Client Advisory: The SECURE Act

January 7, 2020

The Setting Every Community Up for Retirement Enhancement Act of 2019 (the "SECURE Act") is the most far reaching new law affecting retirement benefits in more than a decade. This Client Advisory highlights key aspects of the SECURE Act that affect the design and administration of retirement plans, especially 401(k) retirement plans. Overall, the changes in law enacted by the SECURE Act promote access to employer-sponsored retirement benefits, allow employers to enhance retirement savings opportunities for employees, and allow plan participants to preserve and use retirement benefits more effectively after the cessation of employment. The SECURE Act also introduces a number of new legal requirements that apply to retirement plans starting this year. So it is appropriate for employers to start thinking about how to take advantage of the new opportunities, and adapt to the new legal requirements, now.

Encouraging Retirement Savings

Expansion of 401(k) Plan Eligibility for Part-Time Employees. Under current law, employees who are not credited with at least 1,000 hours in a 12-month period may be excluded from participating in a tax-qualified retirement plan. This long-standing rule tends to keep part-time employees, even those who work for an employer year after year, out of employer-sponsored retirement plans. The SECURE Act will require an employer who maintains a 401(k) plan to allow a long-term, part-time employee to make elective deferrals under the 401(k) plan if the employee works for three consecutive 12-month periods and is credited with at least 500 hours of service in each 12-month period. In the case of employees who become eligible for participation solely by reason of this new rule, the plan sponsor: (1) will not be required to make matching or non-elective contributions on behalf of the employees, and (2) may elect to exclude such employees for purposes of nondiscrimination and coverage testing, and in applying the top-heavy rules. Importantly, this new rule does not apply to collectively bargained plans. **(Effective for plan years beginning after December 31, 2020, but service during periods beginning prior to 2021 will not be taken into account.)**

Changes to Non-Elective Safe Harbor Plans. A non-elective safe harbor 401(k) plan is one that provides for a fully vested employer contribution of at least 3% of each participant's compensation regardless of whether the participant makes elective deferrals. The SECURE Act promotes the establishment of non-elective safe harbor plans by relaxing some of the administrative and operational requirements that have applied to safe harbor 401(k) plans in the past. Specifically, **for plan years beginning after December 31, 2019,** the new law:

- Eliminates the advance safe harbor notice requirement for non-elective safe harbor 401(k) plans (The notice requirement continues to apply to 401(k) plans that meet safe harbor requirements through matching contributions.)

- Permits a 401(k) plan to be amended retroactively to become a non-elective safe harbor plan for a plan year if the amendment is adopted before the 30th day before the close of the plan year
- Permits a 401(k) plan to be amended retroactively to become a non-elective safe harbor plan for a plan year (even if the amendment is not made before the 30th day before the close of the plan year) so long as (1) the non-elective contribution is at least 4% of participant compensation, and (2) the amendment is adopted by the last day of the following plan year

Increase to Default Deferral Limit for Qualified Automatic Contribution Arrangements ("QACAs"). Under current law, the default elective deferral rate for safe harbor automatic enrollment 401(k) plans is capped at 10% of pay. The 10% limit also applies to automatic escalations of elective deferrals for employees already participating in the plan. In a bid to increase the rate of retirement savings for employees, the SECURE Act increases the maximum default enrollment and automatic escalation limit to 15% after the first year of an employee's participation in the plan**, effective for plan years beginning after December 31, 2019**. The 10% limit still applies for the first year of an employee's participation through automatic enrollment.

Easing Distribution Requirements and Eliminating Stretch RMDs

Increase in age for required minimum distributions. The SECURE Act increases the age at which required minimum distributions ("RMDs") are generally triggered, from age 70½ to age 72. This welcome change should help make retirement savings last a little longer. The effective date of the new rule requires a bit of explanation. If an individual attains age 70½ in 2019, she will need to take an RMD for 2019 and 2020, even though she may not attain age 72 until 2021. So the first year in which the change in law really has an effect will be 2020, since a retiree who attains age 70½ in 2020 will not be required to begin RMDs in 2021. Employees who continue to work beyond the triggering age will still be able to delay the commencement of RMDs. Plan documents will need to be amended to reflect this change, and plan sponsors and recordkeepers will need to work together to update procedures and communications notifying participants of an upcoming RMD trigger date. **(Effective for distributions beginning after December 31, 2019 with respect to individuals who would attain age 70½ after December 31, 2019.)**

Elimination of Stretch RMDs. The SECURE Act eliminates the ability of a deceased participant's (or IRA owner's) designated beneficiary to extend distributions from a defined contribution retirement plan (or IRA) over her life expectancy ("stretch RMDs"). Instead, it requires that all RMDs paid after the death of a defined contribution plan participant (or IRA owner) to a designated beneficiary must occur by the end of the 10th calendar year following the year of the participant's death. (RMDs to nondesignated beneficiaries must be completed by the end of the 5th calendar year following the participant's death.) There is an exception to the 10-year distribution rule for surviving spouses, minor children (until reaching the age of majority), the chronically ill, and any beneficiary not more than 10 years younger than the decedent. If the terms of an employer's defined contribution retirement plan permit stretch RMDs, a plan amendment will be required. **(Generally effective for the accounts of participants who die after December 31, 2019.)**

Decrease in age for in-service distributions under pension plans. The spending bill adopted by Congress just before the end of the year included a change that may have been intended for inclusion in the SECURE Act. Specifically, the new law reduces the minimum age for in-service distributions under defined benefit pension plans and money purchase pension plans, from 62 to 59½. This aligns the pension plan rule with the long-standing age threshold for comparable in-service distributions from 401(k) plans. **(Effective for plan years beginning after December 31, 2019.)**

Distributions upon the birth or adoption of a child. The SECURE Act creates a new opportunity for participants to withdraw up to $5,000 penalty-free for expenses relating to the birth or adoption of a child. This new form of distribution will be available from any type of defined contribution plan (including a 403(b) plan) and an IRA. What's more, a participant who receives such a distribution will be permitted to repay it, in which case the repayment would be treated like a rollover. Plan administrators will need to develop a way of identifying which distributions qualify as birth or adoption distributions, even if the plan does not offer such distributions during employment, because a regular distribution (for example, after severance from employment) may qualify as a birth or adoption distribution and would have to be treated differently for purposes of withholding and rollover rights. **(Effective for distributions beginning after December 31, 2019.)**

Promoting Lifetime Income Features in Retirement Plans

New lifetime income disclosure requirements. The SECURE Act requires defined contribution plans to provide an annual benefit statement to participants that includes a new lifetime income disclosure. The lifetime income disclosure must describe the monthly lifetime payments that the participant would receive if her account balance under the plan were paid in the form of an annuity. The new law directs the Department of Labor ("DOL") to publish a model notice that can be used to provide the required lifetime income disclosure, along with implementing regulations. The SECURE Act also limits the liability of employers and plan fiduciaries for any potential flaws in the disclosure – such as monthly payments that fall short of the projection contained in the disclosure – so long as the disclosures are made in accordance with the assumptions developed by the DOL and include the content required by the model notice. **(Effective for benefit statements furnished more than one year after all applicable DOL guidance is issued.)**

Fiduciary safe harbor for selecting an annuity provider. To encourage employers to add lifetime income (i.e., annuity) options to their defined contribution retirement plans, or at least remove a perceived impediment to the inclusion of such options, the SECURE Act provides a measure of protection for plan fiduciaries responsible for the selection of annuity providers. Specifically, a new statutory safe harbor will protect fiduciaries from liability if the insurer of an annuity contract is unable to fulfill its obligation to provide guaranteed retirement income under the contract. In order to qualify for the safe harbor, fiduciaries engaged in the selection of annuity providers must adhere to the detailed selection process described in the SECURE Act. **(Effective immediately as of the date of enactment.)**

Portability of lifetime income products. The SECURE Act facilitates the portability of lifetime income products held in retirement plans by allowing plan participants to take a distribution of a "lifetime income investment" prior to the occurrence of a distributable event (such as death, disability, attainment of age 59½, or termination of employment) under certain circumstances. Such a distribution would be allowed only if (1) the lifetime income investment is no longer available under the plan, and (2) the distribution is made either by direct rollover to an IRA, direct rollover to another retirement plan, or by a distribution of an annuity contract. **(Effective for plan years beginning after December 31, 2019.)**

Promoting the Establishment of Retirement Plans by Small Businesses

Start-up credit. Under current law, employers with up to 100 employees are entitled to an annual tax credit for three years equal to 50% of the costs of starting up and administering a retirement plan, up to a cap on the annual credit of $500. The SECURE Act increases the credit to the greater of (1) $500 or (2) the lesser of (a) $5,000 and (b) $250 multiplied by the number of non-highly compensated employees eligible to participate in the plan. **(Effective for taxable years beginning after December 31, 2019.)**

New automatic enrollment credit. Small employers that adopt automatic enrollment provisions are eligible for an additional $500 credit for three years, regardless of whether the automatic enrollment provisions are adopted when the plan is first effective or the provisions are adopted later. **(Effective for taxable years beginning after December 31, 2019.)**

Expansion of Open MEPs (and relief from "one bad apple" rule). The SECURE Act seeks to expand access to retirement plans by creating a new kind of open multiple employer defined contribution plan ("open MEP") that would be available to unrelated employers. "Pooled employer plans" will allow completely unrelated employers who would otherwise fail to meet the commonality requirements of ERISA to enjoy the cost savings and administrative advantages of an open MEP. Importantly, the new law also eliminates the rule under which the violation of tax qualification requirements by one employer in a MEP could disqualify the entire MEP. The elimination of the "one bad apple" rule should increase participation in open MEPs by small employers.

In order to ease the administrative requirements that apply to MEPs, the SECURE Act authorizes the DOL to permit simplified Form 5500 reporting for MEPs that cover fewer than 1,000 participants, so long as no single employer has 100 or more participants covered by the plan.

(Effective for taxable years beginning after December 31, 2020.)

Facilitating Plan Administration

Initial adoption of a plan. Under current law, an employer must adopt a retirement plan by the end of the employer's taxable year in order for the plan to be effective for that year. The SECURE Act encourages the adoption of new retirement plans by allowing an employer to adopt a new retirement plan for a taxable year as late as the due date for filing of its tax return for that year. **(Effective for taxable years beginning after December 31, 2019.)**

Nondiscrimination testing relief for "soft frozen" defined benefit plans. Many employers that have closed their defined benefit plans to new hires through a "soft freeze" – but allow existing participants to continue to accrue benefits – ultimately decide to freeze their plans completely because the grandfathered group of employees still accruing benefits under the plan becomes too small to meet the minimum participation requirements or becomes too disproportionately highly paid to meet applicable nondiscrimination requirements. The SECURE Act seeks to prevent such complete plan freezes in the future by providing relief from the nondiscrimination requirements that would otherwise apply to the group of employees who continue to accrue benefits, so long as the nondiscrimination requirements were met in the year of the freeze and the two following years. Similar relief would apply to defined contribution plans that provide make-whole contributions or special features for participants who had benefited under a defined benefit plan that has been frozen, which is a strategy commonly applied by employers who wish to freeze a defined benefit pension plan. **(Effective immediately, as of the date of enactment, but an employer may elect to apply the rules to any plan years beginning after December 31, 2013.)**

Termination of a 403(b) custodial account. The SECURE Act directs the Department of Treasury to issue guidance confirming that an employer who wishes to terminate a section 403(b) custodial account may accomplish that goal through the distribution of individual custodial accounts in kind to a participant or beneficiary. The individual custodial account may be maintained on a tax-deferred basis as a 403(b) custodial account until paid out, subject to the section 403(b) rules in effect at the time that the individual custodial account is distributed. **(Expected to be effective retroactively for taxable years beginning after 2008, corresponding to the effective date of the Final Regulations under Code Section 403(b).)**

Other Changes

Increased penalties for failure to file retirement plan annual reports and information returns. The SECURE Act includes a number of revenue raising provisions. The following measures, **all of which take effect as of January 1, 2020**, affect the administration of retirement plans:

- **Form 5500.** A failure to file Form 5500 will result in a penalty of $250 (up from $25) for each day during which the failure continues, but the total amount imposed on any person for failure to file any return will not exceed $150,000 (up from $15,000).

- **Annual registration statement and notification of changes.** A failure to file a registration statement regarding deferred vested participants generally will now result in a penalty of $10 (up from $1) for each participant with respect to whom the failure applies, multiplied by the number of days during which the failure continues, subject to a maximum penalty of $50,000 (up from $5,000) for a failure with respect to any plan year. A failure to file a required notification of certain changes in registration information will result in a penalty of $10 (up from $1) for each day during which the failure continues, subject to a maximum penalty of $10,000 (up from $1,000) for any failure.

- **Withholding notices.** A failure to provide a required withholding notice will now result in a penalty of $100 (up from $10) for each failure, subject to a maximum penalty of $50,000 (up from $5,000) for all failures during any calendar year.

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