Published on *The National Law Review* https://natlawreview.com

Sweeping Changes to Rules for Employer-Sponsored Retirement Plans

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New laws included in the SECURE Act (Setting Every Community Up for Retirement Enhancement Act) and the Further Consolidated Appropriations Act 2020 (Appropriations Act) (Acts) made significant changes to the rules that apply to employer-provided tax advantaged retirement plans.

These new rules strive to enhance retirement savings, encourage employers to offer retirement plans and promote the financial security of plan participants. Some of the most important provisions impacting employer-sponsored retirement plans include: changing when distributions are required or permitted, relaxing requirements for specified retirement plans, allowing more employees to participate, expanding participant disclosures and portability of lifetime income streams, and increasing penalties for annual reporting and distribution notices. This insight outlines key elements of the Acts that may apply to employer-sponsored retirement plans in 2019 and in 2020, as well as action steps employers should consider taking.

Action Steps for Plan Sponsors

- Work with third-party providers and legal counsel to implement operational changes to comply with Acts in timely manner
- Discuss with investment advisors possible changes to investment options, including lifetime income options in defined contribution plans, and update investment policy statement accordingly
- Arrange for education sessions by third-party providers for participants on these changes
- Work with legal counsel and, if applicable, third-party providers to prepare and distribute participant communications related to these changes
- Work with legal counsel to adopt plan amendments to incorporate changes and update summary plan descriptions and summaries of material modifications. Plan amendments will be required to be adopted no earlier than the end of the plan year beginning on or after

January 1, 2022 (or January 1, 2024 for collectively bargained and governmental plans).

Age for Required Minimum Distributions Increased to 72

Tax advantaged retirement plans (qualified pension, profit sharing and stock bonus plans) may now postpone required minimum distributions (RMD) to age 72 for those participants who reach age 72 after December 31, 2019. This extension does not apply to any participants who have reached age 70½ before December 31, 2019. The plan must make RMD to the participants no later than April 1 of the calendar year following:

- the calendar year in which the participant attains age 72, or
- if later, the calendar year in which the participant who is not a 5% owner retires.

Under the previous rules, the plan would need to make the RMD by the April 1 following the year in which the participant attained age 70½, but participants who were not 5% owners could delay the RMD until the April 1 following the year in which they retired.

401(k) Safe Harbor Plan Nonelective Contribution Adoption and Notice Requirements Relaxed

For one type of 401(k) safe harbor plan that provides an employer nonelective contribution in the amount of at least 3% of an employee's compensation, the safe harbor notice requirement is no longer required. In addition, employers can adopt or amend the plan to add a nonelective contribution 401(k) safe harbor plan before the 30th day of the end of the plan year, or by the end of the next plan year, but the nonelective contribution would need to be at least 4% of the employee's compensation. These new rules take effect for plan years beginning after December 31, 2019.

The previous rules required the plan administrator to distribute a safe harbor notice for all 401(k) safe harbor plans (including the employer nonelective contribution 401(k) safe harbor plan) before the plan year begins and a 401(k) safe harbor plan had to be adopted prior to the first day of the plan year and remain in effect for the plan year, except for contingent 401(k) safe harbor plans.

Certain Part-time Employees Must be Eligible for 401(k) Plan Elective Deferrals

For plan years beginning after December 31, 2020, employees who have at least 500 hours of service with an employer for three consecutive years and who are age 21 by the end of this three-year period will need to be eligible to make elective deferrals to the 401(k) plan. Twelve-month periods before January 1, 2021, are not considered for purposes of the three consecutive years, which means these part-time employees would start participation in 2024. After satisfying these age and service requirements, the employee will need to be able to start 401(k) plan participation no later than the earlier of:

- the first day of the plan year starting after the employee completed the age and service conditions, or
- six months after the date the employee completed the age and service conditions.

The 401(k) plan may permit an earlier participation date for part-time employees. The 401(k) plan sponsor is not required to provide employer nonelective contributions or matching contributions to part-time employees. If the 401(k) plan provides part-time employees with employer nonelective contributions or matching contributions and attaches a vesting schedule to these contributions, the part-time employee must be credited with one year of vesting service for each year in which the part-time employee has 500 hours of service.

If the 401(k) plan is an automatic deferral safe harbor plan, part-time employees may be included, but it is not required. The plan sponsor may elect to exclude part-time employees from nondiscrimination testing and the top-heavy plan rules for vesting and benefit requirements. The new rule does not apply to collectively bargained plans.

Under the old law, the 401(k) plan could have required the employee to complete one year of service (1,000 hours of service in a 12-month period) or attain age 21, whichever was later, before being eligible to participate in the plan.

Reduced Minimum Age for Certain In-Service Withdrawals

Under the Appropriations Act, for plan years beginning after December 31, 2019, the minimum age for in-service withdrawals under a defined benefit plan or governmental section 457(b) plan is reduced to age 59½. Previously, the minimum age was 62 for withdrawals from defined benefit plans and 70½ for withdrawals from governmental 457(b) plans.

Defined Contribution Plans Benefit Statements Must Include Lifetime Income Disclosure Once Every 12 Months

The benefit statements for defined contribution plans (e.g., 401(k) plans and profit sharing plans) will need to contain a lifetime income disclosure at least once every 12 months. Typically, benefit statements are provided quarterly by defined contribution plans, but the lifetime income disclosure would only need to be included in one of the quarterly benefit statements for the year. The lifetime income disclosure will depict the monthly amount the participant (or beneficiary) would receive if the participant's plan account were used to provide a lifetime income stream. Examples of lifetime income streams are a single life annuity paid each month over the life of the participant, or a joint and survivor annuity where a monthly payment is paid over the life of the participant and after the death of the participant, 50% of the monthly payment is paid over the life of the participant's surviving spouse. No later than December 20, 2020, the Secretary for the Department of Labor (DOL) must:

- issue interim final rules,
- prescribe the assumptions the plan administrators may use to convert the participants' account balances into lifetime income stream equivalents, and
- release a model lifetime income disclosure for plan administrators to use.

Plan administrators have time for compliance with this provision, as the rule applies to benefit statements furnished more than 12 months after the latest of the DOL's interim final rules, assumption, or the model lifetime income disclosure are issued.

Prior law did not mandate a lifetime income disclosure in the benefit statements for defined contribution plans.

Pooled Employer Plans Are Permitted

Under the SECURE Act, for plan years beginning after December 31, 2020, unrelated employers (e.g., employers who are not in the same “controlled group”) may participate in defined contribution “pooled plans” regardless of whether they have “commonality” of interests, if certain requirements are satisfied. Additionally, one employer qualification issue will not impact the entire employer pool. This is significant because despite the recent DOL guidance that softened the commonality requirement, a limited commonality requirement still applies to unrelated employers who participate in the same defined contribution plan.

Fiduciary Safe Harbor for Selection of Annuity Provider for Defined Contribution Plan

To encourage lifetime income investment options in retirement plans, effective December 20, 2019, a new fiduciary safe harbor became available under the SECURE Act for any employer who includes a lifetime income investment option (Annuity Contract) in its defined contribution plan. When selecting an insurer for an Annuity Contract, a defined contribution plan fiduciary will be deemed to satisfy a designated fiduciary standard and will be relieved from certain potential liabilities when the fiduciary takes the following steps:

- engages in an objective, thorough, and analytical search for the purpose of identifying insurers from which to purchase the Annuity Contract,
- the fiduciary considers:
    - the financial capability of the insurer to satisfy its obligations under the Annuity Contract, and
    - the cost of the Annuity Contract in relation to its benefits and product features and administrative services to be provided under the Annuity Contract; and
- the fiduciary concludes that, at the time of the selection, the insurer is financially capable of satisfying its obligations under the Annuity Contract, and the cost of the Annuity Contract selected is reasonable.

By obtaining certain written representations from the insurer as to its compliance with state insurance laws, a fiduciary is deemed to have satisfied a few of these steps. The fiduciary does not need to select the lowest cost Annuity Contract, but may consider the value of the Annuity Contract and the insurer’s attributes combined with the cost of the Annuity Contract.

Lifetime Income Options Are Portable Under Certain Circumstances

Under the SECURE Act, for plan years beginning after December 31, 2019, a participant may transfer a “lifetime income investment” to an eligible employer plan or IRA if the investment is no longer available under the tax-qualified defined contribution plan, 403(b) plan or governmental 457(b)

plan, even if a distributable event has not otherwise occurred. This option was not previously available to participants.

New RMD Payment Rules for Beneficiaries of Deceased Plan Participant

For distributions related to the death of a participant after December 31, 2019, the new rules provide that the defined contribution plan account balance must be distributed to beneficiaries within 10 years after the participant's date of death, unless the beneficiary is an eligible designated beneficiary. The 10-year rule applies whether or not the participant started to receive RMDs. After a participant's death, an eligible designated beneficiary will need to receive the participant's remaining account balance over the life of the eligible designated beneficiary. An eligible designate beneficiary is:

- the surviving spouse of the employee,
- a child of the employee who has not reached age of majority,
- a designated beneficiary who is disabled (unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death of be of long-continued and indefinite duration),
- a chronically ill individual (within the meaning of Code Section 7702B(c)(2)), and
- an individual not described in any of the above bullets who is not more than 10 years younger than the employee.

The distributions will need to begin for eligible designated beneficiaries, other than a surviving spouse, no later than one year after the participant's death. For a surviving spouse, the distributions must begin no later than the date the employee would have attained age 72.

There are delayed effective dates for certain collectively bargained plans and government plans. In addition, this new rule does not apply to qualified annuity contracts in effect on December 20, 2019. The previous post-death RMD rules applicable to such beneficiaries did not contain this requirement.

Limit Raised on Safe Harbor Automatic Enrollment Default Rate

Prior to the SECURE Act, the maximum default rate under an automatic enrollment safe harbor 401(k) plan (i.e., a 401(k) plan that is deemed to satisfy specified nondiscrimination testing requirements because it includes certain automatic enrollment and minimum matching or nonelective contribution provisions) was 10% of the participant's compensation. For plan years beginning after December 31, 2019, the maximum automatic enrollment default rate is 10% for the first deemed election year but is increased to 15% for subsequent years.

No Participant Loans Via Credit Cards by Retirement Plans

For any employer sponsored retirement plan loans made to participants after December 20, 2019, the rules prohibit the use of a credit card or any other similar arrangement.

Distributions From Retirement Plans for Birth or Adoption of a Child

After December 31, 2019, employer sponsored retirement plans, other than defined benefit plans (*e.g.*, 401(k) plans, 403(b) plans for tax exempt entities and 457(d) plans for government entities), may permit a qualified birth or adoption distribution up to $5,000. The qualified birth or adoption distribution would need to be made within one year of the date of birth or the legal adoption of an eligible adoptee (an individual who has not attained age 18 or is physically or mentally incapable of self-support) is finalized. The 10% additional tax on distributions made before age 59½, unless an exception applies, will not apply to qualified birth or adoption distributions. The distribution may be repaid by the participant provided certain conditions are met.

Increased Penalties for Failure to File Form 5500 and Form 8955-SSA and to Provide Withholding Notices

The penalties for failing to file a Form 5500 (Annual Return/Report of Employee Benefit Plan) have increased substantially to $250 for each day during which the failure occurred, up to a maximum of $150,000. The penalties were previously $25 per day up to $15,000.

Failing to file Form 8955-SSA (Annual Registration Statement Identifying Participants With Deferred Vested Benefits) will result in increased penalties of $10 per participant per day, not to exceed $50,000. Under old law, the penalties were $1 per participant per day, not to exceed $5,000.

If a plan administrator does not provide to participants receiving distributions a notice of voluntary withholding, which informs participants of their right to elect no withholding on distributions from retirement plans, the penalty is now $100 for each failure, up to a maximum of $50,000 for all failures during a calendar year. Previously, these amounts were $10 and $5,000.

These provisions are effective for forms required to be filed and notices required to be provided after December 31, 2019.

Permitted Adoption of Retirement Plan After Tax Year Ends and Before Filing Due Date for Employer Tax Return

For tax years beginning after December 31, 2019, an employer may adopt a retirement plan after the employer's tax year ends, as long as the plan is adopted before the due date for filing (including extensions) the employer's return for that taxable year. Under the old law, a qualified plan would need to be adopted before the end of the employer's tax year.

Additional Changes in the Acts

Some other changes of importance are:

- Defined benefit plans that are closed to new participants but still provide for certain accruals are not subject to nondiscrimination testing requirements if specific requirements are satisfied.

- Additional tax credits may be available to small employers – generally, those with fewer than 100 employees – who sponsor retirement plans.A start-up tax credit of up to $5,000 for three years may be available to a small employer who establishes a retirement plan.A small employer who adds an automatic enrollment feature to a retirement plan may be eligible for a credit of up to $500 per year for three years.

- The 10% penalty on early distributions is waived on distributions from retirement plans made in connection with qualified disaster relief, and repayment of such distributions may be permitted, provided that certain requirements are satisfied.

- The limit on a loan to a plan participant from a defined contribution plan may be increased in connection with qualified disaster relief.

National Law Review, Volume X, Number 18