The Secure Act: What Plan Sponsors Need to Know

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With the rise of crippling student loan and credit card debt and decreased access to defined benefit pension plans, many Americans are simply unable to save enough money towards retirement. For years, Congress has struggled to pass bipartisan legislation to encourage retirement savings. In the final days of 2019, Congress tacked on to the 2020 appropriation bill the long-anticipated Setting Every Community Up for Retirement Enhancement Act (SECURE Act), ushering in the most significant retirement plan changes in over a decade. In this article, we address the most notable provisions of the SECURE Act that impact sponsors of retirement plans.[1] In the coming months, employers will need to focus on the SECURE Act provisions that have an immediate impact on their plans and consider the next steps to ensure plan compliance and effectiveness.

As part of a year-end appropriations measure to keep the federal government funded through September 2020, the SECURE Act was signed into law on December 20, 2019. The SECURE Act was one of five bills introduced in Congress during 2019 aimed at revitalizing the retirement savings landscape.[2] Most notably, the Retirement Enhancement and Savings Act (RESA), originally introduced in 2016, was reintroduced in February 2019 after previously stalling in Congress and was closely tracked by industry stakeholders. RESA contained a number of proposed changes that were ultimately included in the SECURE Act, such as increasing the age at which certain retirement plan participants must begin receiving distributions from their account balance (referred to as "required minimum distributions" or "RMDs"), increasing access to participation in multiple-employer retirement plans (MEPs), and loosening the rules for safe harbor and automatic enrollment 401(k) plans. However, the SECURE Act went much further in expanding workers' access to retirement plans, including a path for certain part-time workers to save for retirement and creating a new penalty-free plan distribution for birth and adoption expenses. The passage of the SECURE Act marks the most significant retirement plan legislation since the Pension Protection Act of 2006 (PPA), yet it remains to be seen whether the SECURE Act will work to increase American workers' retirement savings or whether the needle has only been slightly adjusted in the right direction.

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For now, plan sponsors should take stock of their plans and implement mandatory changes, while considering any optional changes that may be desirable. We address the relevant SECURE Act provisions that employer plan sponsors need to know in the summary that follows. Employers should start reviewing their plans now to determine what action is immediately required under the new legislation, and what steps must be taken to ensure plan compliance in 2020 and beyond. We note that the SECURE Act contains over 30 provisions, and future guidance from the Internal Revenue Service (IRS) and Department of Labor (DOL) is forthcoming. As always, plan sponsors should consult their advisors before embarking upon the implementation of any of the changes we discuss in this article.

SUMMARY OF SECURE ACT CHANGES FOR RETIREMENT PLANS

The SECURE Act implements a number of mandatory and optional changes for employer-sponsored retirement plans by amending numerous sections of the Internal Revenue Code of 1986, as amended (Code) and the Employee Retirement Income Security Act of 1974, as amended (ERISA). While many of these changes become effective currently or in a future year, some have a retroactive effect that requires plan sponsors' immediate attention.

In particular, the SECURE Act pushes the mandatory distribution commencement rule to age 72, puts defined contribution and defined benefit plans on par by allowing in-service withdrawals at age 59½, encourages new multiple employer defined contribution plans and "pooled employer plans," and increases flexibility for safe harbor 401(k) plans, among other changes. We discuss these and other changes in turn, below.

Required Beginning Date Increased to Age 72

To reflect increased life expectancies and fortify retirement savings, the SECURE Act pushes the age at which retirees must start drawing on their plan savings to age 72 (currently 70½). Thus, participants in qualified plans and 403(b) plans will have to start distributions by April 1 following the later of the year of their retirement or the year in which they reach 72. The required beginning date for certain 5% owners is the April 1 following the year in which they attain age 72, even if they have not retired. This change applies prospectively to distributions required to be taken after December 31, 2019, by individuals who attain age 70½ after December 31, 2019. Plans will still have to start distributions by April 1, 2020, for those who reached age 70½ in 2019 and continue distributions for those who reached age 70½ in an earlier year. Plans that permit in-service distributions for those participants who reach age 70½ must continue to do so to comply with the anti-cutback rules of the Code and ERISA. Further, Code § 401(a)(9) still requires actuarial increases to benefits of those employees who work past age 70½. The actuarial increase triggering age has not moved to age 72.

Revamping Post-Death Distribution Rules

To pay for the decreased tax revenue caused by the delay in mandatory distributions discussed above, the SECURE Act tightened the timing rules for post-death distributions from defined contribution plans. Thus, for defined contribution plan participants who die after December 31, 2019, the SECURE Act now requires the participant's entire account balance to be distributed within 10 years following the participant's date of death (this change also applies to individual retirement accounts (IRAs)). This rule replaces the previous five-year rule and, in

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part, the life expectancy rule for defined contribution plans. The new 10-year distribution period applies regardless of whether the participant died before, on, or after the required beginning date (now, age 72). The SECURE Act allows, however, the account balance to be distributed over the life or life expectancy of certain "eligible designated beneficiaries," defined to include the employee's surviving spouse, a child who has not reached the age of majority, a disabled individual, a chronically ill individual, or an individual not more than 10 years younger than the employee. Following the death of the eligible designated beneficiary, the entire account balance must be distributed within 10 years of the eligible designated beneficiary's death. Similarly, once a minor child beneficiary reaches the age of majority, the account balance must be distributed within 10 years. A special rule applies to participants who die before the effective date of this new provision and whose designated beneficiaries die after that date. Any benefits remaining undistributed after the death of those beneficiaries must be distributed within 10 years after their death. The new rules also instruct defined contribution plans how to apply the revised post-death distribution requirements to certain multi-beneficiary trusts that benefit disabled or chronically ill individuals. The new requirements do not affect annuity contracts that were in effect on December 20, 2019, and thereafter, so long as the individuals commenced lifetime distributions before that date or made an irrevocable election before December 20, 2019, to commence lifetime distributions. The revised post-death rules also have special effective dates for collectively bargained and governmental plans. A collectively bargained plan would not have to apply the new rules to participants dying after December 31, 2019, if its bargaining agreement was in effect on December 20, 2019, but can wait until the earlier of the end of the year in which the contract expires (without extensions) or December 31, 2021. Governmental employers may postpone compliance and apply the new rules to deaths occurring after December 31, 2021. Meanwhile, plan sponsors should be on a lookout for possible IRS guidance and consult with their ERISA counsel on the potential impact of these rules on their plans.

Allowing In-Service Pension Plan Distributions at 59½

Pension plans and governmental plans can now permit in-service distributions as early as age 59½ (decreased from age 62 for pension plans and age 70½ for governmental plans). This change applies for plan years beginning after December 31, 2019. Sponsors of pension plans and governmental plans wishing to take advantage of the new law will need to change their operations and amend their plan documents accordingly. Although much of the SECURE Act is aimed at increasing workers' retirement savings, this feature would allow participants to access retirement benefits at an earlier age while they remain actively employed. It is yet another potential source of tax revenue that would pay for the revenue losses caused by other sections of the SECURE Act. Plan sponsors that have concerns about adequacy of their employees' retirement savings may not want to take advantage of this optional early access rule.

Plan Access for Part-Time Employees

Under prior law, employers could exclude part-time employees from retirement plan eligibility until they complete one year of service during which they work at least 1,000 hours. For plan years beginning after December 31, 2020, the SECURE Act will require employers to allow employees who work at least 500 hours

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per year for the last three consecutive years to make elective deferrals to the plan (subject to the age 21 limitation). Employers need not make nonelective and/or matching contributions on behalf of these newly eligible part-time employees and can exclude them from nondiscrimination and top-heavy testing. Once an employer decides to include these employees in the matching and/or nonelective contribution eligibility, the plan must credit them with a year of vesting service for each year the employees complete at least 500 hours. Similarly, 500-hour employees do not need to be included in nondiscrimination safe harbors (such as automatic enrollment features), but if they are included, their contributions must be made at the default rate. Plans must start complying with the new rule for part-time employees for plan years that begin after 2020. However, 12-month periods beginning before January 1, 2021, are not taken into account for purposes of the three-year determination period described above. As a result, the earliest a 401(k) plan will be required to allow long-term, part-time employees to make elective contributions will be the plan year beginning in 2024. The amended statute provides generally that employers must identify the applicable 12-month measurement periods for long-term part-time employees consistent with the rules governing eligibility service computation periods under the Code and ERISA. We understand this to mean that employers would have to use the 12-month period beginning on the date of hire and then will have the option of continuing with the employment anniversary year or switching to a plan year basis for measuring employee hours. A confirmation from the IRS would be welcome.

Increase in the Qualified Automatic Contribution Arrangement (QACA) Auto Deferral Limit to 15%

For 401(k) plans that have adopted a qualified automatic contribution feature, the SECURE Act increases the maximum permissible default rate from 10% to 15% for plan years beginning after December 31, 2019. The new 15% automatic enrollment maximum default rate can only apply during plan years following the participant's first year of participation in the plan. Employers who use robust savings strategies for their employees may find this increase a welcome change. They will, of course, need to start working with their vendors to develop systems that can accommodate the new law.

Increasing Flexibility for Nonelective Contribution Safe Harbor 401(k) Plans

For plan years beginning after December 31, 2019, sponsors of nonelective contribution safe harbor 401(k) plans (which must provide a vested employer nonelective contribution of at least 3% of compensation) will no longer have to provide the safe harbor notice. Under the SECURE Act, employers may also adopt an amendment establishing a nonelective contribution safe harbor design for a given plan year as late as the 30th day before the end of that plan year (for example, by December 1 for a calendar year plan). Moreover, plan sponsors may adopt a nonelective contribution safe harbor design amendment for a plan year by the last day for distributing excess contributions for that plan year (generally, by the end of the following plan year) so long as the nonelective contribution equals at least 4% of compensation. For existing nonelective contribution safe harbor plans, the safe harbor notice is no longer required for plan years beginning on or after January 1, 2020. Employers wishing to adopt a nonelective safe harbor feature for a given plan year will now have more flexibility in making their decisions and adopting corresponding amendments.

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Prohibiting Credit Card Plan Loans

Some qualified plans previously allowed participants to access plan loans through a credit card. Effective for loans processed on or after December 20, 2019, the SECURE Act prohibits plan loans from being made through a credit card or "similar arrangement." The intent behind the prohibition is to minimize the use of plan loans to pay for routine expenses, which can accumulate over time and result in large loan balances that are difficult to pay back. Loans processed through a credit card on or after December 20, 2019, will be treated as a taxable distribution. Interestingly, RESA, the precursor to the SECURE Act, would have allowed credit card loans to continue under existing credit card plan loan arrangements if loans for amounts $1,000 or less were excluded, and if transactions with or on the premises of a liquor store, casino, gaming establishment or adult-entertainment establishment were excluded. The SECURE Act prohibited credit card loans altogether. As a result, plan sponsors that use credit card loans must immediately cease their current practice.

Increasing Plan Loan Limit for Participants in Qualified Disaster Areas

The SECURE Act increases the upper limit on plan loans to $100,000 from $50,000 for participants with a principal residence located in a qualified disaster area. In order to qualify for the new $100,000 limit, the loan must be taken between December 20, 2019, and June 17, 2020, and must be requested in connection with a disaster declared between January 1, 2018, and February 18, 2020. California wildfires already declared as a disaster are excluded from the new $100,000 loan limit under a "denial of double benefit" carve out. The SECURE Act provides special repayment rules for loans taken under the expanded disaster relief that allows such loans to be treated as tax-free withdrawals if repaid over a three-year period. Plans wishing to increase the plan loan limit for participants in qualified disaster areas should consult with plan counsel, as the SECURE Act contains other criteria that may apply.

New Childbirth and Adoption In-Service Distributions

Sponsors of defined contribution plans can amend their plans to allow participants to withdraw up to $5,000 as a birth or adoption distribution after December 31, 2019. The new SECURE Act childbirth and adoption distribution feature applies only to defined contribution plans. The birth- or adoption-related withdrawal will not be subject to a 10% penalty for early distributions. The withdrawal will also be an exception to the distribution limitation rules that apply to elective deferrals under 401(k) and 403(b) plans (as well as IRAs). This exception is not readily apparent since the provision allowing a birth or adoption distribution is buried within the changes to Section 72(t) of the Code. That section addresses a 10% penalty on early distributions and the exceptions to the penalty. The $5,000 individual limit applies on a controlled group basis, requiring employer groups with multiple retirement plans to administer the limit across all plans. In order to qualify as a birth or adoption distribution, the distribution must be made during the one-year period following the date on which the child of the participant is born or on which the legal adoption is finalized. The SECURE Act allows participants to repay the birth or adoption distribution to the plan under certain circumstances. Since this is an optional change, plan sponsors should weigh the pros and cons of allowing participants to

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gain early access to their retirement accounts against their long-term savings potential.

New Plan Adoption By Tax Return Due Date

For tax years beginning after December 31, 2019, the SECURE Act permits employers to adopt a new qualified retirement plan for a taxable year after the close of that year if the plan is adopted before the deadline for filing the employer's tax return for that year. The plan that the employer adopts in this manner will be treated as having been adopted as of the last day of the plan year. This rule does not obviate the requirement for having a written plan document in place before employees can make elective deferral contributions.

Changes Specifically Affecting 403(b) Plans

The SECURE Act directs the IRS, in the next six months, to issue guidance that would provide 403(b) plans held in custodial accounts with a pathway for distributing assets upon plan termination. Currently, 403(b) plans may not distribute their assets other than upon the employee's death, termination of employment, attainment of age 59½, disability, or hardship. The forthcoming guidance would permit a terminated 403(b) plan to distribute participant custodial accounts in-kind to participants to be held in a tax-deferred 403(b) custodial account until the account balance is paid out. For accounts to be considered distributed, the employer must discontinue material involvement with the accounts. However, these accounts will not be considered employer-sponsored plans merely because they were first established as a group contract. The expected guidance will be effective retroactively to tax years beginning after December 31, 2008.

Special rules apply to 403(b) retirement income accounts that a church or church-controlled organization is permitted to have. These accounts are treated as annuity contracts for purposes of Section 403(b). The SECURE Act clarifies those retirement income accounts can cover certain employees of tax-exempt organizations that are controlled by or associated with a church or an association or convention of churches. The clarification cross-references the definition in Section 414(e) that defines a "church plan" and individuals for whom that plan is established. The clarification is effective for plan years beginning on or after December 20, 2019.

Increased Retirement Plan Reporting Penalties Under the Tax Code

Retirement plans that fail to file an annual report on Form 5500 with the DOL will now be subject to a $250 per day penalty (previously, $25) under the Code, capped at $150,000 per year (RESA had proposed penalties of only $100 per day, capped at $50,000). In addition, a failure to file the required Form SSA registration statement for participants with a vested benefit who did not receive payment during the year results in a civil penalty of $10 per day for each participant with respect to whom the failure applies, up to a maximum penalty of $50,000 per year. Finally, failure to notify the IRS regarding a change in the name of the plan, the name or address of the plan administrator, plan termination, or merger or consolidation of the plan with any other plan or its division into two or more plans results in a penalty of $10 per day, up to a maximum of $10,000 for each failure. These penalties may be waived if the failure to file is due to reasonable cause. For returns due after December 31, 2019, plan sponsors and plan administrators must take note of the increased penalties and ramp up their reporting procedures. Note that these are tax penalties. The SECURE Act

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has not changed reporting penalties that the DOL may assess under ERISA.

Consolidated Form 5500 Filing Option for Plans of Unrelated Employers

For plan years beginning after December 31, 2021, defined contribution plans maintained by unrelated employers may file a single Form 5500 if the plans have the same trustee, the same named fiduciary or fiduciaries, the same administrator, the same plan year, and provide the same investments or investment options to participants and beneficiaries. The IRS and DOL will implement changes to Form 5500 no later than January 1, 2022, to allow a consolidated filing. The new opportunity is particularly useful to professional employer organizations (PEOs) and associations of small employers who share consolidated plan administration. However, the requirement to have the same investment option may prove to be a hindrance. For purposes of the electronic filing requirements, in counting the number of returns being filed, the SECURE Act treats information filed for each employer's plan included in the consolidated Form 5500 as a separate return.

Simplified Reporting for Small Multiple-Employer Plans

For plan years beginning after December 31, 2020, the DOL may, by regulation, permit simplified reporting for a multiple-employer plan with fewer than 1,000 participants, provided that each participating employer has fewer than 100 participants. Simplified reporting would reduce expense and administrative burdens for small employers that are participating in a multiple-employer plan through their trade association and similar arrangements. These employers would be able to avoid costly audits under the new rule if promulgated by the DOL.

SECURE ACT CHANGES FOR MULTIPLE-EMPLOYER PLANS

A major hallmark of the SECURE Act is increasing access to multiple-employer plans. The SECURE Act's expansion of multiple-employer plans is a retirement plan corollary to the DOL's 2018 association health plan rule (currently being challenged in federal court), which provides unrelated employers an easier way to band together to offer health plans to employees. The SECURE Act's multiple-employer impact is twofold—it protects traditional multiple-employer plans from failure on account of one participating "bad apple" employer, and introduces a new "pooled employer plan" type for unrelated employers.

The End of the "One Bad Apple" Rule

Employers participating in multiple-employer plans will be able to breathe easier once the SECURE Act provision eliminating the "one bad apple" rule springs into life for plan years beginning after December 31, 2020. The new rule will apply to multiple-employer plans sponsored by employers that have a common interest besides their adoption of the plan and to newly minted "pooled employer plans." The SECURE Act ensures that one participating employer's qualification failure would not cause all other employers participating in the multiple-employer or pooled employer plan to be held liable or lose their tax-favored status under the plan. The relief from disqualification is conditioned on the plan provisions that would require a transfer of the offending employer's plan assets to a plan solely of that employer, to an eligible retirement plan (including an IRA) for each participant, or to such other vehicle as the Secretary of the Treasury may prescribe. The Secretary may also determine that it may be in the best interests of the participants to retain the

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tainted assets in the multiple-employer or pooled employer plan. The offending employer must remain responsible for all liability arising from the qualification failures. The Secretary also has discretion to determine whether a failure by a pooled plan provider must result in the disqualification of the entire plan.

Pooled Employer Plans

The SECURE Act creates a new type of multiple-employer retirement plan (referred to as a "pooled employer plan"), which allows unrelated employers to establish a single ERISA plan for plan years beginning after December 31, 2020. Pooled employer plans allow employers that do not have a common interest to come together to offer their employees a retirement plan. These plans must have a common "pooled plan provider." The terms of the plan must designate the pooled plan provider as the named fiduciary and plan administrator, and the provider must acknowledge its named fiduciary status and register with the Secretary of the Treasury. The SECURE Act directs the Secretary to issue regulations implementing the pooled plan provider requirements. Before the regulations are issued, employers may comply with the new requirements in good faith. The SECURE Act provides that each employer participating in the pooled employer plan shall be treated as the plan sponsor with respect to the portion of the plan attributable to employees of the employer. Special Form 5500 rules will apply to a pooled employer plan, including identifying information for the pooled plan provider, a list of employers participating in the plan, a good faith estimate of the percentage of total contributions made by each employer to the plan during the plan year, and the aggregate account balances attributable to each employer in the plan. Unrelated employers seeking to establish a pooled employer plan beginning in plan years on or after January 1, 2021, should stay tuned for model language from the IRS that can be adopted to establish a pooled employer plan.

SECURE ACT CHANGES FOR RETIREMENT PLAN LIFETIME INCOME REQUIREMENTS

Another hallmark of the SECURE Act is promoting lifetime income distribution and investment options in defined contribution plans. On the one hand, the SECURE Act provides further protections for fiduciaries that select providers for guaranteed retirement income contracts. On the other hand, defined contribution plans will be required to include in their quarterly benefit statements an estimate of a lifetime income stream that the participant's account can provide. In an effort to encourage the offering of guaranteed lifetime annuities, the SECURE Act would also permit plans to make in-kind distributions of annuity investments when the plan sponsors discontinue those options. While the increased burden of providing lifetime income stream estimates in the near future is a given, the uptick in annuity contract investments is uncertain. We anticipate an increased interest in the insurance industry in pitching annuity options to plan sponsors. However, plan sponsors and fiduciaries should exercise caution and engage in a careful and scrupulous analysis of the cost and utility of such investments and distribution options.

Disclosure of Lifetime Income Estimates

The SECURE Act amends ERISA to require defined contribution plans to provide an estimate of the monthly payments a participant would receive if a qualified joint and survivor annuity for the participant and the participant's surviving spouse (if applicable) or a single life annuity were elected.[3] Plan administrators must include the lifetime income stream disclosure in a

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quarterly (or annual) statement of benefits at least every 12 months. The SECURE Act directs the Secretary of the DOL to issue model lifetime income disclosures that would, at a minimum, explain that the disclosures contain only an estimate of the lifetime benefits, that the actual amounts may differ depending on the assumptions used, and the assumptions used in arriving at the estimate. The Secretary must also prescribe assumptions that the plan sponsors may use in converting participants' accounts into lifetime income streams. The Secretary has discretion to prescribe a single set of assumptions (including tabular factors) or ranges of assumptions. Plan sponsors that offer annuities as an investment option may satisfy the lifetime income disclosure requirements by using the amounts payable under those option in lieu of an estimate based on the prescribed assumptions. Within the same timeframe, the Secretary must publish the interim final regulations setting forth the lifetime income disclosure rules. Plan sponsors and fiduciaries will not be liable for information provided in the estimates, as long as the estimates include certain assumptions and explanations included in a model notice that will be issued by the DOL. The annual disclosure requirement will go into effect more than 12 months after the latest of the DOL's publication of an interim final disclosure rule, model disclosures, or assumptions. Plan sponsors should stay tuned for the DOL model disclosure and other guidance. The utility of the disclosures is yet to be seen. After all, the estimates would not take into account participants' savings outside of their 401(k) and 403(b) plans and would be as good as the crystal ball assumptions used in deriving the estimates. Further, many participants are struggling with credit card and student loans debt and live from paycheck to paycheck, and it will take more than a lifetime income disclosure to boost their retirement security.

Safe Harbor for Plan Fiduciary Selection of Annuity Provider

The SECURE Act expands upon a prior DOL annuity selection safe harbor and provides a safe harbor for plan fiduciaries who select a provider of a guaranteed retirement income contract. The fiduciary safe harbor is optional and is available for guaranteed retirement income contracts only. A "guaranteed retirement income contract" means an annuity contract for a fixed term or providing for guaranteed annual or more frequent payments for the life, life expectancy or joint lives or life expectancies of a participant and beneficiary. A plan fiduciary would generally be deemed to have acted prudently in selecting such a provider if the fiduciary engages in an objective, thorough, and analytical search for the appropriate annuity provider, considers the cost and benefit features of the contract, and obtains written assurances from the provider that the provider has satisfied specific requirements, including applicable state insurance laws. As a result of the foregoing analysis, the plan fiduciary must conclude that the issuer is financially capable of satisfying its obligation and the cost of the contract is reasonable relative to the value it provides. The insurance provider bidding for the fiduciary's selection must represent that it complies, and for the seven preceding years, has complied with applicable state licensing, reserves, reporting, accounting and other requirements, is being audited at least every five years by the insurance commissioner it the insurer's domiciliary jurisdiction and is not operating under supervision or liquidation. The insurer must notify the fiduciary of any changes in circumstances that might preclude the insurers from making the

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representation. At the time of the selection, the fiduciary must also not have had notice or knowledge that the insurer's representations are inaccurate. The SECURE Act specifically provides that a fiduciary is not required to pick the lowest cost contract provider but, rather, must weigh the relative value and financial strength of the insurer against the cost of the contract. Generally, a fiduciary does not have an obligation to review the insurance provider after the selection is made. However, if a fiduciary is selecting a provider of a guaranteed retirement contract that would pay benefits to participants in the future, the fiduciary would need to conduct periodic reviews of the insurer's financial capabilities. A fiduciary may satisfy this requirement by receiving the representations described above from the insurer annually, assuming the fiduciary does not receive a notice or possesses knowledge to the contrary. The safe harbor applies to guaranteed retirement income contract providers selected on or after December 20, 2019. Fiduciaries of plans that offer guaranteed retirement income distribution options who wish to take advantage of this safe harbor should familiarize themselves with the statutory requirements and work with their advisors during the selection process. All fiduciaries, including those that are eying annuity contracts as an investment vehicle for participants, should consider not only the costs and benefits of the annuity contracts and financial soundness of the insurance provider, but also the cost of administration and the increased compliance burdens when offering annuity forms of distribution (including the qualified joint and survivor annuity rules). Plan fiduciaries should also compare the investment returns under guaranteed annuity options and the returns participants could attain by investing in mutual funds. All in all, this is not a step to be taken lightly.

Portability of Discontinued Lifetime Annuity Options

Effective for plan years beginning after December 31, 2019, the SECURE Act allows defined contribution, 403(b), and governmental 457(b) plan participants to elect a qualified distribution of a lifetime income investment or a distribution of a lifetime income investment in the form of a qualified plan distribution annuity contract that is being removed as investment options under a plan. The terminology in the SECURE Act on this point is a bit convoluted, but we will attempt to distill it: the first type of distribution is a "qualified distribution of a lifetime investment option." It is, in essence, a direct rollover of an option that offers annuity distributions to another eligible retirement plan or contract that offers those lifetime income rights. The second type of distribution is a distribution to a participant by an eligible retirement plan (other than an IRA) of an annuity contract purchased by the plan for the participant. In either case, the transfer to another eligible plan or to the participant, as the case may be, may only occur on or after the date that is 90 days before the date the lifetime income option is eliminated by the plan. These in-kind distributions of a lifetime income investment constitute a new in-service distribution exception to the distribution limitations on elective deferrals under 401(k), 403(b) and 457(b) plans. Even though the new rules apparently encourage annuity offerings within defined contribution plans, the overarching question for plan sponsors and fiduciaries is whether these lifetime income investments are appropriate investments for their participants to begin with.

SECURE ACT NONDISCRIMINATION RELIEF FOR CERTAIN FROZEN DEFINED BENEFIT PLANS

Over the past several de-

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cades, employers sponsoring traditional defined benefit pension plans have gradually shifted their retirement plan offerings to defined contribution plans funded primarily by employee salary deferrals (such as, a 401(k) or 403(b) plan). As part of this trend, employers that sponsor defined benefit pension plans have taken steps to completely eliminate ongoing pension accruals (a "hard freeze") or to close their plans to new entrants while continuing accruals for existing participants (what is commonly known as a "soft freeze"). Employers that elected a soft freeze and only continued pension accruals for participants in a grandfathered class often fail nondiscrimination testing. This is not surprising, as longer-term employees are more likely to become highly compensated and their benefit levels tend to be too high compared to the contributions and benefits that younger, lower-compensated employees accumulate in defined contribution plans. The SECURE Act provides such defined benefit plans that eliminated accruals for new participants but continued benefit accruals for longer service, older employees, the long-anticipated relief from the nondiscrimination rules, so long as such "soft-frozen" plans meet certain requirements. The relief only applies to certain closed plans and classes of participants.[4] The SECURE Act permits plan sponsors to adopt the defined benefit nondiscrimination testing relief provisions retroactively for plan years beginning on or after January 1, 2014.

Prior to the enactment of the SECURE Act, the IRS issued limited relief for employers that elected to freeze benefit actuals for new participants prior to December 13, 2013 (and extended it several times). The SECURE Act expands upon existing guidance by providing a nondiscrimination testing safe harbor. Further, the SECURE Act permits certain defined benefit plans that discontinued accruals for a closed class to "unfreeze" the accruals for that class subject to satisfaction of the new nondiscrimination relief.

Relief Under the Benefits, Rights, and Features Test

Under the nondiscrimination safe harbor, a frozen defined benefit plan will not fail to satisfy the nondiscrimination requirements of Section 401(a)(4) of the Code due to the composition of the closed class or the benefits, rights and features provided to that class if the plan passed that test (without regard to the new safe harbor) for the year in which the plan was "frozen" and the two following plan years. In order to take advantage of the new benefits, rights, and features safe harbor relief, the plan cannot have been amended after being frozen in order to favor highly compensated employees,[5] and the plan must have been frozen before April 5, 2017.[6] Plans that were frozen on or after April 5, 2017, can still qualify for the safe harbor if the plan does not have a "substantial increase in coverage" during the five-year period leading up to the date the plan was frozen. A "substantial increase in coverage" is defined as either a 50% increase in the number of participants covered by the benefits, rights, and features between the first day of the first plan year in which the five-year period began and the date the plan was frozen, or, as a result of one or more amendments, the average benefit provided to the closed class at the end of the five-year period is more than 50% greater than the average benefit provided to that class on the first day of the plan yea in which the five-year period began.[7]

Aggregation with Defined Contribution Plans for Benefits Testing

The frozen defined benefit plans that qualify for the relief can take advantage of new aggregation rules, which permit

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the defined benefit plan to be aggregated and tested on the benefits basis with one or more defined contribution plans sponsored by the same employer.

An eligible "frozen" defined benefit plan can be aggregated with defined contribution plans that provide matching contributions, 403(b) annuity contracts with employer matching or nonelective contributions, and employee stock ownership plans (ESOPs). If a defined benefit plan is aggregated with a defined contribution plan that provides matching contributions, the defined benefit plan must also be aggregated with the defined contribution plan's elective deferrals, and the defined contribution plan matching contributions must be treated as nonelective contributions for purposes of the permitted disparity rules. The SECURE Act provides that plans can be aggregated for testing purposes even if they have different plan years. Generally applicable aggregation and testing methodologies under Section 401(a)(4) and 410(b) can be used when aggregating defined benefit and defined contribution plans for testing, including for purposes of satisfying the requirements for the requisite three-year period.

Relief Extends to Certain Spun-Off Plans

The SECURE Act clarifies that if a frozen defined benefit plan is spun off to another employer and the spun-off plan continues to satisfy the requirements for nondiscrimination testing relief under the Act, then the employer that adopts the spun-off plan will be eligible for the relief.

Testing of Defined Contribution Plans

The safe harbor takes into account the fact that certain defined benefit plans had to freeze or reduce benefits to a closed class of participants and make-up for the loss of benefits through additional nonelective contributions under a defined contribution plan. For these defined contribution plans, the SECURE Act provides a path for meeting the nondiscrimination requirements on a benefits basis, substantially mirroring the rules for testing defined benefit plans. To be eligible for this relief, the defined contribution plan must meet four factors. First, it must provide make-whole contribution to a closed class that was affected by the freeze or a reduction in benefits. Second, the plan must benefit a nondiscriminatory classification of employees for the year of the freeze and two succeeding years. Third, any plan amendments after the two succeeding years following the year of the freeze which modify the class, allocations, benefits and rights and features provided to that class, cannot discriminate significantly in favor of highly compensated employees. Fourth, the class must have either closed before April 5, 2017 or, alternatively, the plan was in existence for at least five years prior to the amendment and during that period and the five-year period leading up to the freeze of the plan, the plan did not have a substantial increase in coverage or value of the benefits, rights or features (for a defined benefit plan) or, in coverage or value of the benefits (for a defined contributions plan).

An eligible defined contribution plan may aggregate the feature providing for make-whole contributions with other defined contribution plans of the employer, including those that provide for matching contributions, 403(b) plans and ESOPs. Plans would not fail the nondiscrimination testing if they would have met the requirements of the safe harbor but for the fact that make-whole contributions are made in whole or in part through matching contributions.

Minimum Participation Test

The SECURE Act also pro-

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vides relief to frozen plans for purposes of meeting the minimum participation requirements under Section 401(a)(26) of the Code. A plan would be deemed to have satisfied those requirements if the plan meets three factors. First, the plan was amended to cease all benefit accruals or to provide future accruals only to a closed class of participants. Second, it must have satisfied the participation requirements as of the effective date of the amendment. Third, the amendment must have been adopted before April 5, 2017, or, alternatively, the plan was in existence for at least five years prior to the amendment and during that period and the five-year period leading up to the freeze of the plan, the plan did not have a substantial increase in coverage or value of the benefits, rights or features (for a defined benefit plan) or, in coverage or value of the benefits (for a plan aggregated with a defined contributions plan). For purposes of the plan's five-year period, the effective date of the amendment is treated as the date the class was closed. The rule extends to spun-off plans in the same manner as for purposes of the benefits, rights or features testing.

Post-Enactment Amendments

Some plan sponsors whose plans could no longer meet the nondiscrimination requirements amended their plans before the enactment of the SECURE Act to cease all benefit accruals for the closed class or eliminate one or more benefits, right or features for such class. The SECURE Act permits those plan sponsors to reinstate the eliminated benefits, rights or features or resume accruals for the closed class and take advantage of the new nondiscrimination testing safe harbor. On the face of the SECURE Act, it appears that plan sponsors who contemplated an amendment eliminating certain benefits, rights or features, or ceasing accruals before the SECURE Act's enactment (December 20, 2019), but did not execute the amendment until shortly thereafter, would be out of luck and cannot now unfreeze accruals for the closed class. This is one area where agency guidance would be very much appreciated.

THE MILLION-DOLLAR QUESTION: "WHEN DO WE NEED TO AMEND OUR PLAN?"

After considering the mandatory and optional changes the SECURE Act brings about for retirement plans, plan sponsors certainly will want to know when they must amend their plans in order to implement these changes. The SECURE Act itself establishes the deadline for amendments reflecting the changes made by the Act or by the regulations unless the Secretary of the Treasury permits a later amendment deadline. The statutory amendment period will end on the last day of the first plan year beginning on or after January 1, 2022. However, to qualify for the extended amendment period, plan sponsors must operate the plan consistent with the change they implemented, beginning on the date the change becomes effective either because it is mandated by the SECURE Act or, for optional amendments, the date of the plan sponsor's election. Given the magnitude of the changes and the complexity of certain provisions, we would not be surprised if the IRS extends the remedial amendment period necessary for plan sponsors to modify their plans. Sponsors, however, should roll up their sleeves sooner rather than later on the analysis and implementation of the required or desirable changes. Design changes may take quite some time, including system programing, vendor engagement and employee communications. Moreover, early implementation efforts help uncover areas of uncertainty and concern and leave time for relaying these con-

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cerns to the IRS and Department of the Treasury, as well as the DOL. As experience shows, the agencies often issue interim subregulatory guidance in response to the feedback they receive from the employers and benefits community at large.

NOTES:

[1]In this article, we will not address certain tax credits that small employers may claim, the provisions affecting owners of individual retirement accounts (IRAs), elimination of certain health care taxes, or certain reforms for multi-employer plans.

[2]The Retirement Enhancement and Savings Act, Retirement Security and Savings Act, the Retirement Parity for Student Loans Act, and the Social Security 2100 Act were also introduced during 2019. The SECURE Act is the only piece of legislation to have been signed into law thus far.

[3]The SECURE Act provides that single life and qualified joint and survivor options could include term life and other features that the Secretary may permit in its guidance.

[4]The following summary is not a comprehensive analysis of the nondiscrimination safe harbor for frozen plans. Sponsors of closed defined benefit plans should consult with qualified ERISA counsel to determine whether and how they may avail themselves of the nondiscrimination relief discussed herein.

[5]When determining whether a defined benefit plan satisfied the requirement to have passed the benefits, rights, and features test for the year in which the plan was "frozen" and the two following plan years, the freezing of the plan is not considered a significant change in coverage under Internal Revenue Code § 410(b). Additionally, changes in employee populations are disregarded if attributable to mergers, acquisitions, divestitures, or "similar events."

[6]A plan will be treated as having closed before April 5, 2017, if the plan sponsor's intention to create the closed class was reflected in formal written documents and communicated to participants before that date.

[7]When calculating increases in coverage, employers may exclude employees who became participants as a result of a merger or acquisition during the seven-year period leading up to the date the plan was frozen, or who became participants as a result of a plan merger with another plan that had been in effect for at least five years as of the merger date (only if the benefits, rights, and features of the first plan are conformed to the other plan prospectively). The average benefit provided to participants under the plan will be treated as having remained the same if the benefit formula applicable to participants did not change between first day of the first plan year in which the five-year period leading up to the freeze began and the date the plan was frozen. If the benefit formula applicable to any participant changed between the first day of the first plan year in which the five-year period leading up to the freeze began and the date the plan was frozen, then the average benefit is only considered to have increased by more than 50% (rendering the defined benefit plan ineligible for aggregation with a defined contribution plan) if the total value of benefits for all participants under the plan for the final year of the five-year period leading up to the plan freeze exceeds the total value of benefits for all participants under the plan for the first year of the five-year period by more than 50%.

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