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A Preview of The Retirement Plan That Could Become Law

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After years of discussing major retirement plan changes, Congress seems poised to act. On May 23, 2019, the U.S. House of Representatives passed the Setting Every Community Up for Retirement Enhancement Act of 2019 (H.R. 1994) — the SECURE Act — with broad bipartisan support in a 417-3 vote. The retirement plan industry also strongly supports the SECURE Act. The SECURE Act was sponsored by the House Ways and Means Committee Chairman Richard Neal, D-Mass., with bipartisan co-sponsors.

The Ways and Means Committee unanimously approved the SECURE Act on April 2, 2019, but the full House vote was held up due to disagreement on a provision that would have expanded the use of savings accounts under Section 529 of the Internal Revenue Code to reimburse homeschooling and other expenses. The final bill mostly removed expansion of the 529 accounts.

The SECURE Act incorporates and mirrors many provisions from the Retirement Enhancement and Savings Act of 2019 (S. 972) — RESA — which Senate Finance Chairman Charles Grassley, R-Iowa, and ranking member Ron Wyden, D-Ore., introduced to the Senate on April 1, 2019. Like the SECURE Act, RESA has extensive bipartisan and industry support. Therefore, the Senate may reconcile the provisions of the two bills.

The SECURE Act's intent is to help Americans save for retirement and make it easier for employers to offer retirement plans for their employees by making administrative simplifications. Provisions of the SECURE Act would generally apply to plan years beginning after Dec. 31, 2020.

If adopted in its current format, the SECURE Act would do the following:

Facilitate Unrelated Employers Banding Together in Multiple Employer Plans

One of the biggest changes the SECURE Act makes is to allow unrelated employers to band together in "multiple employer plans," or MEPs, even if the employers do not have a commonality of interest. A MEP is a plan maintained by two or more unrelated employers — in other words, employers who are not in the same controlled group or not otherwise considered to be a single employer under applicable federal rules.

Currently, MEPs are limited to groups of employers that have a commonality of interest such as being in the same industry. The SECURE Act allows unrelated employers to participate in "open" MEPs of employers

that are unrelated in any respect except for sponsoring the same plan.

The open MEP must be maintained by a “pooled plan provider” that meets certain requirements. Under the SECURE Act, employers who participate in open MEPs are relieved of many of their duties with respect to the plan, since the pooled plan provider would take on most of the administration and would be a named fiduciary of the plan.

The provider would only have to file one Form 5500 for the MEP. However, each employer in the plan would retain fiduciary responsibility for the selection and monitoring of the pooled plan provider, investment and management of the portion of the plan's assets that relate to the employees of that employer, as well as certain other responsibilities.

The SECURE Act alleviates a specific concern of employers considering MEP participation — the “one bad apple rule.” Under existing law, one employer's error can jeopardize the qualified tax status of the entire plan. The SECURE Act eliminates the one bad apple rule for both closed and open MEPs, as long as the tainted assets are transferred out of the plan to another plan or IRA.

Increase the Required Minimum Distribution Age From 70-1/2 to 72 and Modify the Required Minimum Distribution Rules for Beneficiaries

Employer retirement plans and traditional IRAs are subject to required minimum distribution rules that require a participant to start drawing taxable distributions by April 1 of the calendar year following the calendar year in which the individual reaches age 70-1/2 — or if later and the individual is not a 5% owner, then the date that the employee retires from that employer.

The SECURE Act would increase the required distribution age to 72. This is intended to reflect longer life expectancies and the fact the individuals now tend to work longer. The change would apply only for individuals who attain age 70-1/2 after Dec. 31, 2019.

The SECURE Act also changes minimum distribution rules for beneficiaries, generally eliminating “stretch RMDs” whereby beneficiaries can distribute RMDs over their own lifetime. The SECURE Act requires RMDs to be distributed to beneficiaries within 10 years, except for beneficiaries who are the participant's spouse or minor child, disabled or chronically ill, or not more than 10 years younger than the participant.

Require Employers to Allow Long-Term, Part-Time Employees to Participate in 401(k) Plan Elective Deferrals

Currently, an employer can design a 401(k) plan to exclude an employee until the employee is at least age 21 and has worked at least one year of service, measured as 1,000 hours in the relevant 12-month period. The SECURE Act allows employees to contribute elective deferrals once the employee has worked at least 500 hours per year with the employer for at

least three consecutive years.

The employer could still exclude these long-term, part-time employees from eligibility for matching and other employer contributions, but to the extent such employees are eligible under the plan, the plan must credit a year of service for vesting purposes for each year that the employee works at least 500 hours. Nondiscrimination testing relief would apply with respect to these employees.

Allow Employers to Increase the Automatic Enrollment Percentage in Safe Harbor Plans Up to 15%

Many employers' 401(k) plans are designed as “safe harbor plans” that are deemed to meet nondiscrimination requirements due to meeting minimum levels of contributions and other requirements. Safe harbor plans that include automatic enrollment provisions, whereby a participant is automatically enrolled at a default rate if the participant does not take affirmative action otherwise, are currently limited to a maximum 10% automatic enrollment rate. The SECURE Act increases the maximum automatic enrollment rate from 10% to 15% after the first year of participation. This would allow plans to enroll participants at a lower rate initially — minimum 3% — and increase the deferral rate up to as much as 15% in subsequent years.

Eliminate the Annual Notice Requirement for Nonelective 401(k) Safe Harbor Plans and Allow Later Adoption

As mentioned above, safe harbor plans avoid some annual nondiscrimination tests. Safe harbor plans can be designed to provide either a minimum employer match on elective deferrals or a minimum nonelective employer contribution of at least 3% of compensation for nonhighly compensated employees.

Under the SECURE Act, employers with nonelective safe harbor plans would no longer have to provide an annual safe harbor notice to employees. Also, the SECURE Act extends the date for amending a plan to become a nonelective safe harbor plan up to as late as the close of the following plan year — with a 4% contribution.

Allow Employers to File One Consolidated Form 5500 Annual Report for Similar Plans

Currently, if an employer maintains more than one ERISA plan, the employer is required to file a separate Form 5500 annual report for each plan. The SECURE Act reduces that burden and cost by requiring only one Form 5500 per employer, provided that the plans are all individual account plans and have the same plan year, trustee, administrator and investments. This provision would not be in effect until a consolidated Form 5500 is issued — no later than 2022.

Provide for Penalty-Free Withdrawals for Qualified Birth or Adoption Distributions

Unless an exception applies, when a participant takes a distribution from a qualified retirement plan — including a 401(k) plan, Section 403(b) plan, governmental Section 457(b) plan or IRA before age 59-1/2 — the participant is subject to an early withdrawal tax of an additional 10% on any distribution that isn't rolled over to another eligible retirement plan.

The SECURE Act adds a new exception to the early withdrawal tax, allowing penalty-free withdrawals up to $5,000 for the one-year period following birth or adoption. The withdrawals can later be recontributed. This flexibility is intended to encourage younger workers to save.

Require Lifetime Income Disclosure to Participants

Under the SECURE Act, participant benefit statements for defined contribution plans such as 401(k) plans must set forth the monthly amount that would be payable over the participant's lifetime under a lifetime income stream that is equivalent to the participant's total account balance under the plan. Disclosure is required at least once every 12-month period and must show payments in the form of a single life annuity as well as a qualified joint and survivor annuity, using assumptions specified by the U.S. Secretary of Labor. The secretary would issue a model disclosure and plan sponsors are protected from liability due to the disclosures.

This provision would not be effective until further guidance is issued. The requirement to disclose the lifetime income stream amounts does not require the plan to actually provide a lifetime income investment or distribution option, it is merely to give the participant a better understanding of the value of the benefit. However, if a plan sponsor wishes to add a lifetime income investment option, another SECURE Act provision protects the plan sponsor in that respect as further discussed below.

Reduce Barriers to Adding Lifetime Income Distribution Options to Plans

To encourage all plans to add a guaranteed lifetime income distribution payout, the SECURE Act adds a new fiduciary safe harbor that would protect plan sponsors from liability for selection of an insurance company to provide a guaranteed lifetime income distribution option. Also, if a plan adds a lifetime income investment option and then eliminates it, a participant may transfer the lifetime income investment to another employer plan or an IRA. Distribution would be allowed even if the participant is not otherwise eligible for a distribution.

Extend the Deadline for Employers to Adopt New Retirement Plans

Currently, employers that want to adopt a retirement plan for the taxable year must adopt the plan by the last day of the taxable year, although funding can occur during the following year up to the due date of the employer's tax return. The SECURE Act gives employers more time to make the decision about whether to adopt a plan for the preceding year, up to the due date of the employer's tax return. Certain plan provisions, such as 401(k) provisions allowing deferrals, would still have to be in place

earlier.

Make Other Changes

The SECURE Act also:

- Prohibits credit card loans from retirement plans;
- Increases tax credits for start-up costs for plans of small employers — generally, no more than 100 employees;
- Allows otherwise eligible individuals who are over age 70-1/2 to make contributions to a traditional IRA, as currently allowed for employer-sponsored plans and for Roth IRAs;
- Facilitates termination of 403(b) plans that use custodial accounts over which the employer does not have control;
- Provides nondiscrimination and minimum participation testing relief for certain closed and frozen defined benefit plans;
- Increases penalties for failure to file tax returns and Form 5500 annual reports; and
- Allows 529 plan amounts to be withdrawn tax-free for payment of expenses in apprenticeship programs and to repay qualified student loans.

Senate leaders have indicated that they will act quickly on the comparable RESA legislation, but it remains to be seen how the Senate might reconcile the differences between the SECURE Act and RESA. The Senate could also choose to take up the House version of the SECURE Act.

Some of the SECURE Act provisions that are not in RESA are: The increase in the required beginning date to age 72, withdrawals for birth or adoption, and the participation requirement for long-term, part-time employees. The Senate Finance Committee could consider the legislation as soon as June 3, 2019, upon their return following the Memorial Day break.

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For questions regarding this update, please contact:

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