Benefits Brief

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SECURE Act – Impact on 401(k) Plan Sponsors

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The Setting Every Community Up for Retirement Enhancement Act of 2019 (the "SECURE Act"), the largest package of retirement system reforms in over a decade, was enacted on December 20, 2019. Many of the provisions in the SECURE Act are effective on January 1, 2020, and require significant changes to 401(k) plan design and operations. The SECURE Act was part of the Further Consolidated Appropriations Act of 2020 (the "Act"), which also included disaster relief for 401(k) plan sponsors. Below, we summarize the 401(k) plan changes that need to be put into operations as soon as effective. Importantly, there is special anti-cutback and plan amendment relief, so no plan amendment is needed until at least the end of the 2022 plan year.

1. Part-time Employee Participation for 401(k) Plans (Div. O, Section 112) (Mandatory, 2021 Change)

Old Rule: Part-time employees can be excluded from a plan, provided that they do not reach 1,000 hours in any 12-month eligibility computation period.

New Rule: Long-term part-time employees must be eligible to contribute to a 401(k) plan once they have (i) reached age 21, and (ii) worked at least 500 hours in three consecutive 12-month periods. For vesting service, a year of service is a 12-month period during which the part-time employee earned at least 500 hours of service. There is nondiscrimination and top-heavy plan relief, and no requirement to provide any match or profit sharing contribution to these workers. Notably, this rule does not extend to collectively bargained employees.

Effective Date: Plan years beginning after December 31, 2020. Service during periods beginning before 2021 are not taken into account.

Next Steps: Starting with the 2021 Plan Year, 401(k) plan sponsors will need to track hours of service performed by part-time employees for eligibility and vesting purposes under a special rule, and will be required to permit certain part-time employees to make elective deferrals in a 401(k) Plan beginning in the 2024 Plan Year. Therefore, we recommend reviewing your plan provision regarding the treatment of any excluded classifications and to the extent that there is a service-

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based exclusion (part-time workers, seasonal employees, etc.), these workers may be eligible to make 401(k)/Roth/catch-up deferrals on the same basis as other employees beginning in the 2024 Plan Year.

2. Safe Harbor 401(k)/(m) Plans (Div. O, Sections 102 and 103) (Optional, 2020 Change)

   a. Qualified Automatic Contribution Arrangement ("QACA") Increase in Maximum Automatic Deferral Rate

      Old Rule: A QACA is a form of plan that has an automatic enrollment feature and provides nondiscrimination testing relief under Code section 401(k) and 401(m). QACAs have strict compliance requirements, with one of the requirements being that the maximum automatic deferral rate for a participant is 10% of compensation.

      New Rule: The new limit is generally 15% of compensation except for the participant's first year, which remains 10%. The minimum thresholds of 3% to 6% (depending on the participation year) are unchanged.

      Effective Date: Plan years beginning after December 31, 2019.

      Next Steps: Plan sponsors that have an existing QACA that are interested in encouraging participants to save more for retirement should consider implementing this change (understanding first the additional cost of any matching contribution and impact on other employer contributions). Such a change will impact a variety of provisions including enrollment procedures and participant safe harbor notices, processes for changing deferral elections, plan documents, SPDs, and participant communications. The IRS has provided relief for various mid-year changes, but Notice 2016-16 did not contemplate this change in law, so although the provision is available for 2020 Plan Years, careful consideration should be given to adopting the change mid-year. Sponsors should also confirm with their service provider that plan operations can support the new approach. Plan sponsors that do not have a safe harbor plan, or have a traditional safe harbor plan, may want to give QACAs a fresh look.

   b. Expanded, Relaxed Nonelective Employer Contribution Safe Harbor Plans

      Old Rule: The existing rules require that an annual safe harbor plan notice be provided for a QACA or a traditional 401(k) safe harbor plan (regardless of match or nonelective employer safe harbor contribution). Moreover, there is a special rule that permits a plan sponsor to adopt a safe harbor with a nonelective employer contribution by the 30th day before the close of the plan year if specific contingent and follow-up notices are provided and certain other parameters are met.

      New Rule: A plan sponsor can adopt a nonelective employer contribution safe harbor plan (QACA or traditional) with no participant notice requirement (unlike a safe harbor using a matching contribution). Also, this safe harbor can be adopted via a plan amendment (1) by the 30th day before the close of the plan year, or (2) if at least a 4% nonelective employer

contribution is made for the plan year, before the last day for distributing excess contributions for the plan year (i.e., generally the close of the following plan year).

Effective Date: Plan years beginning after December 31, 2019.

Next Steps: For plan sponsors with a nonelective employer contribution safe harbor plan, there is no longer an annual safe harbor notice requirement to provide to participants, and operational procedures can be updated accordingly. For plan sponsors that are considering a safe harbor plan, this safe harbor may be worth a closer look, particularly as it can be adopted retroactively in the event that ADP/ACP testing failures arise. Adopting the safe harbor retroactively would eliminate a testing failure, but at a cost of the 3% or 4% employer contribution.

3. In-service Withdrawal Option for Birth and Adoption Expenses (Div. O, Section 113) (Mainly Optional, 2020 Change)

Old Rule: There is no special relief for plan distributions for birth or adoption expenses incurred within a year following birth or legal adoption.

New Rule: Withdrawals of up to $5,000 are permissible within one year following the birth or legal adoption of a child, and not subject to the 10% early withdrawal tax. (The distribution is permissible if it does not exceed $5,000 to an individual from all plans within the controlled group.) These amounts must also be able to be recontributed back to a plan (or can be transferred to an IRA). Notably, similar to hardship withdrawals, they are treated as not eligible for rollover, and not subject to mandatory 20% withholding. Instead, a 10% withholding rate applies, unless the participant elects out.

Effective Date: Distributions after December 31, 2019.

Next Steps: Plan sponsors can elect to add a new in-service withdrawal feature to their plans to help with child and adoption expenses. The details on this new option still need to be worked out by the IRS, such as whether documentation or representations will be required. Like certain disaster payments, there is a special recontribution right that needs clarification from the IRS. Even if a plan sponsor does not elect to add this feature, a participant may be eligible for the 10% early withdrawal tax relief for an otherwise available in-service withdrawal. This change has a number of operational implications, including updating distribution forms (including 402(f) rollover notices), plan documents, SPDs, participant communications, Form 1099-R reporting and withholding processes, and rollover processes.

4. Lifetime Minimum Required Distributions ("MRD") Delayed (Div. O, Section 114) (Mandatory, 2020 Change)

Old Rule: Distribution from an eligible employer plan must be made by April 1 of the calendar year following the year in which the employee turns age 70-1/2 (or retires, if later and not a 5% owner).

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New Rule: Age 70-1/2 is replaced with age 72.

Effective Date: This change applies to employees who turn age 70-1/2 after December 31, 2019 (born after June 30, 1949); the old rule continues for employees that already reached age 70-1/2 prior to January 1, 2020.

Next Steps: Plan sponsors should review their MRD processes and procedures and discuss the same with their service providers to ensure compliance – which will now require tracking two separate rules. This change will require modifications to distribution forms, plan documents, SPDs, participant communications, 402(f) notices, etc.

5. Post-Death Minimum Required Distributions Accelerated (Div. O, Section 401) (Mandatory, 2020 Change)

Old Rule: Distributions must be paid out following the death of the participant in accordance with the Plan terms, but no later than when mandated by Code section 401(a)(9). The rules vary if the participant dies before or after they reached their required beginning date; in general, the rules permit distributions to be paid over the beneficiary's life expectancy.

New Rule: Distributions after death of the participant generally must be made by the end of the tenth calendar year following the year of death. However, payments can be made over the beneficiary's life expectancy if the beneficiary is (1) a surviving spouse, (2) a disabled or chronically ill individual (or certain trusts for the same), (3) a beneficiary no more than ten years younger than the participant, or (4) a minor child of the participant (generally until the child reaches majority). Non-designated beneficiaries are still subject to the prior rules (*e.g.*, 5 year rule).

Effective Date: Deaths after December 31, 2019. Special rules apply for beneficiaries where the employee died prior to January 1, 2020. There are also special delayed effective dates for collectively bargained and governmental plans, and special grandfather relief for certain commercial annuities.

Next Steps: Plan sponsors should review their Plan terms and their MRD processes and procedures for compliance with these new rules. We anticipate guidance from the IRS due to the complexities of these rules, which we expect will clarify how the changes impact the existing regulations (e.g., the impact on the look-through trust rules, the application of the "at least as rapidly" rule, etc.). This change will likely need to be reflected in various places, including beneficiary designation forms, distribution forms and notices, plan documents, SPDs, and various participant/beneficiary communications.

6. Lifetime Income Disclosures and Investment Options (Div. O)

a. Lifetime Income Disclosures (Section 203) (Mandatory, 2022 Change)

Old Rule: Section 105(a)(2) of ERISA establishes disclosure requirements for employee benefit plan statements provided to participants in defined contribution retirement plans, such as the participant's account balance and the value of each investment option held in the account.

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New Rule: The SECURE Act amends section 105(a)(2) to require that a defined contribution plan statement include, at least once during a twelve-month period, a lifetime income disclosure that that sets forth the "lifetime income stream equivalent" of the participant's account balance.

Effective Date: The requirement becomes effective 12 months after the later of the Department of Labor's ("DOL") issuance of (i) interim final rules implementing the lifetime income provisions, (ii) model disclosures, and (iii) the assumptions plans should use in converting the participant's account balance to a lifetime income stream. The SECURE Act directs the DOL to issue such guidance by December 20, 2020.

Next Steps/Implications: Many plan sponsors will rely upon plan recordkeepers and third party administrators to change the statements those service providers currently send to plan participants. Sponsors should work with their service providers to determine when and how service providers intend to implement the lifetime income disclosure requirements. Practically speaking, such implementation will not begin to occur until the DOL issues the above-described guidance.

b. Fiduciary Safe Harbor for Selection of Lifetime Income Provider (Section 204) (Optional, 2020 Change)

Old Rule: In 2008, the DOL issued 29 C.F.R. § 404a-4, which provides a safe harbor ("Annuity Selection Safe Harbor") for the selection of an annuity provider and contract in connection with annuity distributions from defined contribution plans.

New Rule: The SECURE Act provides for a specific safe harbor applicable to the selection of an insurance company that issues a "guaranteed income contract" made available under a defined contribution plan.

Effective Date: The safe harbor was effective upon the SECURE Act's enactment, December 20, 2019.

Next Steps/Implications: Some plan sponsors have expressed interest in adding lifetime income features to defined contribution plans. Sometimes insurance companies guarantee the lifetime income streams. Plan fiduciaries have been concerned with the difficulty in applying the Annuity Selection Safe Harbor and other DOL guidance when evaluating an insurance company that guarantees lifetime income streams. The SECURE Act provides a specific safe harbor applicable to such products. The safe harbor is much easier to apply than the Annuity Selection Safe Harbor. For example, the financial wherewithal of the insurance company need only be evaluated by the plan's named fiduciary at the time of selection and the fiduciary may accept representations from the insurance company about its financial wherewithal to pay claims rather than engage in a complex due diligence examination. In light of the new safe harbor, plan sponsors should consider whether now is the time to add lifetime income features to their plans.

c. Portability of Lifetime Income Options (Section 109) (Optional, 2020 Change)

Old Rule: Code sections 401(a), 401(k)(2)(B), 403(b)(11), 403(b)(7)(A), and 457(d)(1)(A) provide restrictions on when a distribution may be made from tax-qualified plans, like 401(k) plans, as well as 403(b) plans and 457 plans.

New Rule: The SECURE Act amends the above Code sections, except as otherwise provided by regulations, to allow for the distribution of a "lifetime income investment" that is a "qualified distribution" or the distribution of a "lifetime income investment" in the form of a "qualified plan distribution annuity contract." The distribution event is tied to when the distribution option ceases to be made available under the plan rather than other distribution events found in the Code, such as severance from employment.

Effective Date: The amendments to these Code sections become effective in plan years beginning after December 31, 2019.

Next Steps: Congress amended the Code to address concerns that lifetime investment options lacked portability because of certain features such options sometimes have, e.g., surrender charges. Effective immediately, plans with lifetime income investment options presumably may be amended to include the additional distribution provisions. Affected plan sponsors should consider making such amendments.

7. Expanded Disaster Relief (Div. Q, Sections 202-205) (Optional, 2018-2020 Changes)

Old Rule: There is statutory relief for certain listed hurricanes and other nationally declared disasters, along with a new 401(k) hardship distribution provision.

New Rule: For nationally declared disasters from January 1, 2018 through 60 days following enactment (Feb. 18, 2020), other than California wildfires that already have relief, impacted participants can take up to a $100,000 distribution or a loan (with no 10% early withdrawal tax), which can be recontributed within three years. The key features of this relief include: (1) an extended plan loan payoff for an additional year, (2) repayment of hardship withdrawals for home purchases in the disaster area, and (3) a three-year spread of taxation of a qualified disaster distribution.

Effective Date: On enactment. Participants generally have 180 days from enactment to take advantage of the relief (June 17, 2020). Special plan amendments must be adopted by the end of the 2020 plan year (2022 for governmental plans), unless otherwise extended.

Next Steps: Plan sponsors in impacted areas should consider whether to offer this additional disaster relief, which the process steps should largely track the steps taken for similar hurricane relief in the past (e.g., Maria, Harvey, Irma). This includes special distribution packages,

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updated rollover processes, updated loan processes, updated Form 1099-R reporting processes, revised SPDs, and plan amendments.

8. Form 5500 Changes and Increased Penalties (Div. O, Section 403)

a. Form 5500 and Form 8955-SSA Penalty Changes (Mandatory, 2020 Change)

Current Rule: ERISA requires 401(k) plans to file an annual Form 5500 with the federal government each year. Similarly, the Code imposes its own requirement to file an annual return. ERISA-covered retirement plans satisfy both ERISA and the Code by filing the Form 5500 each year with the DOL. Plan administrators who fail to file the required report when due can be subject to significant monetary civil penalties under both ERISA and the Code. Currently, civil penalties under ERISA can amount to as much as $2,200 per day in connection failing to file an annual Form 5500 when due. Under the Code, separate penalties in connection with filing failures can amount to $25 per day, up to a maximum of $15,000.

Under section 6057 of the Code, qualified retirement plans are required to submit a registration statement to the IRS providing the IRS and Social Security Administration with information regarding terminated vested participants, and certain updates to that information over time. IRS Form 8955-SSA is used to satisfy these requirements. Under the Code, penalties in connection with failing to file the initial statement for any participant when due can amount to $1 per participant, per day, up to $5000. A similar penalty applies to any failure to provide updates regarding changes in the status of terminated vested participants, of $1 per participant per day, up to a maximum of $1000.

New Rule: The SECURE Act increases by ten-fold the Code's penalties in connection with failing to file an annual report for a 401(k) plan. Under the new law, penalties imposed under the Code in connection with failing to file an annual report can amount to $250 per day, up to a maximum of $150,000 per annual report. The separate civil penalty imposed under ERISA in connection with failing to file a Form 5500 has not changed. (We note that the ERISA civil penalty for Form 5500 failures increases every year under the Federal Civil Penalties Inflation Adjustment Act, enacted in 2015.)

Additionally, the penalty for failing to file a Form 8955-SSA when due in the case of a terminated vested participant has also been increased by a factor of ten. The new penalty for failing to file an initial registration statement amounts to $10 per participant, per day, up to a maximum of $50,000. Failing to file an update can result in a penalty of $10 per day, per participant, up to a maximum of $10,000.

Effective Date: The increased penalty amounts apply to returns and statements required to be filed after December 31, 2019.

Next Steps and Implications: Plan sponsors should keep in mind that failures to satisfy annual reporting requirements for retirement plans carry the potential for substantial monetary penalties under both ERISA and the Code and therefore compliance is paramount, and

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corrective programs should be considered in the event of a failure. In our experience, the DOL maintains a significantly more vigorous program for the enforcement of civil penalties in connection with Form 5500 violations; however, we have seen the IRS seek to enforce penalties under the Code in connection with the Form 5500 to a more limited extent.

b. Consolidated Form 5500 Reporting (Optional, 2022 Change)

Old Rule: Under current law, each ERISA-covered retirement plan is subject to its own requirement to file an annual Form 5500.

New Rule: The SECURE Act directs the agencies responsible for the Form 5500 to modify the Form 5500 rules and instructions to permit multiple defined contribution plans in a related "group" of plans to file a single, consolidated Form 5500 for all plans in the related group. Plans that are deemed "related" for purposes of consolidated Form 5500 reporting include those defined contribution plans that share the same (1) trustee, (2) plan administrator, (3) plan year, and (4) investments or investment options. Interestingly, the law does not specifically require the plan sponsors to be related or affiliated in order to take advantage of this rule.

Effective Date: Consolidated reporting is required to be available for plan years beginning in 2022.

Next Steps and Implications: The legislative history related to this change suggests that Congress intended this rule to apply in the context of unrelated employers that each adopt virtually identical plans, using a common administrator, trustee and investments. This rule should also apply where multiple plans of employers within a controlled group use a master trust to give several plans access to the same investments. In this regard, we are seeing more and more large plan sponsors offer multiple defined contribution plans that give participants access to the same investment options through a master trust in order to take advantage of lower service and investment costs. This rule could ease the administrative burdens associated with completing the Form 5500, depending on the rules ultimately developed by the agencies.

Note that the SECURE Act does not change the rules that require each plan to receive its own separate audit for Form 5500 purposes. Audits are an important driver of Form 5500 compliance costs.

9. Additional Miscellaneous Changes

Other rules that impact 401(k) plan sponsors that are also effective in 2020 include: (1) expanded non-refundable tax credits for small employers that establish plans or add an eligible automatic contribution arrangement, (2) an increase in the penalty for failure to provide the proper withholding notice for plan distributions under Code section 3405, (3) a special provision to count certain non-taxable foster care payments (so-called "difficulty of care" payments) as eligible 415 compensation, (4) a prohibition on the use of credit cards for plan loans, and (5) an extended period of time through the employer's tax filing deadline to establish a new plan (other than 401(k) deferrals).

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There are a number of other provisions in the SECURE Act that could impact retirement plan and product development. For example, the SECURE Act creates Pooled Employer Plans to allow employers to participate in "open" multiple employer plans. This issue and more are discussed in detail in other Groom releases and webinars. More information is available at the Groom SECURE Act Resource Library.