Next move for SECURE?

It's time to start thinking strategically about next steps.

January 2020

KEY POINTS

- The SECURE Act presents opportunities for plan sponsors and their service providers to review plan design and determine how best to approach optional provisions.
- Some provisions became effective as of January 1, 2020, and may merit immediate plan sponsor attention.

The passage of the SECURE Act in December 2019 launched the retirement industry into a world of competing priorities. Service providers, including T. Rowe Price, focused on administrative distinctions and participant communications for the more immediate provisions in SECURE—including the change to the beginning date for required minimum distributions (RMDs) and the revision of rules relating to how long a plan or IRA beneficiary could "stretch" a distribution.

Service providers are now taking a more strategic look at the provisions in SECURE. Discussions between plan sponsors, advisors, and T. Rowe Price should focus on determining which strategies to embrace and which require proceeding with caution in order to maximize the potential for retirement success for plan and participants.

First steps: Items to address in 2020

Plan sponsors and their advisors will want to focus on how and whether new options in SECURE will provide the best retirement benefit for their plan participants. Those conversations should start with the following provisions, which are effective immediately.

- Automatic contribution improvements
- New baby/adoption distributions
- Annuities
- Streamlined plan administration
- Small employer incentives
- Defined benefit plan considerations
- Phased retirement

Automatic contribution improvements

Plan sponsors who want to increase their participants' likelihood of success in retirement may want to consider adoption of a safe harbor qualified automatic contribution arrangement (QACA). This arrangement requires a plan to automatically enroll individuals and to automatically increase their deferral percentage, up to a statutory cap.

15%

cap on salary deferrals aligns with T. Rowe Price's analysis, which shows that 15% is the yearly contribution rate likeliest to lead to successful retirement outcomes.

"New baby/adoption distributions could be appealing to participants, but they may have an outsized negative impact on individuals' ability to meet their retirement needs.

SECURE has changed the cap on salary deferrals under these programs from 10% to 15% (except in the first year, where the cap remains at 10%). Even sponsors who already have a QACA may want to increase the cap on deferrals, and some may even want to consider changing the first-year deferral rate to the new statutory maximum. (The prior legislation started deferrals at 3% and many plan sponsors adopted the permissible "floor" deferral rate at that time.)

This change is good news for plan sponsors who have been persuaded by T. Rowe Price's analysis showing that 15% is the yearly contribution rate likeliest to lead to successful retirement outcomes. Even so, enthusiastic plan sponsors may want to wait for Internal Revenue Service ("IRS") guidance before adopting immediate changes.

It is not clear whether safe harbor QACA plans (which remain subject to annual advance notice requirements) can change the rate of automatic deferral mid-year. Without clarification about the immediate effective date, there is a risk that plan sponsors will violate QACA notice rules if they change before the beginning of the next plan year (2021 for calendar year plans).

Plan sponsors who do not have formal safe harbor QACA arrangements have more freedom to act quickly and may want to consider increasing their automatic contribution and automatic increase programs to mimic the QACA levels. Certainly, the Congressional recognition of a need for increased contributions serves as a powerful signal and can provide some comfort to sponsors who fear being seen as overly aggressive in their automatic contribution programs.

New baby/adoption distributions

SECURE provides provision that allow distributions for a new baby or adoption (up to $5,000 per new baby or adoption taken within 12 months of the event). These provisions were adopted in response to some in the federal government who were seeking greater adoption of paid parental leave by private employers. (The same government funding bill instituted paid family leave for federal workers.)

Employers without paid leave programs for birth or adoptions might find this provision to be a useful option to meet employee demands. The provisions exempt these distributions from early withdrawal penalties (but not from ordinary income taxation if the amounts are pre-tax) and allow repayment of the amounts distributed.

The IRS has taken one step forward in making this option more attractive by providing early guidance on the type of tax reporting that can be used for these distributions. However, many questions remain relating to the recordkeeping and administration of this option, and we are hopeful that the Treasury Department and the IRS will provide guidance in the coming months.

There's a note of caution for employers who are considering this plan design or individuals who are contemplating a withdrawal from a plan or IRA:

- Individuals who are eligible for new baby or adoption benefits are frequently earlier in their careers. This means that the distributions, if taken early and not repaid, will be deprived of the chance to experience tax-deferred gains, whether through appreciation or reinvestment of dividends.
- Individuals saving through Roth features might destroy the Roth treatment if distributions are taken from Roth sources.

In short, new baby or adoption withdrawals may have an outsized negative impact on individuals' ability to meet their retirement needs.

With new fiduciary protection, sponsors considering annuities may want to re-evaluate the potential role that annuities might play in their plan.

The new disaster distributions authorized in the government spending bill (covering those experiencing losses in a narrow window of time attributable to federally declared disasters other than the California wildfires) might have a similar impact, but these distributions provisions are far less likely to be adopted by plans.

Annuities

Retirement annuities have not proven popular with defined contribution plan sponsors or plan participants. Few plans (outside of those serviced by insurance companies) offer accumulation annuity investments. Even though many defined contribution plans offer an annuity form of distribution, that option is rarely selected.

Some plan sponsors and industry observers attribute the relative rarity of annuities to the extremely high fiduciary bar imposed by the Department of Labor, as well as structural inflexibility. Historically, ERISA fiduciaries have been required to select the “safest possible annuity” by Department of Labor guidance. In the context of defined contribution plans, this rule required fiduciaries to ascertain and monitor the claims paying ability of the issuer.

Fiduciary stakes were high because of the structural inflexibility: Even if a fiduciary were willing to select and monitor an annuity, a fiduciary decision to discontinue the annuity might subject participants to surrender penalties unless they happened to be eligible for a distribution for other reasons.

SECURE has solved both the fiduciary barrier and the lack of portability. SECURE still requires fiduciaries to evaluate annuity carriers carefully but allows fiduciaries to rely on issuer certifications and state licensing standards to evaluate the claims-paying ability of the issuer. In addition, if the fiduciary decides to discontinue the annuity option in the plan, SECURE allows participants holding annuities a unique in-service distribution right to take a distribution of the annuity contract, or to do a trustee-to-trustee transfer of the annuity to an eligible retirement plan, including an IRA.

For those sponsors considering annuities, this new fiduciary protection is very important. Those sponsors will want to re-evaluate the potential role that annuities might play in their plan. Certainly, sponsors that offer distribution annuities today may want to evaluate additional participant education about that plan feature.

Streamlined plan administration

Plan sponsors have new opportunities to streamline plan administration.

All sponsors have new deadlines for plan adoptions for profit-sharing, money purchase, annuity, or stock bonus defined contribution plans. SECURE now allows such plans to be adopted up until the tax filing deadline for the sponsor. There is a trap for the unwary in these provisions: 401(k) cash or deferral arrangements must be adopted before the first opportunity for individuals to defer under the plan.

Plan sponsors who maintain (or seek to adopt) plans that take advantage of safe harbor provisions through qualified nonelective contributions (QNECs) have new flexibility. The annual safe harbor notice requirement for these plans is eliminated. Further, QNEC safe harbor provisions can be adopted anytime during the year up until the 30th day before the close of the plan year and can even be amended any time before the end of the following year so long as the QNEC is at least 4%.

Small employer incentives

Small employers (those with fewer than 100 employees) have new opportunities in SECURE. Employers without plans have a new three-year tax credit of up to $5,000 annually for “qualified start-up costs” of establishing a plan, including a SEP or a SIMPLE IRA. (The specific amount of the credit is dependent on the number of non-highly compensated employees eligible for the plan.) In addition, small employers can get an

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additional three-year credit of up to $500 per year for establishing and maintaining in all three years an eligible automatic enrollment arrangement in a plan.

These tax incentives can provide powerful motivation for those who have been debating establishment of a plan. It is worth noting that a decision to participate in a multiple employer plan does not appear to qualify a small employer for these credits.

Defined benefit plan considerations

Sponsors of closed defined benefit (DB) plans received some very good news with the passage of SECURE. These plans historically faced challenges with passing nondiscrimination testing if they were closed to new entrants (typically more non-highly compensated employees) but continued to benefit more tenured employees (typically skewed to more highly compensated employees). The new provisions address this challenge by providing a number of alternative testing methods that can be used to establish that the plan is nondiscriminatory.

Phased retirement

Traditionally, sponsors of defined benefit plans and 457 plans had a more difficult time facilitating phased retirements because in-service distributions from these plans were not allowed until age 62 and 70½, respectively.

Sponsors of these types of plans will want to evaluate whether promoting payments that could facilitate phased retirement would be helpful to their organizations. While such distributions dilute the amount available when an individual has fully retired, they are less likely than new baby or adoption withdrawals to have substantial impact on an individual's ability to meet his or her needs after full retirement. These amounts have a shorter opportunity to appreciate or generate earnings that can be reinvested in a tax-deferred structure, so a participant loses out on less by withdrawing the funds at this stage.

Looking to 2021 and beyond

While not effective in 2020, these provisions also could warrant strategic discussions among plan sponsors, advisors, and service providers:

- Participation in multiple employer plans
- Mandatory eligibility for long-term part-time employees
- Lifetime income disclosures on statements

Participation in multiple employer plans (MEPs)

SECURE introduced pooled employer plans (PEPs) sponsored by financial services firms. It also relaxed the daunting "one bad apple" rule that penalized the entire plan for qualification failures of one employer.

With these changes, we expect an explosion in efforts to develop and market this new type of MEP to smaller employers. As the provisions have a delayed effective date (plan years beginning after 2020), we expect development of PEPs and associated rulemaking to be a focus of the industry, but less impactful to plan sponsors in the near term.

Other firms may seize on the opportunity to establish a quasi-MEP using the ability to file a common Form 5500 for plans with identical investments and service providers. This provision becomes effective for plan years beginning after 2021. Unlike traditional MEPs, these "common filer" arrangements will allow small employers adopting plans for the first time to take advantage of the higher small employer incentives.

Mandatory eligibility for long-term part-time employees

Starting in 2021, except in the case of collectively bargained plans, employers will be required to track hours for part-time employees over age 21 (working at least 500 hours) with the goal of determining whether such employees must be allowed in the plan.

Given the three-year time period for determining eligibility, we don't anticipate that employers will be required to allow these individuals to enroll before 2024. Individuals who are enrolled in plans under these provisions do not need to be made eligible for matching contributions, nor must they be counted for non-discrimination testing purposes.

It is worth noting that these provisions do not directly impact employers with immediate or near-immediate eligibility, except that plans will these provisions should be able to exclude the long-term part-time population from nondiscrimination testing after 2025.

Lifetime income disclosure on statements

There is little that plan sponsors or their advisors can do now to prepare for lifetime income disclosures. Effective 12 months after release of Department of Labor guidelines, plans will be required to provide lifetime disclosures using annuity assumptions provided by the government. The disclosures will be required to forecast current balances under two different annuity assumptions for all participants—a joint and survivor annuity assumption (using a hypothetical spouse of equal age to the participant) and a single life annuity assumption.

Until further insight is provided, it will be difficult to know how to position this new information.

A CRITICAL YEAR

SECURE presents plan sponsors with a rich selection of provisions to consider, making 2020 an ideal year to rethink plan design strategy.

For questions about these retirement provisions, contact your T. Rowe Price representative.

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