative nature of cryptocurrency investments, the difficulties individuals might have in evaluating whether to—or how much to—include in their investment portfolios, recordkeeping challenges, valuation concerns, and the regulatory environment.<sup>164</sup>

Advocates for including cryptocurrency as an investment option in retirement plans provide several reasons for why it is an appropriate investment option. They note that it is a widely used asset class outside of retirement plans. In addition, cryptocurrencies may provide diversification benefits to an investment portfolio, potentially reducing a portfolio's risk without necessarily harming the portfolio's return. Advocates also claim that younger individuals may be more likely to participate in workplace retirement plans if investment choices include cryptocurrency.<sup>165</sup>

### ***Regulatory and Congressional Responses***

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<sup>161</sup> A Senate Finance Committee summary of SECURE 2.0 noted that this provision builds on recommendations made in the aforementioned 2021 GAO report. See U.S. Congress, Senate Committee on Finance, *SECURE 2.0 Section-by-Section Summary*, [https://www.finance.senate.gov/imo/media/doc/Secure%202.0\\_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf](https://www.finance.senate.gov/imo/media/doc/Secure%202.0_Section%20by%20Section%20Summary%2012-19-22%20FINAL.pdf).

<sup>162</sup> See <https://www.forusall.com/press>.

<sup>163</sup> See Fidelity, "A First-of-Its-Kind Investment Account," <https://www.fidelityworkplace.com/s/digitalassets>.

<sup>164</sup> See DOL, "Compliance Assistance Release No. 2022-01: 401(k) Plan Investments in 'Cryptocurrencies,'" March 10, 2022, <https://www.dol.gov/sites/dolgov/files/ebsa/employers-and-advisers/plan-administration-and-compliance/compliance-assistance-releases/2022-01.pdf>.

<sup>165</sup> See Anne Tergesen, "Cryptocurrency Comes to Retirement Plans as Coinbase Teams Up with 401(k) Provider," *Wall Street Journal*, June 10, 2021, <https://www.wsj.com/articles/coinbase-teams-up-with-401-k-provider-to-offer-crypto-11623317402>.

On March 10, 2022, DOL released a Compliance Assistance Release, “401(k) Plan Investments in ‘Cryptocurrencies,’” in which the department expressed “serious concerns” about plan fiduciaries’ decisions to allow DC plan participants to invest in cryptocurrencies.<sup>166</sup> The release indicated that DOL planned to conduct an investigative program aimed at plans that offer such investments and that plan fiduciaries could expect to be questioned by DOL about their decisions. Subsequently, a DOL official noted that plans that allow their participants to invest in cryptocurrency would not be automatically subjected to audits.<sup>167</sup>

The Financial Freedom Act of 2023 (S. 427 introduced by Senator Tommy Tuberville, and H.R. 1177, introduced by Representative Byron Donalds) would prohibit DOL regulations that require plans to consider factors beyond the risk and return relationship that would constrain or prohibit the type of investments that could be offered through a brokerage window in a DC plan.

### ***Private Equity***

Private equity funds are pooled investment vehicles that are not registered with the SEC.<sup>168</sup> Private equity funds are typically open to *accredited investors*, such as high-income and high-net-worth individuals, and qualified clients, such as institutional investors (which includes pension funds).

**In DC plans**, plan sponsors have not made private equity available as a standalone investment option, most likely due to characteristics of private equity, such as illiquidity and difficulty of regular valuation.

**In DB plans**, fiduciaries invest in private equity funds. The Pensions and Investments 1,000 Summary Report found that, as of September 30, 2021, the top 200 DB plans (both public and private sector) held \$680.8 billion in private equity (out of \$6.9 trillion in total assets).<sup>169</sup>

### ***Regulatory and Congressional Responses***

While private equity is not available as a standalone investment in DC plans, in June 2020, DOL issued an information letter in response to a request from Groom Law Group that clarified that a DC plan fiduciary would not violate fiduciary duty for including private equity as a component of an asset allocation fund (e.g., a target-date fund), provided the fiduciary determined that it was an appropriate investment choice for the plan.<sup>170</sup>

In December 2021, DOL issued a Supplement Statement to the June 2020 information letter regarding private equity in DC plans.<sup>171</sup> The Supplement Statement cautioned plan fiduciaries from misreading the 2020 information letter as saying that private equity (as a component of an asset allocation fund in a DC plan) was appropriate for a typical 401(k) plan and stated that the letter “did not endorse or recommend such investments.” DOL noted that it agreed with some stakeholders that, in the requester’s original letter to DOL, “the claimed benefits of [private equity] investments reflected the perspective of the industry.” DOL also cited stakeholder

<sup>166</sup> See DOL, “Compliance Assistance Release No. 2022-01.”

<sup>167</sup> For more information, see CRS In Focus IF12153, *Cryptocurrency in 401(k) Retirement Plans*.

<sup>168</sup> See Investor.gov, “Private Equity Funds,” <https://www.investor.gov/introduction-investing/investing-basics/investment-products/private-investment-funds/private-equity>.

<sup>169</sup> See Pensions and Investments, “P&I 1,000 Summary Report,” <https://www.pionline.com/pi1000>.

<sup>170</sup> See EBSA, “Information Letter 06-03-2020,” June 3, 2020, <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020>.

<sup>171</sup> See EBSA, “U.S. Department of Labor Supplement Statement on Private Equity in Defined Contribution Plan Designated Investment Alternatives,” December 21, 2021, <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020-supplemental-statement>.

concerns about the ability of plan fiduciaries in a typical 401(k) plan to fulfill the obligations required to determine whether private equity was an appropriate investment for the plan.

### **Collective Investment Trusts in 403(b) Plans**

In general, pension plans have few investment restrictions. However, 403(b) plans—which are DC plans sponsored by public educational organizations (including public primary and secondary schools, state colleges and universities, and public junior colleges), 501(c)(3) tax-exempt organizations, and certain ministers—may invest only in (1) annuity contracts provided by insurance companies and/or (2) custodial accounts invested only in SEC-registered mutual funds.<sup>172</sup>

In contrast, while many 401(k) plans offer mutual funds as investment options, they also often invest through collective investment trusts (CITs). CITs are pooled investment funds maintained by banks or trust companies that are available only to certain qualified retirement plans. Mutual funds and CITs differ in their regulatory structure. Mutual funds are investment trusts and are regulated by the SEC. Because CITs are held by banks, however, they are regulated by the Comptroller of the Currency.<sup>173</sup>

#### ***Regulatory and Congressional Responses***

Over the years, Congress has tried to harmonize some of the rules that cover 401(k) and 403(b) plans.<sup>174</sup> A provision in SECURE 2.0 (enacted as Division T of P.L. 117-328; December 29, 2022) amended the IRC to permit 403(b) custodial accounts to invest in group trusts (e.g., CITs) with other tax-preferred savings plans and IRAs. A CIT is an example of a group trust. Previously, assets of 403(b) custodial accounts could not be commingled in group trusts with assets other than those of regulated investment companies (i.e., mutual funds).

SECURE 2.0 amended the IRC but did not amend securities laws (e.g., the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940, which would be required to permit 403(b) plans to participate in CITs).

In the 118<sup>th</sup> Congress, H.R. 3063, as reported out of the House Financial Services Committee on May 24, 2023, would amend securities laws to permit 403(b) plans to invest in CITs.<sup>175</sup>

### **Qualified Professional Asset Managers**

In order to facilitate transactions between DB and DC pension plans and service providers that would otherwise be prohibited by ERISA,<sup>176</sup> DOL issued PTE 84-14 (referred to as the QPAM

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<sup>172</sup> A third type of 403(b) arrangement, which is only available to church employees described in Title 26, Section 403(b)(9), of the *U.S. Code*, is a *retirement income account*. Retirement income accounts do not have any investment restrictions.

<sup>173</sup> See Office of the Comptroller of the Currency, “Collective Investment Funds,” <https://www.occ.treas.gov/topics/supervision-and-examination/capital-markets/asset-management/collective-investment-funds/index-collective-investment-funds.html>.

<sup>174</sup> For example, the SECURE 2.0 Act of 2022 (Division T of P.L. 117-328) modified the types of contributions that 403(b) participants may withdraw in hardship distributions to mirror the rules for 401(k) plan hardship distributions.

<sup>175</sup> The bill would also permit 403(b) plans to invest in non-registered variable annuities (referred to as *insurance separate accounts*). Insurance separate accounts are investment vehicles made available through group annuity contracts that commingle assets from multiple retirement plans. Their assets are separated from all other assets of the insurance companies.

<sup>176</sup> Title I of ERISA, as amended, broadly prohibits transactions between plans and “parties in interest,” and Title II of ERISA, as amended, includes parallel provisions applicable to tax-qualified plans and “disqualified persons.”

exemption).<sup>177</sup> A QPAM is an entity independent of the plan sponsor that has discretionary authority over an investment fund (e.g., a bank, savings and loan association, insurance company, or investment advisor). The QPAM exemption permits various parties that are related to pension plans to engage in transactions involving plan assets (e.g., sale of any property, lending money, furnishing of services) if the assets are managed by QPAMs. Without this class exemption, most transactions between pension plans and a “party in interest” would be prohibited.

### ***Regulatory and Congressional Responses***

The QPAM exemption was first issued in 1984 and has twice been amended.<sup>178</sup> In July 2022, DOL gave notice of a proposed amendment to the QPAM exemption.<sup>179</sup> The comment period closed on September 26, 2022. Under current law and regulation, QPAMs may no longer qualify for the PTE if they are convicted of certain crimes. The proposed amendment would make several changes, among which include updating the list of crimes to explicitly include certain foreign crimes and adjusting the asset management and equity thresholds in the QPAM definition.

After the comment period on the proposed amendment closed on September 26, 2022, in March 2023, DOL announced it was reopening the comment period for the proposed amendment to the prohibited transaction class exemption 84-14 (the QPAM exemption).<sup>180</sup> The reopened comment period started on March 23, 2023, and ended on April 6, 2023.<sup>181</sup> As of the date of this report, DOL has not finalized the proposed amendment.

## **Individual Retirement Accounts (IRAs)**

IRAs are tax-advantaged accounts that individuals can establish to accumulate funds for retirement.<sup>182</sup> Depending on the type of IRA, contributions may be made on a pretax or post-tax basis, and investment earnings are either tax-deferred or tax-free. In addition, workers can roll over savings from employer-sponsored retirement savings plans into IRAs to preserve their savings’ tax advantages.

Traditional IRA contributions may be tax deductible depending on the IRA owner’s household income and workplace pension coverage. The contributions may accrue investment earnings in an account, and these earnings can be used as a source of income in retirement. Taxes are paid on both contributions and any investment earnings when funds are distributed.

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<sup>177</sup> DOL has authority to grant additional PTEs on an individual or class basis.

<sup>178</sup> See EBSA, “Class Exemptions,” <https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/exemptions/class>.

<sup>179</sup> See EBSA, “Proposed Amendment to Prohibited Transaction Class Exemption 84-14 (the QPAM Exemption),” 87 *Federal Register* 45204-45232, July 27, 2022, <https://www.federalregister.gov/documents/2022/07/27/2022-15702/proposed-amendment-to-prohibited-transaction-class-exemption-84-14-the-qpam-exemption>.

<sup>180</sup> See EBSA, “Reopening Comment Period for the Proposed Amendment to Prohibited Transaction Class Exemption 84-14 (the QPAM Exemption),” 88 *Federal Register* 17466-17467, March 23, 2023, <https://www.federalregister.gov/documents/2023/03/23/2023-05522/reopening-comment-period-for-the-proposed-amendment-to-prohibited-transaction-class-exemption-84-14>.

<sup>181</sup> Comments are available at <https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-ZA07>.

<sup>182</sup> For more information on IRAs, see CRS Report RL34397, *Traditional and Roth Individual Retirement Accounts (IRAs): A Primer*.

## **IRAs: Authority and Administration**

Traditional IRAs were authorized by ERISA (P.L. 93-406). Roth IRAs were authorized by the Taxpayer Relief Act of 1997 (P.L. 105-34). One key difference between traditional and Roth IRAs is that contributions to Roth IRAs are made with after-tax funds, and qualified distributions are not included in taxable income; investment earnings accrue free of taxes. The IRS has responsibility for enforcing IRA tax laws.

An IRA must be a trust or custodial account, and the trustee must be either (1) a bank or (2) a nonbank that applies to the IRS to be considered eligible. Trustees that meet these requirements include financial institutions, credit unions, mutual fund companies, life insurance companies, and stock brokerages. Most individuals with IRAs hold them through large financial institutions (e.g., Fidelity, Vanguard).

These institutions offer an array of investment choices for IRA investors, such as mutual funds, exchange-traded funds, bonds, and publicly traded stocks. IRA investors are limited to the options offered by their financial institutions.

Some individuals save for retirement through *self-directed IRAs* (SDIRAs). SDIRAs are set up through IRS-approved custodians that specialize in SDIRAs. These custodians permit individuals to exercise discretion over their investment choices and invest in nearly any asset class, including cryptocurrencies; private equity; real estate; and ownership interests in limited liability corporations, partnerships, trusts, or similar entities. SDIRA owners are responsible for selecting, managing, monitoring, and retaining all investments in their accounts.

## **Investment Restrictions and Prohibited Transactions**

Owners of IRAs or SDIRAs must adhere to IRA investment rules. In general, while IRAs have few investment restrictions, the following do apply:

- Any amounts invested in collectibles—such as artwork, rugs and antiques, metals, gems, stamps, alcoholic beverages, and most coins<sup>183</sup>—are treated as distributions and may be subject to income tax and a 10% penalty.<sup>184</sup>
- IRA owners are not permitted to invest in life insurance contracts.<sup>185</sup>
- IRAs (absent some meeting narrow exceptions) are not permitted to be shareholders of S corporations.<sup>186</sup>

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<sup>183</sup> Gold, silver, and platinum coins issued by the U.S. Treasury and gold, silver, palladium, and platinum bullion are permissible.

<sup>184</sup> See 26 U.S.C. §408(m).

<sup>185</sup> See 26 U.S.C. §408(a)(3) and 26 U.S.C. §408(e)(5).

<sup>186</sup> See Treasury Regulation Section 1.1361-1(h)(1)(vii).

## Prohibited Transactions

In addition to the investment restrictions above, IRA owners, beneficiaries, and any disqualified persons—such as the IRA owners’ fiduciaries and any family members—are not permitted to engage in a number of prohibited transactions.<sup>187</sup> These include borrowing money from an IRA, selling property to it, using it as security for a loan, and buying property for personal use (present or future) with IRA funds. An individual who engages in a prohibited transaction causes the IRA to no longer be treated as an IRA as of the first day of the year. The entire amount of the account is treated as a distribution (based on the account’s value at the beginning of the year) and may be subject to tax and penalty.

DOL and the IRS have oversight responsibilities for prohibited transactions relating to IRAs.<sup>188</sup> IRA owners who invest in unconventional assets—typically done through SDIRAs—are more likely to engage in prohibited transactions compared to IRA owners who invest in assets offered by their financial institutions. A 2019 GAO report recommended that formalizing collaborative efforts from DOL and the IRS could strengthen oversight of prohibited transactions within IRAs.<sup>189</sup>

## Regulatory and Congressional Responses

In general, there has been little action from a regulatory or congressional standpoint regarding IRA investments. An early version of the Build Back Better Act, which later became the Inflation Reduction Act, included several provisions that would have affected IRA investments.

For example, some investments are available only to what are referred to as *accredited investors*.<sup>190</sup> These investments are private securities offerings, which are exempt from certain SEC requirements. Examples include hedge funds, venture capital, and private equity. Individuals can qualify as accredited investors if they meet certain income or net worth thresholds or have specified educational credentials. Section 138312 of H.R. 5376, as reported in the House on September 27, 2021, would have prohibited IRA owners from investing in securities that are available only to accredited investors.<sup>191</sup> This provision was not included in the version of H.R. 5376 that became law (P.L. 117-169).

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<sup>187</sup> See 26 U.S.C. §4975.

<sup>188</sup> DOL may provide interpretive guidance and has authority to grant exemptions from prohibited transactions rules. The IRS enforces tax laws relating to IRAs (including assessing additional taxes for IRA owners who engage in prohibited transactions).

<sup>189</sup> See GAO, *Individual Retirement Accounts: Formalizing Labor’s and IRS’s Collaborative Efforts Could Strengthen Oversight of Prohibited Transactions*, GAO-19-495, June 2019, <https://www.gao.gov/assets/gao-19-495.pdf>.

<sup>190</sup> For more details on accredited investors, see CRS In Focus IF11278, *Accredited Investor Definition and Private Securities Markets*.

<sup>191</sup> See Section 138312 at <https://www.congress.gov/117/crpt/hrpt130/CRPT-117hrpt130-pt3.pdf>.

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