EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION

SECURE ACT IMPLICATION FOR QUALIFIED RETIREMENT PLANS

The Setting Every Community Up for Retirement Enhancement Act of 2019 (the "SECURE Act") was approved in December 2019, and includes a number of provisions affecting qualified retirement plans and IRAs. The provisions likely to be of the most interest to employers sponsoring qualified retirement plans and 403(b) plans are outlined in this newsletter, along with benefits-related provisions included in companion legislation. A number of the provisions require clarification or transition guidance from the Internal Revenue Service ("IRS") or Department of Labor ("DOL"), so the analysis in this newsletter may change as more information becomes available.

Required Minimum Distributions

Under pre-SECURE Act law, a participant in a qualified retirement plan, 403(b) plan or eligible 457(b) plan generally was required to commence "required minimum distribution" payments from the plan no later than April 1st of the year following the year he/she attained age 70½ (or, if the participant was still employed at age 70½ and not a "5% owner" of the employer, as of the April 1st following the year in which the participant terminated employment with the employer). The SECURE Act allows a participant who had not attained age 70½ by December 31, 2019 to wait until April 1st after the year in which the participant attains age 72 to commence payments. A participant who is still employed at that point and not a "5% owner" can continue to delay payment until April 1st after the year in which he/she terminated employment. (Aside from the permitted delay for employed participants who are not "5% owners," the required minimum distribution rules, and the SECURE Act's change in deadline from age 70½ to age 72, apply to IRA owners as well.)

Since participants who were already age 70½ as of December 31, 2019 are not affected by the Act, required minimum distribution payments due by April 1, 2020 should be made as scheduled, notwithstanding the new law. Likewise, an individual who turned 70½ before January 1, 2020 but who was still working will need to commence payments by April 1st after the year in which he/she terminates employment, even if he/she is not yet age 72 in the year of termination. However, an individual who turns 70½ in 2020 will not need to take payment by April 1, 2021, and payments made to that participant in 2020 should not be treated as required minimum distributions. Since required minimum distributions are not eligible for rollover and are subject to different disclosure and tax-withholding rules than rollover-eligible payments, plan recordkeepers will need to update their systems to reclassify these payments.

The SECURE Act also changes the required minimum distribution rules applicable to non-spousal beneficiaries of deceased participants in defined contribution plans and IRAs. Previously, these beneficiaries could in most cases elect to receive payments over their own life expectancies, if the plan permitted. Under the SECURE Act, a non-spousal beneficiary who is more than ten years younger than the

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participant generally must complete payment from a defined contribution plan (or IRA, as applicable) within ten years of the participant's death, unless the beneficiary is a minor child (in which case, the ten-year deadline is calculated from the date the beneficiary reaches the age of majority), or unless the beneficiary qualifies for an exception by reason of a qualifying disability or chronic illness.

The new rules apply to beneficiaries of participants who die after December 31, 2019, as well as to successor beneficiaries for beneficiaries of participants who had died on or before December 31, 2019, if the original beneficiary dies after December 31, 2019 and before full payment of the account. However, collectively bargained plans and governmental plans have a delayed effective date, and distribution schedules under qualified annuity contracts (as described in the Act) already in effect and binding as of the date of the SECURE Act are not affected.

Spousal beneficiaries continue to have the right to calculate required minimum distribution payments based on their own life expectancies. Spousal beneficiaries also retain the right to delay commencement of payment longer than non-spousal beneficiaries. Under pre-SECURE Act law, the spousal beneficiary of a participant who died prior to the April 1st as of which distributions would have been required to commence could delay payment until the end of the year the participant would have attained age 70½, or until the end of the year after the participant's year of death, if later. The SECURE Act allows the delay to extend until the year the participant would have attained age 72 (or until the end of the year after the year of death, if later), at least in the case of participants who would not have turned 70½ as of December 31, 2019.

Beneficiaries other than individual humans or qualifying trusts (e.g., a charitable organization, an estate, or a trust that does not meet IRS requirements to be treated as an individual human for this purpose) continue to be subject to the requirement that payment be completed in full by the end of the calendar year containing the fifth anniversary of the participant's death.

IRA vendors and plan recordkeepers for defined contribution plans will need to update their systems to reflect the new beneficiary rules for participants and beneficiaries who die after December 31, 2019.

401(k) Participation

Effective for plan years beginning after December 31, 2020, 401(k) plans must allow part-time employees who meet a reduced service threshold to make elective deferrals. Currently, a 401(k) plan can exclude an employee who has not completed at least 1,000 hours of service in a twelve-month eligibility computation period (i.e., the first 12 months of employment, and thereafter either each twelve-month period beginning on the employment anniversary or each plan year). The new rule will require the plan to allow employees who have not met the 1,000-hour year of service requirement but who have completed at least 500 hours of service in each of three consecutive eligibility computation periods, and who are at least age 21 upon satisfaction of the service requirement, to make elective deferrals. The employer is not required to make employer contributions for these employees, and may disregard them for purposes of coverage and nondiscrimination testing, safe harbor contributions and top-heavy benefits. However, a 500-hour computation period will count as a year of vesting service for employees eligible under this rule.

Many employers already allow participation without requiring a 1,000-hour year of service, so many plans will not be affected by this new rule. However, some plans which provide for a more generous structure for most employees apply a 1,000-hour service requirement to certain subclasses, such as temporary employees. Employers therefore need to review all of their service and eligibility requirements to determine the impact of this new rule.

The new requirement is not effective until the 2021 plan year, and service for computation periods beginning prior to January 1, 2021 can be disregarded, so employers have some lead time before they need to implement this rule. The new rule does not apply to collectively bargained employees or non-resident aliens with no U.S.-source income.

401(k) Safe Harbor Changes

Previously, 401(k) plans using a "safe harbor" design to claim exemption from ADP and ACP testing had to provide an annual notice, and in most cases had to include the requisite safe harbor contribution rules before the start of the plan year. The SECURE Act eliminates the notice requirement for safe harbor plans that offer a safe harbor nonelective contribution rather than a safe harbor matching contribution. In addition, the Act allows an employer to amend its plan to add a safe harbor nonelective contribution feature at any time before the 30th day prior to the end of the year (or at any time before the end of the next plan year, if the contribution is at least four percent of compensation, rather than the usual safe harbor minimum of three percent). These new options are available for plan years beginning after 2019.

Finally, the SECURE Act increases the ten percent cap on automatic enrollment for "qualified automatic contribution arrangement" ("QACA") safe harbor plans to fifteen percent (except for the first year of automatic enrollment, when the maximum permissible automatic enrollment amount remains at ten percent). Since that provision took effect for plan years beginning in 2020, QACA plans will be permitted (or perhaps required, if the plan incorporates the statutory limit by reference) to increase automatic deferrals for participants automatically enrolled for more than one year who would otherwise be affected by the ten percent limit in 2020. The IRS will need to issue guidance on how to apply the new limit, especially to participants who have been at the ten percent limit for more than a year already.

Birth/Adoption Distributions

A participant may now take a distribution from a defined contribution plan (including defined contribution qualified retirement plans, 403(b) plans and governmental eligible 457(b) plans) or IRA of up to $5,000 within a year of the birth or qualifying adoption of a child, without being subject to the Section 72(t) ten percent tax penalty on early distributions. A plan may allow this type of payment even if the participant is not otherwise eligible for a distribution. Presumably, a plan will not be obligated to allow early distribution for this purpose if the employer prefers not to add this feature, but IRS guidance has yet to be issued on this point.

A birth/adoption distribution is not subject to the normal tax withholding and disclosure rules applicable to rollover-eligible distributions, but may be repaid to the source plan if the employee is otherwise entitled to contribute to that plan, or to an IRA. Additional IRS guidance will be necessary to clarify the extent of a plan's responsibility to determine whether an employee who is otherwise permitted to receive payment would qualify for the special birth/adoption rules and the extent to which an employee can choose to request a direct rollover even if he or she would by chance qualify for the birth/adoption rules. The IRS will also need to provide guidance with respect to the rules and tax treatment for subsequent repayment of these distributions.

Nondiscrimination Testing Relief for Frozen and "Soft-Frozen" Defined Benefit Plans

The SECURE Act liberalizes nondiscrimination and minimum participation rules for defined benefit plans which no longer permit new employees to participate but which do allow continued benefit accrual by existing plan participants, if certain requirements are met. The Act also includes provisions intended to facilitate contributions to defined contribution plans intended to make up for or offset the impact of the freeze of a defined benefit plan, in specified circumstances.

Defined Contribution Plan Lifetime Income Options

In order to facilitate lifetime income options and retirement planning, the SECURE Act:

- Requires the Department of Labor to provide guidelines for calculating lifetime income projections for defined contribution plan statements and model disclaimers to be included with those projections. Plan administrators will be required to include life annuity and joint & 50% survivor annuity projections at least once annually on defined contribution plan statements after the necessary guidance has been issued, and will be protected against liability for discrepancies between the projections (calculated based on the Department's guidelines and accompanied by the model disclaimers) and actual results. The requirement to include projections on participant statements will take effect a year after the requisite guidance is issued, and the Department is required to issue the guidance within a year after the SECURE Act was approved.
- Allows defined contribution plan participants to receive distributions, via rollover to an IRA or in the form of an annuity contract, of lifetime income products if the plan ceases to allow those products as investments. These distributions can be made even if the participant would not otherwise meet the legal threshold to receive a distribution.
- Protects fiduciaries selecting insurance companies as annuity providers for defined contribution plans from liability in the event the provider defaults on payments in the future, if certain conditions were met at the time the provider was selected. Those conditions include an appropriate investigation of the insurance company's financial ability to meet its payment obligations, but the fiduciary is permitted to rely (absent knowledge to the contrary) on certain representations from the insurer in that regard.

"Open" Multiple Employer Plans

Previously, the Department of Labor restricted the ability of a vendor to offer a single retirement plan to unrelated clients. Effective for plan years beginning after 2020, the SECURE Act will facilitate employers' ability to join a "pooled" defined contribution plan of this type offered by a qualifying provider, so long as the "pooled" plan contains certain specified provisions. The new rules will also protect innocent employers against the consequences of another employer's portion of the plan breaching legal requirements and losing tax-qualification. These provisions are intended to facilitate cost-effective retirement plan offerings for smaller employers.

However, an employer that chooses to join one of these arrangements should be aware of its fiduciary responsibility for selection of the pooled plan vendor (even if that vendor will assume fiduciary responsibility for actual administration and investment oversight). In addition, the employer should be sure it understands the potential complications it may experience if it later wants to discontinue participation in the pooled plan in favor of joining a different pooled plan, establishing its own plan, or joining a plan offered by an acquiring company in the wake of an acquisition, although pooled plans will be prohibited from imposing unreasonable restrictions on cessation of participation.

Community Newspaper Pension Funding

Community newspaper publishers may qualify for pension funding relief. Employers in this category should review the new rules with their actuaries.

403(b) Plans

Under the SECURE Act, the IRS is required to issue guidance with respect to allowing in-kind distributions of 403(b) custodial accounts from terminating plans. This aligns the termination options for plans with these accounts with the options available to terminating plans that offered 403(b) annuity contracts. The SECURE Act also clarifies participation rules for Section 403(b)(9) retirement income accounts for employees of certain church-controlled organizations.

New Plans and Tax Credits

Small employers may qualify for an increased tax credit if they start a new plan. The SECURE Act also allows employers (regardless of size) additional time to adopt a plan by extending the adoption deadline to the deadline for the employer's tax return. It remains to be seen whether this new provision will affect the IRS' view that a cash-or-deferred arrangement must be adopted in advance of the date elective deferrals begin.

A tax credit is also available for small employers that offer automatic enrollment as part of a new plan, or as a new feature for an existing plan.

Penalty Increases

The SECURE Act increases the Internal Revenue Code penalties applicable for failure to file Form 5500 and Form 8955-SSA (as well as for failure to provide certain updates regarding the plan's status and contact information). It also increases penalties associated with failure to provide proper tax-withholding disclosures.

Form 5500 Filing

The Department of Labor and the Internal Revenue Service will be required to modify Form 5500 so that a group of plans with the same trustee, plan administrator, named fiduciary, plan year and investment options can file a consolidated Form 5500. This option will be available beginning with the 2022 plan year.

No Credit Card Loans

Qualified retirement plans are prohibited from offering participant loans via credit card or similar arrangements, effective immediately upon the enactment of the SECURE Act.

Additional Provisions in Companion Legislation:

- Companion legislation extended special tax relief and plan loan provisions applicable to individuals living in areas affected by qualifying natural disasters who experience economic losses as a result of the disaster. The special distribution rules (which include expanded access to plan funds, if the plan permits, extended rollover deadlines, an extended income recognition timeline, and early-distribution-penalty-tax relief) apply for qualifying distributions taken on account of presidentially declared major natural disasters (excluding California wildfires covered by the Bipartisan Budget Act of 2018) from January 1, 2018 through 60 days after the date of the SECURE Act. The distribution must be taken within 180 days of the date of the SECURE Act. Repayment of distributions intended for home purchases prevented by the disaster can be repaid within 180 days of the SECURE Act. Expanded loan access opportunities are available to qualifying participants for 180 days after the SECURE Act, while special provisions relating to relief for unpaid loan payments can apply to payments due as early as January 1, 2018.
- Pension plans will now be allowed to make in-service distributions beginning at age 59 ½, rather than being required to wait until a participant is at least age 62.
- Companion legislation also makes some important changes relevant to health and welfare plans, including repeal of the "Cadillac" tax for expensive health insurance plans and extension of the Patient-Centered Outcomes Research Institute ("PCORI") and associated health plan fees through 2029.

Plan Amendments

SECURE Act amendments will generally be due by the end of the 2022 plan year, with collectively bargained and governmental plans having an extended deadline.

Please feel free to contact a member of the Employee Benefits & Executive Compensation group for more information about the items discussed in this newsletter at 585.232.6500, 716.853.1616, or visit www.hselaw.com.