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President Signs Spending Legislation, Including SECURE Act

On December 20, 2019, President Trump signed appropriations legislation that included the Setting Every Community Up for Retirement Enhancement (SECURE) Act. Highlights of the new SECURE legislation include:

- A DC annuity fiduciary safe harbor
- Mandatory lifetime income disclosure
- Closed group nondiscrimination relief
- Authorization of DC Open MEPs
- Required coverage of long-term part-time employees
- Increased cap on the automatic escalation of contributions in 401(k) testing safe harbor
- Increased mandatory distribution age from 70½ to 72

In what follows we provide more detail on these and other significant SECURE Act provisions.

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Provide DC Annuity Safe Harbor

As a general matter, many DC plan sponsors have been reluctant to add an annuity option because of possible fiduciary liability—perhaps years after the selection of the annuity carrier—based on a claim that the fiduciary should have known that the carrier was not "financially capable of satisfying its obligations."

In 2008 the Department of Labor (DOL) finalized a regulation providing a safe harbor for the purchase of annuities in a DC plan. While that rule improved on DOL's "safest available annuity" standard, it still imposed significant duties on plan fiduciaries, including that the fiduciary appropriately conclude that "at the time of the selection, the annuity provider is financially able to make all future payments under the annuity contract and the cost of the annuity contract is reasonable in relation to the benefits and services to be provided under the contract."

In the view of many plan sponsors, this regulation did not solve the problem of fiduciary risk, and most 401(k) plans still do not offer in-plan annuities.

SECURE addresses this issue by, generally, deferring to state insurance regulation on the issue of the financial condition of the annuity carrier. Under SECURE, a fiduciary would be deemed to satisfy the "financially capable" requirement if it obtains certain representations from the insurer (e.g., that it is appropriately licensed and has complied with certain state regulatory requirements). The insurer must notify the fiduciary of any relevant change in circumstance, and the fiduciary cannot be aware of other facts that would cause it to question the insurer representations.

(Effective as of date of enactment.)

Require Mandatory Lifetime Income Disclosure

SECURE requires DC plan administrators to annually provide participants a description of the monthly "income stream" they would receive if their account balance were paid in the form of a single life annuity and joint and surviving spouse annuity, based on assumptions specified in DOL guidance. DOL is instructed to issue model disclosures.

SECURE provides that plan fiduciaries shall not be liable "solely by reason of the provision of lifetime income stream equivalents" derived from DOL prescribed assumptions and rules.

Provide Closed Group Nondiscrimination Relief

"Closed groups", e.g., a limited group of participants who get grandfathered benefits under a DB plan or make-up benefits under a DC plan, present several problems under Internal Revenue Code nondiscrimination rules. Very briefly (and oversimplifying a lot): while a closed group may be nondiscriminatory when it is "closed," as some participants remaining in the group are promoted and get pay increases, and younger, lower-paid, non-closed group members join the plan, the closed group may over time become discriminatory. IRS has provided temporary relief with respect to this issue, but not an adequate permanent solution.

To address this issue, SECURE provides that DB plans may be aggregated with DC plans and tested on a benefit accruals basis, without having to satisfy (burdensome) threshold conditions (sometimes referred to as gateways) if:

- For the year the class closed and the two preceding years the plan satisfied the nondiscrimination requirements.
- Either the class was closed before April 5, 2017, or the plan has been in effect for at least five years before the class is closed and, during that five-year period, there has not been a substantial increase in the coverage or the benefits or other rights or features under the plan, other than in connection with certain transactions.
- After the class was closed, either no discriminatory amendment is adopted to modify the class or the benefit accruals or benefits, rights, and features for the closed class, or the nondiscrimination requirements are otherwise met.

Similar relief is provided for closed groups receiving make-up benefits in DC plans.

In addition, a plan that meets these requirements would be deemed to satisfy the minimum participation requirements (the "50 employee" rule under Internal Revenue Code section 401(a)(26)) – another problem closed groups present.

(Effective as of date of enactment; retroactively under certain circumstances.)

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Authorize DC Open MEPs

By way of background, an MEP is a multiple employer plan, defined as a plan for (non-union) employees of unrelated employers. An "Open MEP" would, generally, be a provider-based multiple employer plan in which the participating employers do not have any special relationship with each other or with the provider.

Open MEPs are effectively prohibited under a current DOL rule that requires that employers participating in a MEP have a "commonality of interest" (and meet certain other requirements) and generally prohibits financial services firms, record keepers and third-party administrators from operating MEPs. SECURE would allow defined contribution plan Open MEPs ("Pooled Employer Plans") that meet certain requirements and that are provided by a "Pooled Plan Provider."

The MEP must, among other things, state that each participating employer retains fiduciary responsibility for the selection and monitoring of the Pooled Plan Provider and the investment and management of that employer's share of the plan's assets (to the extent not otherwise delegated to another fiduciary by the Pooled Plan Provider and subject to ERISA section 404(c)).

Require Coverage of Long-term Part-time Employees

SECURE generally requires sponsors of 401(k) plans to cover employees working more than 500 but fewer than 1,000 hours per year for three consecutive years. Internal Revenue Code nondiscrimination and top-heavy rules would, however, generally not apply to these employees, and the rule would generally not cover collectively bargained employees.

Increase the Safe Harbor Auto-escalation Cap

Under the current automatic escalation 401(k) nondiscrimination testing safe harbor, escalation is capped at 10% of pay. SECURE increases this cap to 15%.

Increase the Mandatory Distribution age to 72

Internal Revenue Code section 401(a)(9) generally requires that distributions under a qualified plan begin as of the later of age 70½ or when a participant retires. SECURE increases the Code's "required beginning date" to age 72, effective in 2020.

In Other Retirement-related Provisions, SECURE:

- Adds an exception to the (10%) early distribution tax rules, limited to $5,000, for distributions made during the year after a child is born to or adopted by the taxpayer receiving the distribution.
- Eliminates certain notice requirements with respect to nonelective contributions under 401(k) safe harbors and, in limited circumstances, extends the time for the election of the 401(k) design-based safe harbors.
- Increases the plan startup tax credit for small employers from $500 to $5,000.
- Provides a new small employer plan automatic enrollment credit of $500 per year for three years beginning with the year the automatic enrollment provision is included in the plan.
- Generally prohibits credit card loans. (Effective as of date of enactment.)
- Allows the distribution of certain annuity contracts, generally when the annuity is "no longer authorized to be held as an investment option" under the plan.
- Allows adoption of certain qualified retirement plans after year-end but before the tax return due date.
- Instructs DOL and Treasury to modify annual report (Form 5500) rules to allow (subject to certain conditions) a group of DC plans sponsored by unrelated employers to file a single aggregated annual report.

- Eliminates certain "stretch" payments to beneficiaries under DC plans, generally requiring payment over 10 years after the participant's death, with exceptions for the participant's surviving spouse and (minor) children, disabled or chronically ill individuals, and individuals not more than 10 years younger than the participant.
- Increases the Form 5500 late filing penalty from $25 per day, not to exceed $15,000, to $250 per day, not to exceed $150,000.

Finally, not part of SECURE but part of the overall spending package, the legislation will allow in-service distribution from a defined benefit plan beginning at age 59½ (the current rule is age 62).

Except where noted above, these changes are generally effective beginning in 2020.

With a limited number of exceptions, the provisions of SECURE are regarded as a significant improvement in current retirement plan policy. The 2020 effective date will, however, in many cases present challenges for both providers and sponsors, and we expect significant regulatory work in connection with the new legislation.

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