Axia Advisory

SETTING EVERY COMMUNITY UP FOR RETIREMENT ENHANCEMENT ACT
The SECURE Act of 2019

On December 20, 2019, President Trump signed appropriations legislation that included the Setting Every Community Up for Retirement Enhancement (SECURE) Act. In this brief outline we review the new legislation as well as our initial thoughts regarding some of the various provisions. Highlights of the more relevant items to plan sponsors in the new legislation include:

- A Defined Contribution Lifetime Income/Annuity Fiduciary Safe Harbor
- Mandatory Lifetime Income Disclosure
- Portability of Lifetime Income options
- Authorization of Defined Contribution Open MEPs (Multiple Employer Plan)
- Allowing long-term part-time employees in 401(k) plans
- Increase the Safe Harbor Auto-Escalation cap
- Increase the mandatory distribution age from 70½ to 72.

Fiduciary Safe Harbor for Selection of Lifetime Income Provider

The legislation provides safe harbor for plan sponsors in the selection of lifetime income/annuity providers, a fiduciary act under ERISA. Under the bill, fiduciaries are afforded an optional safe harbor to satisfy the prudence requirement with respect to the selection of insurers for a guaranteed retirement income contract and are protected from liability for any losses that may result to the participant or beneficiary due to an insurer's inability in the future to satisfy its financial obligations under the terms of the contract. Plan sponsors should be aware that the safe harbor provisions in the Act regarding selecting lifetime income providers do not have an effective date and will be effective on the date of enactment.

Axia's Thoughts: *We're not necessarily sure the new legislation offers plan sponsors much comfort in moving forward with in-plan annuities or other lifetime income products. With Washington regulators deferring to state insurance laws, plan sponsors should take pause.*

Mandatory Lifetime Income Disclosure

At least annually, plan sponsors would be required to provide participants a lifetime income disclosure. The disclosure would project a lifetime income stream in retirement based upon each participant's accrued account balance. The disclosure would include a qualified joint and survivor annuity for the participant and the participant's surviving spouse along with a single life annuity. The Secretary of Labor is directed to develop a model disclosure.

Axia's Thoughts: *We generally believe that plan participants will be well served by putting their accrued balances into a monthly income stream. The devil is in the details as to how the model disclosure will be presented. Unfortunately, it is rare that participants read the disclosures they are provided and previous attempts by the DOL to provide more disclosure has increased costs and added confusion.*

Portability of Lifetime Income Options

The legislation permits qualified defined contribution plans, section 403(b) plans, or governmental section 457(b) plans to make a direct trustee-to-trustee transfer to another employer-sponsored retirement plan or IRA of lifetime income investments or distributions of a lifetime income investment in the form of a qualified plan distribution annuity, if a lifetime income investment is no longer authorized to be held as an investment option under the plan.

Axia's Thoughts: *Plan sponsors should consider the administrative burden, as well as the system capabilities for themselves and recordkeepers in facilitating annuities in and out of plans.*

The previous three provisions: fiduciary safe harbor for annuities/lifetime income providers, lifetime income disclosure and lifetime income portability are brought to you with substantial lobbying by the insurance industry. Plan sponsors should not be surprised by an increase in marketing by insurance agents and their companies to market their annuities/lifetime income products. While the idea of a guaranteed monthly income may sound appealing, there are costs for that guarantee. We believe that annuitization of some portion of a retirees assets may be an appropriate part of retirement income planning. The increased costs over a person's lifetime make them potentially unsuitable during the accumulation phase of a person's working years. Plan sponsors will be well-served by an independent, knowledgeable advisor (of insurance products) who has no financial interest in the products they oversee or recommend.

Authorization of Open MEPs
A MEP is a multiple employer plan, defined as a plan for (non-union) employees of unrelated employers. "Open MEPs" are generally provider-based multiple employer plans in which the participating employers do not have any relationship with each other or with the provider.

Open MEPs have been effectively prohibited due to the fact that DOL regulations require that employers participating in a MEP have a "commonality of interest" and generally prohibits financial services firms, record keepers and third-party administrators from operating MEPs. The SECURE Act would allow defined contribution plan Open MEPs ("Pooled Employer Plans") that meet certain requirements and that are provided by a "Pooled Plan Provider."

The MEP must, among other things, state that each participating employer retains fiduciary responsibility for the selection and monitoring of the Pooled Plan Provider and the investment and management of that employer's share of the plan's assets.

Allowing Long-term Part-time Employees in 401(k) Plans
The SECURE Act will require employers maintaining a 401(k) plan to cover employees working more than 500 but less than 1,000 hours per year for three consecutive years. The employer may elect to exclude such employees from testing under the nondiscrimination and coverage rules, and from the application of the top-heavy rules. The rule would not cover collectively bargained employees.

Increase the Safe Harbor Auto-Escalation Cap
Under the current automatic escalation 401(k) nondiscrimination testing safe harbor, escalation is capped at 10% of pay. The SECURE Act increases this cap to 15%.

Axia's Thoughts: *MEPs, allowing part-time employees in plans and increasing the automatic enrollment cap further enhances access to and provides the opportunity for participants to save. Importantly, we generally believe that employees need to save between 10% and 15% of their income during their working years (including employer contributions). These provisions help to foster an increase in savings behavior.*

Increase in Age for Required Beginning Date for Mandatory Distributions

Under current law, participants are generally required to begin taking distributions from their retirement plan (or IRA) at age 70½. However, the age 70½ was first applied in the retirement plan context in the early 1960s and has never been adjusted to take into account increases in life expectancy. The bill increases the required minimum distribution age from 70½ to 72.

Axia's Thoughts: *With many workers extending employment and living longer, allowing individuals to defer required distributions longer certainly will benefit those individuals.*

In other retirement related provisions, the SECURE Act …

Increases Credit for Small Employer Pension Plan Start-Up Costs

The legislation increases the credit by changing the calculation of the flat dollar amount limit on the credit to the greater of (1) $500 or (2) the lesser of (a) $250 multiplied by the number of non-highly compensated employees of the eligible employer who are eligible to participate in the plan or (b) $5,000. The credit applies for up to three years.

Small Employer Automatic Enrollment Credit

The legislation creates a new tax credit of up to $500 per year to employers to defray startup costs for new section 401(k) plans and SIMPLE IRA plans that include automatic enrollment. The credit would also be available to employers that convert an existing plan to an automatic enrollment design.

Axia's Thoughts: *Increasing the credits for plan start-up costs as well as automatic enrollment will make setting up a plan or converting to automatic enrollment more affordable for businesses. While the credits may not seem significant, they further augment the notion that saving for retirement is important.*

As an example, take a small employer with 15 employees that wants to establish a safe harbor 401(k) plan for its employees and is willing to initiate automatic enrollment. The provider quotes an out-of-pocket cost to the employer of $1,500 per year. In that case, the tax credit available to this employer will be $750 plus $500 or $1,250, which is almost the entire cost to the employer.

Simplification of Safe Harbor 401(k) Rules

The legislation changes the non-elective contribution 401(k) safe harbor to provide greater flexibility, improve employee protection and facilitate plan adoption.

- The legislation eliminates the safe harbor notice requirement, but maintains the requirement to allow employees to make or change an election at least once per year.
- The bill also permits amendments to non-elective status at any time before the 30th day before the close of the plan year. Amendments after that time would be allowed if the amendment provides (1) a non-elective contribution of at least four percent of compensation (rather than at least three percent) for all eligible employees for that plan year, and (2) the plan is amended no later than the last day for distributing excess contributions for the plan year, that is, by the close of following plan year.

Combined Annual Reports for Group of Plan

The legislation directs the IRS and DOL to effectuate the filing of a consolidated Form 5500 for similar plans. Plans eligible for consolidated filing must be defined contribution plans, with the same trustee, the same named fiduciary (or named fiduciaries) under ERISA, and the same administrator, using the same plan year, and providing the same investments or investment options to participants and beneficiaries.

Repeal of Maximum Age for Traditional IRA Contributions
The SECURE Act repeals the prohibition on contributions to a traditional IRA by an individual who has attained age 70½.

New 10-year Distribution Maximum for Death Benefits from IRAs and Defined-contribution Plans for Non-spouse Beneficiaries
Currently, spending down from inherited accounts can be stretched over the life of beneficiaries to mitigate taxes. This provision is intended to generate tax revenue and offset the cost of the act's tax credits.

Treatment of Custodial Accounts on Termination of Section 403(b) Plans
Under the provision, not later than six months after the date of enactment, Treasury will issue guidance under which if an employer terminates a 403(b) custodial account, the distribution needed to effectuate the plan termination may be the distribution of an individual custodial account in kind to a participant or beneficiary. The individual custodial account will be maintained on a tax-deferred basis as a 403(b) custodial account until paid out, subject to the 403(b) rules in effect at the time that the individual custodial account is distributed. The Treasury guidance shall be retroactively effective for taxable years beginning after December 31, 2008.

Penalty-free Withdrawals from Retirement Plans for Individuals in Case of Birth or Adoption
The legislation provides for $5,000 penalty-free withdrawals from retirement plans within a year for any "qualified birth or adoption distributions."

Modification of Nondiscrimination Rules to Protect Older, Longer Service
The legislation modifies the nondiscrimination rules with respect to closed plans to permit existing participants to continue to accrue benefits.

Plans Adopted by Filing Due Date for Year May Be Treated as in Effect as of Close of Year
The legislation permits businesses to treat qualified retirement plans adopted before the due date (including extensions) of the tax return for the taxable year to treat the plan as having been adopted as of the last day of the taxable year.

529 Account Beneficiary's Student Loan Payments Now are Considered Qualified Expenses
Money withdrawn for that purpose will be tax-free. This could potentially benefit people who have excess 529 assets after a beneficiary's graduation.

Implications of the SECURE Act …

Qualified retirement plans will need to be amended to reflect the SECURE Act by the end of the 2022 plan year (or later if provided guidance). We will be on the lookout for more guidance from the IRS and DOL regarding many of these provisions.

This brief outline should not be construed as legal or tax advice.