An Analysis of the SECURE Act

Questions and Answers from Newport's Webinar

Regarding Long-Service, Part-Time Employees

Will allowing part time employees with three consecutive years of service the ability to participate increase the count of eligible employees for plan audit purposes?

Yes. Unless future guidance provides otherwise, we believe long-service part-time employees who are eligible to participate in the plan as the result of the SECURE Act will be counted as participants for purposes of determining whether a plan is subject to audit requirements.

Please comment on hours counting for the new 500-hour rule eligibility rule. I understand that the change is effective for plan years after 12/31/2020 but hours of service prior to January 1, 2021 are not taken into account. This seems to imply that an employee would need to work 500 hours in 2021, 500 hours in 2022 and 500 hours in 2023 to become eligible to enter the plan even if the employee had worked 500 hours in 2020, as well as 500 hours in 2019. Thanks in advance for the clarity.

We agree with the above.

Will the part time eligibility rules be eventually required in 2022?

The rule is effective for plan years beginning on or after December 31, 2020. However, only service performed on or after January 1, 2021 is counted, so the earliest a part-time employee would have to enter the plan under the rule would be 2024.

What if you decide to give a match... will (part time employees) then be included in testing?

No. Employees who are eligible to participate in the plan solely as a result of the long-service part-time employee provision may be disregarded for both ADP and ACP testing purposes, even if they are deferring to the plan and even if they are receiving matching contributions.

On slide 16 "Long Service, Part Time Employees - the slide says "Disregarded for coverage, discrimination, top heavy testing" however, one of the speakers said such employees could limit the amount HCEs can defer. Please elaborate.

Our apologies for the confusion. Prior to the date this provision of SECURE takes effect, if you allow part-time employees to participate in a 401(k) plan, they have to be counted for testing purposes and, because they have to be counted and generally defer at lower rates than full-time employees, they could adversely affect the testing results which, in turn, would limit the amount HCEs could defer. In recognition of the adverse effect that allowing part-time employees to participate could have on testing, SECURE provides that part-time employees who are eligible to participate in the plan solely as a result of the long-service part-time employee provision do not have to be counted for testing purposes.

Note: If part-time employees are eligible to participate under a plan's "normal" eligibility rules (rather than solely as a result of the long-service part-time employee rule), it is possible that you may not get to exclude part-time employees from testing, because in that case the employees are able to participate due to the plan's liberal eligibility provisions rather than "solely" due to the long-service part-time employee rule. We anticipate that IRS guidance, when issued, will address how part-time employees will be treated in these circumstances.

Example 1: A 401(k) plan allows all employees to participate on the first day of the month following 30 days of employment. A part-time employee can participate the same as any other employee after 30 days. In this type of plan design, it is not clear whether the part-time employee has to be counted for testing purposes, because he/she may not be participating "solely" due to the long-service part-time employee rule.

Example 2: A 401(k) plan allows employees to participate on the first day of the month following the completion of 1,000 hours of service in a 12-month period. To comply with SECURE, the plan is amended to also allow participation on the first day of the month following the completion of 500 hours of service in each of three consecutive 12-month periods. In this type of plan design, part-time employees can clearly be excluded from any required testing until they complete 1,000 hours of service and are eligible to participate in the plan as the result of the plan's normal eligibility rules.

Is the long service part-time employee provision effective for 403(b) plans as well?

No. This provision applies only to 401(k) plans.

On page 16, is the vesting accrual going from 1,000 hours to 500 hours?

Long-service, part-time employees will accrue a year of vesting service for each computation period in which they earn 500 or more hours of service. It is hoped that guidance will be issued that explains how this rule will work in operation.

Does the long-service, part-time employees requirement apply to 1099 employees or only W-2 employees?

Only W-2 employees; generally speaking, 1099 employees cannot participate in a 401(k) plan.

Changes to Required Minimum Distribution (RMD) Rules

While the RMD age was pushed a year-and-a-half and there is now no age cap on making contributions to an IRA, did the rule change whereby once RMDs are begun the account holder can no longer make contributions? Meaning, can someone who is taking an RMD also make contributions now?

An individual who reaches age 70-1/2 after December 31, 2019 can contribute to an IRA even if he/she has reached age 72 and is required to take RMDs from the IRSimilarly, a plan participant can continue to make contributions to a qualified plan after attainment of age 72.

Did I see a blurb about RMDs for charitable giving pre-72?

Yes. Prior to SECURE, IRA account holders who were required to receive required minimum distributions could have up to $100,000 of the RMD transferred directly to a charity. The amount transferred to a charity counted for purposes of satisfying the RMD, but was not included in the IRA account holder's income. Under SECURE, these "charitable distributions" are still permitted, but the amount that may be excluded from income is reduced by any deductible IRA contributions that the IRA account holder makes after attainment of age 70-1/2.

Please clarify the vague parameters around the new beneficiary IRA rules. I realize there is currently a grey area that many firms are trying to clarify. One firm said that annual distributions do not have to be made but by the completion of the 10th year all assets must be distributed.

In general, for distributions with respect to deaths occurring after December 31, 2019:

Beneficiaries who are not "designated beneficiaries" must be paid the entire account balance by December 31 of the 5th calendar year following the year of the participant's death. This includes estates, charities, and certain trusts* designated as beneficiaries.

Beneficiaries who are "designated beneficiaries" but not "eligible designated beneficiaries" must be paid the entire account balance by December 31 of the 10th calendar year following the year of the participant's death. This generally includes non-spouse beneficiaries who are more than 10 years younger than the participant.

Beneficiaries who are "eligible designated beneficiaries" may receive payments from the account over their lifetimes, provided payments begin by December 31 of the calendar year following the calendar year of the participant's death. This includes spouses, minor children of the participant (until they reach the age of majority), disabled or chronically ill individuals, and individuals who are not more than 10 years younger than the participant. Note that a spouse may be able to delay the start of payments beyond December 31 of the calendar year following the calendar year of the participant's death.

*A trust whose beneficiaries all qualify as designated beneficiaries would generally be treated as a designated beneficiary such that distributions would be required to be completed by the 10th year following the year of death. It is not clear whether a trust could qualify as an eligible designated beneficiary; more guidance is needed.

Given the new rules regarding payments upon death, is a Qualified Longevity Annuity Contract (QLAC) no longer being used with retirement plans?

A QLAC is an annuity contract whose value can be excluded from the participant's account balance when calculating the minimum amount that is required to be distributed under the required minimum distribution rules. Payments under a QLAC can begin as late as age 85 and payments upon death can be made over the life of a designated beneficiary. It isn't clear that the accelerated death payment rules described above are intended to override existing QLAC rules regarding payments at death but, even if they are, a QLAC can still be designed to satisfy the new rules, for example, by designating someone who qualifies as an eligible designated beneficiary as the beneficiary of the QLAC. (Also, SECURE provides that some annuity contracts in effect on December 20, 2019 are exempt from the new rules, for example, if elections as to payment amount and method had irrevocably been made.) Commentators have suggested that the new fiduciary safe harbor for selecting a retirement income contract provider, and the rules for allowing portability of lifetime income investments, may actually increase the use of QLACs in retirement plans.

Non-Qualified Deferred Compensation

What impact do you think these changes will have, if any, on non-qualified deferred compensation plans as you view the Act currently?

SECURE did not make any direct changes to the rules governing nonqualified deferred compensation plans (other than governmental 457(b) plans, which operate more like qualified plans than nonqualified plans). We do not foresee any significant impact on nonqualified deferred compensation plans.

Lifetime Income Disclosures

With regard to lifetime income disclosures, do "pension benefit statements" apply only to DB plans or will it apply to 401ks and 403bs?

The new rule requiring lifetime income disclosures to be included on pension benefit statements at least once every 12 months applies only to individual account plans (e.g., 401(k) and 403(b) plans) that are subject to ERISA; it does not apply to defined benefit plans. Note that the disclosure will not be required until 12 months after guidance is issued.

Extended Deadline for Adopting Plans

Please address the impact on elective deferrals of the extension for establishing retirement plans up until the tax filing deadline (plus extensions) for the business. Deferrals still need to be made 15 days after the month withheld or earlier via DOL Safe Harbor for under 100 employee plans. If plan isn't set up until 10/15/2021 for 2020, deferrals won't be made in 2020.

Although a plan can be established as late as the tax filing deadline of the employer for a year, it is still the case that elective deferrals cannot be made prior to the date the plan is formally adopted. For example, an employer with a calendar year fiscal year files its tax return for its 2020 tax year on September 15, 2021. If the employer formally adopts a plan document by September 15, 2021 for a plan that is effective in 2020, and deposits a non-elective contribution to a trust on or before that date, the contribution is deductible for its 2020 tax year. However, the earliest an employee could elect to defer compensation to the plan would be September 15, 2021, and that deferral would count as a contribution for the employer's 2021 tax year.

I believe the retroactive adoption of a plan is not permitted for 2019, it is for tax years after 2019. Can you clarify?

You are correct that the retroactive adoption is for taxable years beginning after December 31, 2019. It could not be used to adopt a plan in 2020 for the 2019 taxable year.

403(b) Plans

In one communication I saw regarding the SECURE Act, I saw mention of something indicating there was language in this Act that will make terminating 403(b) plans with legacy individual annuities possible without having to liquidate the annuity policies. If you could address this topic, I would appreciate it.

SECURE includes a provision that permits 403(b)(7) custodial accounts to be distributed "in-kind" to the 403(b) custodian when the plan is being terminated. Practically speaking, this will probably involve the retitling of the 403(b)(7) account so that it is no longer associated with an employer 403(b) plan. The distribution is treated as such solely for purposes of enabling the plan sponsor to say it has distributed the custodial account assets so that it can effectuate the termination of its 403(b) plan. The participant is not treated as having received a taxable distribution; instead, the account continues to be treated as a tax-deferred 403(b) account, so long as the account continues to be administered in accordance with tax rules applicable to the plan on the date it terminated. To take advantage of this provision, the employer must not maintain any material rights in the custodial account. IRS guidance on this provision is expected sometime in June of 2020.

What provisions apply to 403(b) plans?

All provisions of SECURE apply to 403(b) plans except the following:

- Special minimum funding rules for community newspaper plans
- Modifications to PBGC premiums for CSEC plans
- Testing relief for closed defined benefit plans
- Provisions regarding 529 education savings accounts
- Lowering of in-service distribution age for pension plans and governmental 457(b) plans
- Tax credits (not available to tax-exempt or governmental entities)
- IRA-specific provisions (e.g., inclusion of taxable non-tuition fellowships as IRA compensation, elimination of age limit for IRA contributions, provisions regarding charitable distributions)
- Retroactive adoption of qualified plan by tax filing deadline
- Pooled employer plan (PEP) provisions
- If the 403(b) plan is not subject to ERISA, then the lifetime income disclosure rule and the fiduciary safe harbor for selecting a guaranteed retirement income issuer
- Long-service part-time employee provision

General

Does this act sunset eventually?

No, there are no built-in sunset provisions in SECURE. Note: The provision allowing volunteer firefighters and emergency responders to exclude qualified state and local tax benefits and qualified payments from income applies only to benefits and payments received in 2020. This provision of SECURE does not relate to retirement benefits.

Is there a 5k eligible distribution from 401k plan to offset student loans?

No, there is no such provision in SECURE.

Qualified Startup Cost Tax Credit

Can the $5,000 start-up credit be used by plan sponsors to pay for employer match as well as plan expenses?

No. The startup tax credit is only available for administration expenses incurred in establishing and maintaining a plan, or providing retirement education to employees; it cannot be used to pay for employer matching or other contributions.

Are existing small employer pension plans eligible for tax credits?

Possibly. The qualified startup cost tax credit is available for three consecutive years starting with the year the plan is first established. The auto-enrollment tax credit is available for three consecutive years starting with the year the plan first include an auto-enrollment feature. An existing small employer pension plan may take advantage of the credits if it is still in one of these three-year windows.

To be eligible for the tax credit an employer cannot have maintained a plan in the prior three years. Does that mean ANY plan or the same kind of plan? i.e., had a 401k plan for several years and start cash balance plan.

In order to take advantage of the startup tax credit, neither the employer nor any member of its controlled group can have maintained any "qualified employer plan" in the three years preceding the first credit year for substantially the same group of employees. Qualified employer plan is defined in Code Section 4972(d) as a qualified plan, a qualified annuity, a SEP, or a SIMPLE. Thus, for example, if an employer previously maintained a SEP that was terminated within the last three years and established a 401(k) plan (or a 401(k) plan that was terminated and established a cash balance plan), the tax credit would not generally be available.

What is the definition of administration expense for the credit? Are there any limitations for how the expense is paid?

Under Code Section 45E(d)(1), "qualified startup costs" include any ordinary and necessary expenses of an eligible employer which are paid or incurred in connection with the establishment or administration of an eligible employer plan. Any expense that is ordinarily incurred in connection with the plan should be acceptable, including recordkeeping fees, audit fees, legal fees, consulting fees, investment management or advisory fees, etc. The expense would have to be paid or incurred by the employer, not by the plan itself. Any expenses that are passed through the plan and paid by participants would not be eligible for the tax credit.

Your slide shows SEP as being eligible for the automatic enrollment credit. Does this apply only to those who sponsor a SARSEP? I didn't think that you can start up new SARSEPs.

Qualified startup costs incurred in connection with a SEP are eligible for the credit. This likely includes a SEP with a salary reduction arrangement (i.e., a SARSEP) that was in effect as of December 31, 1996.

Does the automatic enrollment tax credit apply to existing plans that already have the auto enroll feature in place? Does it apply for an existing plan that wants to add auto enroll? Or does it only apply to new plans that add auto enroll?

The auto-enrollment credit is available only for the first three years that an auto enrollment feature is included in the plan. It would apply to existing plans that add auto enrollment, and to new plans that include auto enrollment, but it would be available to existing plans that already have auto enrollment only if the auto enroll feature had been added within the last three years.

When is the number of Non-Highly Compensated Employees (NHCE) determined when calculating the plan start up tax credit? The number of NHCEs can change through the year.

While the statute does not specifically address this, we believe you can count any NHCE who was eligible to participate at any time during the year.

Safe Harbor

Regarding the safe harbor provisions, how would any employer contributions be treated if a plan retroactively became safe harbor for the plan year? Would the new non-elective contribution be on top of any previously provided employer contributions or could the employer contributions be re-characterized as a NEC?

The safe harbor non-elective contribution would generally have to be in addition to any other employer contributions that had already been made to the plan for the year. If there is a forfeiture account that has a balance, and the plan document so permits, forfeitures could be used to offset the required non-elective contribution.

Slide 9. Is the October 1st deadline still in place for Safe Harbor 401k plans? Doesn't appear to have been addressed. Legislation refers to year end, but SH didn't have a year-end establishment deadline, it was 10/1.

You may be thinking about the deadline for adopting a new plan that contains a safe harbor feature. In general, a safe harbor feature must be in effect for the entire plan year, and the plan year must be 12 months long. An exception applies for new plans, where the plan year may be less than 12 months as long as it is at least 3 months long. The SECURE Act provision allows existing plans to retroactively adopt a non-elective safe harbor feature, whereas the new plan rule allows new plans to adopt either a non-elective or matching contribution feature if the plan is in effect for at least 3 months.

Qualified Birth or Adoption Distributions

Slide 15. I've seen other pieces that specify this applies to IRAs and DC plans. Are the DB rules under 2019 rules?

Qualified birth or adoption distributions are not available from defined benefit plans.

In the event of twins, can the plan participant receive a maximum distribution of $10,000 ($5,000 per child) or does the aggregate rule limit the distribution to $5,000?

The statute states that the aggregate amount "with respect to any birth or adoption" shall not exceed $5,000. Thus, we believe in the event of twins, up to $10,000 may be treated as a qualified birth or adoption distribution.

Qualified birth or adoption distributions are subject to regular income tax, correct? If the distribution is taken from pre-tax 401(k) sources, is it still pre-tax if repaid to the plan?

In general, qualified birth or adoption distributions are subject to regular income tax (they are exempt from the 10% early payment penalty tax). However, the recipient has the option to repay the distribution and, if the distribution is repaid, it is treated as though it was rolled over within 60 days of receipt. Thus, if the distribution is repaid, the amount repaid would not be included in income or subject to tax. It would also be treated as a contribution of pre-tax funds if it originally came from pre-tax funds.

Example: A participant has a child on April 1, 2020 and requests a qualified birth or adoption distribution from the plan of $5,000 within one year of the child's date of birth. The distribution is not an eligible rollover distribution so it is not subject to 20% mandatory income tax withholding; it is subject to 10% income tax withholding but the participant can opt out of withholding so that no taxes are withheld. The participant opts out of tax withholding and receives a gross payment of $5,000 in 2020. The participant must report the distribution of $5,000 as taxable income when filing his/her 2020 tax return unless by the time that return is filed, he/she has repaid the $5,000. If the $5,000 has been repaid, it does not need to be reported as taxable income. We expect that Form 1040 instructions would provide specific guidance on how to report the distribution, including distributions that have been repaid.

MEPs/PEPs

Regarding an Open MEP - what are the responsibilities of the adopting employers, if any, as it relates to ongoing monitoring of the Pooled Plan Provider or other Advisors/Fiduciaries?

A Pooled Employer Plan (PEP) is a type of Open MEP that has a Pooled Plan Provider. Adopting employers are responsible for selecting and monitoring the Pooled Plan Provider and all other persons that are designated as named fiduciaries of the PEP.

In a MEP, can employers find any audit cost efficiencies if they have more than 100 eligible employees?

For a Closed MEP and a PEP there is one 5500 (and thus, one audit) for the entire plan and all adopting employers.

How does an advisor get paid if the plan goes into a PEP or MEP?

Advisors can get paid by acting as the 3(38) to the MEP/ PEP, by delivering education services to the plan participants, by plan consulting, etc.

Can we, as advisors, design a MEP and invite our clients to join it?

Advisors can serve as the Lead Employer/Plan Sponsor for an Open MEP and as the Pooled Plan Provider for a PEP, but cannot sponsor a Closed MEP.

Any thoughts of private labeling MEP plans?

Given the new regulations, the opportunity to private label MEP plans is certainly a possibility.

Do you see this working better for an advisor that creates one open MEP as 3(38) with one recordkeeper and 3(16) as their own solution or better to work with associations with unrelated companies (chambers of commerce) to craft their own solution?

We believe both scenarios offer a tremendous opportunity for advisors in the market. Note that advisors may serve as the pooled plan provider for a PEP, but cannot sponsor an open MEP.

Please clarify what are MEPs and PEPs.

These are plans that pool employers together to gain efficiencies in pricing, operations of the plan and reduce fiduciary liability (Closed MEP/PEP for the adopting employers).

Can PEP and MEP sponsorship be compensated by direct fee or marketing fee?

Yes under Department of Labor rules the lead employer/plan sponsors can receive reasonable compensation for services that are appropriate and necessary to the plan and that do not relate to services provided to its own employees. All fees must be adequately disclosed under ERISA Section 408(b)(2).

How will Newport Group work with TPA's or advisors who wish to establish a PEP?

Newport acts as the integrated recordkeeper, administrator, 3(16) Administrative Fiduciary, Trustee, and Custodian. If the advisor chooses not to be the 3(38) Investment Fiduciary, then Newport is able act in this capacity to support the advisor.

Can 403(b) plans use a PEP?

No, not at this time. Only 401(a) plans are allowed to join a PEP.

Are there any provisions for 403(b) MEPs?

SECURE did not include any provisions for a 403(b) MEP.

Does the PEP start in 2021?

Yes it is effective for plan years beginning after December 31, 2020.

I want to understand who has the investment selection fiduciary responsibility and what freedom each individual employer has to customize matching etc.

Both SECURE and final Department of Labor regulations provide that participating employers are responsible for managing investments, unless that duty is assumed by or delegated to another entity. A Most MEP/PEP can provide that the MEP/PEP sponsor will select the investment lineup (or will appoint an advisor to do so) so that the burden does not fall to participating employers. The MEP/PEP sponsor also determines how much flexibility each adopting employer has to determine matching contributions.

Please discuss any ramifications with respect to fiduciary liability of plan trustees.

In a PEP, the trustee is responsible for ensuring plan contributions are remitted to the trust. In both MEPs and PEPs, plan trustees also continue to have fiduciary responsibilities to safeguard the assets and provide other contracted services as set forth in applicable trust agreements.

Is DOL/Treasury guidance clear on this? Meaning, is this ready to sell, or must we wait for regulations before selling?

SECURE provides that employers and pooled plan providers can implement a PEP in accordance with a good faith interpretation of its provisions, pending the issuance of guidance by the DOL and IRS. We anticipate that guidance will be issued that provides more details for implementation.

How does Portman-Cardin (Retirement Security and Savings Act) relate to the SECURE Act?

SECURE included many of the provisions of the Retirement Enhancement and Savings Act (RESA), a bill introduced by Senators Grassley and Wyden. Senators Portman and Cardin introduced the Retirement Security Preservation Act to address nondiscrimination challenges faced by frozen defined benefit plans; SECURE also included similar provisions.

Does the Secure Act make it easier for other entities to act as plan sponsor?

Yes, SECURE includes a provision allowing a pooled plan provider to sponsor a retirement plan for multiple employers, and a provision that eliminates the "one bad apple" rule for defined contribution MEPs that either have commonality or a pooled plan provider.

Why would a bona fide group or association choose to put a MEP in place rather than a PEP?

There are some aspects of sponsoring a PEP that are different than sponsoring a Closed MEP. For example, a PEP must be sponsored by a registered pooled plan provider and its trustee must assume responsibility for ensuring contributions to the PEP are timely made.

What liability does the adopting employer possess in a PEP?

Participating employers retain fiduciary responsibility for selecting and monitoring the pooled plan provider and other named fiduciaries. They also retain fiduciary responsibility for investing and managing plan assets when those duties are not delegated to another fiduciary.

Are MEP/PEPs only for startup and small plans?

No, not at all. Some existing and larger plans may decide to migrate to a Closed MEP or PEP in order to offload the plan operations and fiduciary liability of running a separate plan. However, larger/existing plans will need to consider whether the MEP/PEP provides sufficient plan design flexibility.

How do you handle signing authorization, adoption agreements, and service agreements for individual employers participating in a MEP?

Adopting employers typically identify authorized signers with authority to address employer-specific duties, execute services agreements, and sign "participation agreements" to reflect adoption of the MEP/PEP.

What is the benefit/value-add of a MEP over a traditional plan with participating employers?

Reduced expense, time and fiduciary liability of running a separate plan.