SECURE Act Requires Immediate Action by Plan Service Providers

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Congress recently passed 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. Many of the provisions in the SECURE Act are effective on January 1, 2020, and will require significant changes to plan administration and recordkeeping.[1] Below, we discuss the ten most pressing implementation issues.

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

Current 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).

New Rule: Age 70-1/2 is replaced with age 72. Notably, for employees working past age 70-1/2, there was no change to the required actuarial adjustment for defined benefit plans (which was intentional).

Effective Date: This change applies to employees who turn age 70-1/2 after December 31, 2019; the old rule continues for employees that have already reached age 70-1/2 prior to such date.

Next Steps: This change has a number of implications depending on the plan type, including requiring changes to distribution forms, plan documents, SPDs, participant communications, 402(f) notices, and MRD processes.

[1] Some provisions of the SECURE Act may require a plan amendment. To retain anti-cutback protections and a delayed effective date for adopting plan amendments (generally until at least 2022), plans should be in operational compliance as of January 1, 2020.

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

Current Rule: Distributions must be paid out following the death of the participant. The rules vary if the participant dies before or after they reached their required beginning date, and in general the rules permit distributions to be paid over the beneficiary's life expectancy.

New Rule: For defined contribution plans and IRAs, 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 grandfathered relief for certain commercial annuities.

Next Steps: This change has a number of implications, including requiring changes to beneficiary designation forms, distribution forms, plan documents, SPDs, participant communications, and MRD processes.

3. Safe harbor 401(k) Plan (Div. O, Sections 102 and 103) (Optional)

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

Current Rule: The current limit on the maximum automatic deferral rate for a QACA is 10%.

New Rule: The new limit is generally 15% 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: This change has a number of implications, including enrollment procedures and participant notices, related increases in employer matching contributions, processes for changing deferral elections, plan documents, SPDs, and participant communications. Additional guidance will be needed on mid-year changes and the application of the uniformity requirement.

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B. Expanded, Relaxed Nonelective Employer Contribution Safe Harbor Plans

Current Rule: The current 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 non-elective 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 (e.g. the close of the following plan year).

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

Next Steps: This change has a number of implications, including requiring revisions to the safe harbor policies and procedures, participant notices, plan documents, SPDs, and other participant communications, and providing flexibility for plan sponsors to address testing issues.

4. Expanded Small Employer Plan Tax Credits (Div. O, Sections 104-105) (Optional)

Current Rule: Small employers that sponsor an eligible employer plan are eligible for a non-refundable tax credit of up to $500 per year (for three years) for qualified start-up costs.

New Rule: The existing credit is increased to up to $5,000 per year for three years. There is also a new credit (up to $500 per year for three years) for adding an eligible automatic contribution agreement (EACA) to a new or existing plan. An eligible employer is one that meets the requirements to adopt a Simple IRA.

Effective Date: Effective for taxable years beginning after December 31, 2019.

Next Steps: Service providers in the small market can consider providing educational information on these credits to new and existing clients, including how their products take full advantage of these credits.

5. Nondiscrimination, Coverage and Minimum Participation Relief (Div. O, Section 205) (Optional)

Current Rule: In December 2013, the IRS issued limited, temporary relief for closed plans to satisfy the nondiscrimination rules. This relief has been reissued each year since then and current extends through 2020.

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New Rule: The SECURE Act provides expanded relief – discussed in more detail in here – for certain closed and frozen defined benefit plans and includes Code sections 401(a)(4), 410(b), and 401(a)(26) relief if specific requirements are met.

Next Steps: It is important to incorporate this new relief into the plan's testing processes and procedures, and consider the impact on pending corrections, and any future plan design changes.

6. Expanded Disaster Relief (Div. Q, Sections 202-205) (Optional)

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

New Rule: For nationally declared disasters from January 1, 2018 through 60-days following enactment (*e.g.*, 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. There is also, among other relief, the following: (1) an extended plan loan payoff for an additional year, (2) participants can repay 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: Review the process steps taken for previous hurricanes (e.g., Maria, Harvey, Irma) and adapt them for this new relief, including special employer election forms, distribution packages, rollover processes, loan processes, 1099-R reporting, SPDs, and plan amendments.

7. New in-service withdrawal right for Child Birth and Adoption Expenses (Div. O, Section 113) (Optional)

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

New Rule: For defined contribution plans (and IRAs), withdrawals of up to $5,000 for eligible child care and adoption expenses are permissible and not subject to the 10% early withdrawal tax. These amounts may also be recontributed back to a plan (or IRA). Notably, similar to hardship withdrawals, they are treated as not eligible for rollover, and not subject to mandatory 20% withholding (rather 10% withholding applies, unless electing out).

Effective Date: Distributions after December 31, 2019.

Next Steps: This change has a number of implications, including potential impacts on existing plan distributions, distribution forms, plan documents, SPDs, participant communications, Form 1099-R reporting and withholding processes, 402(f) notices, and rollover processes.

8. In-service withdrawal right from pension, 457(b) plans (Div. M, Section 104) (Optional)

Current Rule: Pension plans may permit in-service distributions at age 62, and governmental 457(b) plans may permit in-service distributions at age 70-1/2.

New Rule: Pension plans and 457(b) plans may permit in-service distributions at age 59-1/2.

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

Next Steps: Offering this change to plan sponsors will require changes to distribution policies and procedures, and related distribution forms, plan document, SPD, etc.

9. Part-time Participation for 401(k) Plans (Div. O, Section 112) (Mandatory)

Current 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 participate in a 401(k) plan once they have (i) reached age 21, and (ii) have worked at least 500 hours in three consecutive 12-month periods (beginning in 2021). 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 notably no requirement to provide any match or profit sharing contribution to these workers.

Effective Date: Plan years beginning after December 31, 2020.

Next Steps: This requirement will require service providers to administer special eligibility and vesting provisions for part-time workers, which will add complications particularly for elapsed time plans and for transfers between part-time and full-time workers.

10. Form 5500 Changes and Increased Penalties (Div. O, Section 403) (Optional, except penalties mandatory)[2]

A. Form 5500 Civil Penalty Changes

Current Rule: ERISA requires pension plans to file an annual Form 5500 with the federal government each year. The Code imposes its own requirement to file an annual return on qualified pension and deferred compensation plans. 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 6657 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 SSA-8955 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 Act increases by ten-fold the penalties in connection with failing to file an annual report for a qualified retirement plan. Under the new law, penalties imposed under the Code in connection with failing to file an annual report for a retirement plan 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 registration statement 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.

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[2] Note there is also an increase in the penalty for failure to provide the proper withholding notice for plan distributions under Code section 3405.

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

Next Steps and Implications: Service providers and 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. Moreover, service providers should review their service agreements (and in particular their indemnification clause) and their late filing procedures. 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. Changes to the Form 5500

Current 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 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 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.

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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 and includes several provisions designed to encourage lifetime income.[3] Those issues and more will be discussed in detail in future Groom releases and webinars. More information is available at the Groom SECURE Act Resource Library.

[3] Other rules include (1) an increase in the penalty for failure to provide withholding notice under Code Section 3405, (2) a special provision to count certain non-taxable foster care payments (so-called "difficulty of care" payments), as eligible 415 compensation, (3) relief for retroactively adopting certain new plans, (4) prohibits the use of credit cards for plan loans), and (5) special relief for 403(b) plan terminations and special clarifications for church plans.

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