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Fiduciary Hot Topics

Q1 2020

Never say Never – The SECURE Act Becomes Law

- Last December, President Trump signed into law the “Setting up Every Community for Retirement Enhancement (SECURE) Act” (gotta love the name).
- Although the most significant law affecting retirement plans in many years, all in all, it is a modest piece of legislation, as compared to prior laws such as Pension Protection Act of 2006 and the Tax Reform Act of 1986. It is really a hodge podge of policy initiatives that have been bouncing around the halls of Congress in recent years.
- The stated concerns of Congress in enacting this legislation are that almost half of the American work force is not covered by an employer sponsored retirement plan and many of those who are covered are not saving enough to provide adequate income in retirement.
- Some of the provisions in the SECURE Act reduce or defer federal tax revenues. To pay for this the taxation of inherited IRAs is changing. Under current law, individuals who inherit an IRA may elect to take distributions based on their life expectancy which can be many years. Going forward, non-spouse beneficiaries must take all distributions from an inherited IRA within 10 years. This change does not affect individuals who inherit an IRA from their spouse.

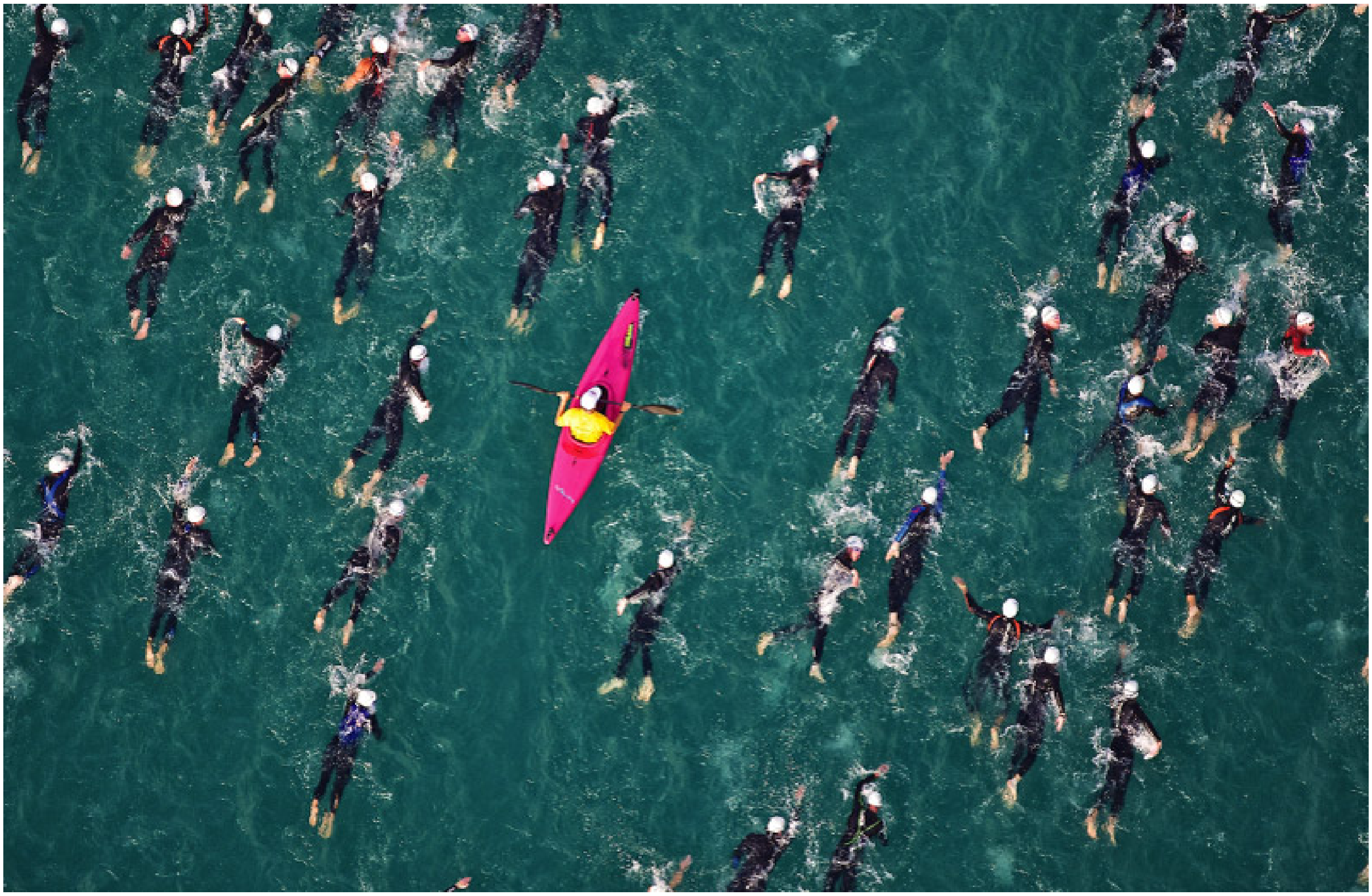
Opening the Gate for Annuities in 401(k) Plans

- One of the most important changes in the SECURE Act is removing a major stumbling block to offering annuities in 401(k) plans.
- Only about 10 percent of 401(k) plans currently offer an annuity as an investment option. One of the main reasons for the reluctance to offer annuities is the potential fiduciary liability if the provider becomes insolvent, which may occur many years after the provider is selected.
- The SECURE Act provides for a safe harbor that relieves plan fiduciaries of potential liability in regards to selection of annuity provider. This does not excuse plan fiduciaries from making a prudent and well considered decision in the initial selection and monitoring the provider ongoing. Additional guidance will be issued by the Department of Labor regarding the requirements to gain such protection.
- The upside to including annuities in 401(k) plans is this offers participants an investment option that will provide a steady stream of income in retirement. This has become a greater concern in recent years as the American population ages and plan participants move from the accumulation phase into retirement. The concern is that annuities are complex and expensive, and the fees can be difficult for the average investor to discern.
- Notwithstanding the potential complexities of annuities, participants who decide to invest in an annuity will probably be better off if the plan fiduciaries select the annuity provider, as opposed to participants rolling their account to a brokerage firm and then purchasing an annuity which frequently occurs under current law.
- The SECURE Act makes a second important accommodation for offering annuities in plans. Where a plan sponsor eliminates a lifetime income option, the Act permits individuals to transfer this investment to another plan or to an IRA.

Lifetime Income Disclosure Now Required

- At present a few record keepers include on participant statements an estimate of the monthly income a participant’s account might generate. Often this estimate is based on a projected account balance at retirement.
- The SECURE Act requires an annual disclosure on participant statements of the estimated monthly income a participant’s accrued benefit might produce in the form of a either a single life annuity or, if married, a joint life annuity.
- The Department of Labor is directed to develop standards for making life time income projections. The Department has a year to develop these standards. This notice does not have to be provided to participants until after these standards are published.

Opening Up Multiple Employer Plans to Small Employers



- Under existing law multiple employer plans must be limited to employers that are in some way related, for example employers in the same industry.
- The SECURE Act effectively removes this requirement by allowing for what it calls “pooled employer plans” (PEPs). These are multiple employer 401(k) plans sponsored by a financial institution, a record-keeper or other type of organization offered to any number of unrelated employers.
- PEPs are meant to appeal to small employers because the economies of scale is intended to reduce costs and because these plans will have a single plan document, single 5500 and a single plan audit. These tasks will be handled by the sponsor of the PEP rather than each adopting employer. However, a straw poll of providers indicates recordkeeping costs may not be much lower than individual plans and investment expense will not be lower in the early, and initial growth, stages of PEPs until a PEP reaches scale, which could take considerable time.
- The Act makes it clear that the “one bad apple rule” does not apply. In other words, a violation of a tax qualification rule by one member of a PEP does not disqualify the entire PEP. The assets of the noncompliant member must be spun off into a separate plan.
- This is an attempt by Congress to encourage small employers to establish retirement plans. Past attempts such as SEPs and simple IRAs have had only a modest impact. The pooled plan concept may have more success if some of bigger players in the industry view establishing a PEP as a business opportunity and market it aggressively.

Age for Required Distributions Pushed back to 72 / Age 70 ½ Limit Removed for Tax Deductible IRA Contributions

- The SECURE Act increases the age at which minimum required distributions (MRDs) must commence.
- The MRD rules are designed to prevent individuals from effectively using retirement plans and IRAs for estate planning and deferring income taxes on retirement benefits until the next generation. This rule requires individuals to begin taking distributions each year based on life expectancy and paying income taxes on these distributions. Under current law, for retirement plans, MRDs must commence in the year individuals reach age 70½, or if later, the year the individual retires. For IRAs, it is always the year the individual attains age 70½. The Act pushes this back to the year individuals reach age 72.
- WARNING – This change is effective for individuals who do not reach age 70½ until 2020. Individuals who reached age 70½ in 2019 must take their first MRD April 1st, 2020.
- The SECURE Act allows individuals to make tax deductible contributions to IRAs after age 70½. Under current law, only Roth contributions are permitted after age 70½. This change takes effect immediately and allows deductible contributions for 2019.

Long Term Part time Workers Must be Offered Opportunity to Defer

- Current law allows plan sponsors to exclude part time workers who work less than 1,000 hours a year. The SECURE Act requires sponsors to allow "long term" part time workers to participate in their retirement plans. A "long term" part time worker is someone who works at least 500 hours in three consecutive years.
- Employers are only required to offer these part time workers the opportunity to defer and do not have include these workers in any company contributions. These part time workers may be excluded from discrimination testing.
- Practically speaking, this provision is not effective till 2023 as it does not require employers to begin tracking part time workers until 2021.

Tax Credit to Encourage Small Employers to set up Plans Increases to $5,000 and to Include Automatic Enrollment

- The existing tax credit of $500 to encourage small employers to set up plans will increase to $5,000 per year for the first three years.
- There is an additional tax credit of $500 for small employers that add an automatic enrollment feature to their plan.

KEY PROVISIONS

Applicability and Effective Dates

PROVISION	APPLICABILITY	EFFECTIVE DATE
Multiple employer plans	*Defined contribution (DC) plans*	Plan years beginning after 2020
Tax credits to encourage small employers to set up plans	*Qualified plans (e.g., 401(k) plans), SIMPLE IRA and Simplified Employee Pension (SEP) plans*	Tax years beginning after 2019
Credit for small employers that add automatic enrollment	*401(k) and SIMPLE IRA plans*	Tax years beginning after 2019
Participation by long-term part-time employees	*401(k) plans*	Plan years beginning after 2020
Lifetime income disclosure on participant statements	*DC plans*	12 months after the DOL provides guidance
Fiduciary safe harbor for selecting insurer to provide lifetime income	*DC plans*	Date of enactment–December 20, 2019
Portability of lifetime income options	*DC, 403(b) and 457(b) plans*	Plan years beginning after 2019
Increase in the automatic escalation cap to 15% in the automatic enrollment safe harbor	*401(k) plans*	Plan years beginning after 2019
Simplification of the rules for nonelective safe harbor 401(k) plans	*401(k) plans*	Plan years beginning after 2019
Penalty-free withdrawals for birth or adoption expenses	*Qualified DC plans, 403(b) plans and IRAs*	Distributions made after 2019
Increase in the age when distributions must begin	*Qualified plans, traditional IRAs, 403(b) and 457(b) plans*	Individuals who reach age 70 ½ after 2019
Changes to the required minimum distribution rules for nonspouse beneficiaries	*Qualified DC plans, traditional and Roth IRAs, 403(b) and 457(b) plans*	Effective with respect to participants and account holders who die after 2019
Permit traditional IRA contributions after 70 ½	*Traditional IRAs*	Contributions for tax years beginning after2019
Expand tax-free distributions from 529 plans	*529 college savings plans*	Distributions made after 2018

For Plan Sponsor Use Only.
This information was developed as a general guide to educate plan sponsors and is not intended as authoritative guidance or tax/legal advice. Each plan has unique requirements and you should consult your attorney or tax advisor for guidance on your specific situation.

For more information regarding the SECURE ACT, please go to https://www.appropriations.senate.gov/imo/media/doc/H1865PLT_44.PDF