SECURE Act Creates Near-Term Challenges

Guidance is needed to facilitate implementation.

March 2020

KEY POINTS

- Many provisions of the SECURE Act and related retirement measures passed in December 2019 became effective almost immediately, without an opportunity for regulatory guidance or relief.
- Questions have been presented to the Treasury and IRS, and we're hopeful that they will begin to provide guidance on these issues over the coming months.

On December 20, 2019, President Trump signed a comprehensive government spending bill that includes the Setting Every Community Up for Retirement Enhancement ("SECURE") Act, along with a handful of other retirement measures.

The legislation did not alter any of the effective dates in SECURE as originally passed in the House on May 23, 2019. As a result, many of the provisions became effective almost immediately, without an opportunity for regulatory guidance or relief.

T. Rowe Price has been participating with industry trade groups in seeking clarity from the Treasury Department ("Treasury") and the Internal Revenue Service ("IRS") as to how to adapt in the short run to these immediate changes.

We've outlined in this article some near-term challenges in implementing changes for defined contribution plans, as well as some areas where guidance is needed.

Increase in age for required minimum distributions ("RMDs")

The required beginning date for RMDs has changed from April 1 of the calendar year following the calendar year in which an individual reaches age 70½ to April 1 of the calendar year following the calendar year in which an individual reaches age 72. The exception for plan participants who are still employed continues to apply. This change is effective for participants turning 70½ after December 31, 2019.

Immediate challenges

One immediate challenge associated with this change is distinguishing between participants who are subject to the old rules (i.e., born before July 1, 1949) and those who can benefit from the new required beginning date (i.e., born after June 30, 1949). This distinction must be made in distribution forms, participant communications, web experiences, and phone interactions. It will also be necessary to consider this distinction in the context of tools and calculators including retirement income estimates.

> An eligible designated beneficiary includes a surviving spouse, a child under the age of majority, a disabled or chronically ill beneficiary, and a beneficiary who is not more than 10 years younger than the participant.

To the extent that systems updates lagged behind the effective date of the change in RMD beginning date, it is possible that some distributions (or a portion of some distributions) were treated as RMDs when they were in fact eligible for rollover. This is significant because eligible rollover distributions are subject to mandatory 20% withholding and require the provision of a "rollover options notice" (the "402(f) Notice").

Also, to the extent a participant took a distribution because he or she thought an RMD was required, and more than 60 days has passed, it normally would not be permissible to recontribute the distribution back into the plan or an IRA without receiving a waiver from the Internal Revenue Service ("IRS").

It is worth noting that the current model 402(f) Notice issued by the IRS does not reflect the change in RMD age or other retirement-related changes in the spending bill. Until the IRS updates the model 402(f) Notice, we will use an independently revised 402(f) Notice that incorporates certain SECURE Act changes (which will be available soon).

Guidance needed
It is possible that the Treasury Department ("Treasury") and/or IRS may provide relief relating to the incorrect reporting and withholding of distributions occurring early in 2020 that were processed as RMDs but otherwise eligible for rollover. Treasury/IRS may also provide for automatic waivers relating to the 60-day rollover rule for individuals receiving eligible rollover distributions that were treated as RMDs by retirement plan service providers.

Changes to beneficiary distributions

New rules apply to beneficiary distributions, significantly limiting the ability of beneficiaries (other than "eligible designated beneficiaries") to "stretch" distributions throughout their lifetimes.

With respect to deaths after 2019, the rules generally require that benefits be distributed in full within 10 years (delayed effective dates apply to governmental and collectively bargained plans). An eligible designated beneficiary has the option of taking distributions (which must begin in the year after death) based on his or her life expectancy.

Immediate challenges

There will be challenges in distinguishing beneficiaries who are subject to the limitations on stretch distributions and the exceptions for eligible designated beneficiaries. Even though the changes generally apply to deaths after 2019, and distributions do not need to begin earlier than 2021, distinctions based on the date of death must begin to be made now in materials and interactions that address distribution rules (such as distribution forms, participant communications, web experiences, and phone interactions).

The delayed effective date for governmental and collectively bargained plans presents a similar need to distinguish between participants subject to old and new beneficiary distribution rules. In making these distinctions, we need to consider the delayed effective dates that are unique to these plans:

- **Governmental plans:** The new rules apply to deaths after 2021.
- **Collectively bargained plans:** The effective date depends upon the expiration of the collective bargaining agreement(s). If the collective bargaining agreement (or the last collective bargaining agreement in a plan that is maintained in accordance with more than one collective bargaining agreements) expires during 2020 or 2021, the new rules apply immediately to deaths following such expiration. If the (last) collective bargaining agreement expires after 2021, the rules apply to deaths in 2022 and afterwards.

Guidance needed
When a plan covers both collectively bargained and non-collectively bargained employees, it is not clear whether the regular effective date or the collectively bargained plan effective dates apply. In conversations with industry groups, Treasury officials have suggested that whether or not a plan is "maintained pursuant to 1 or more collective bargaining agreements" turns on whether a certain number or percentage of union employees are covered under the plan. The Treasury may decide to provide guidance on this issue, including whether and what minimum standard applies, and may clarify whether beneficiaries of non-union participants in the same plan would be subject to the delayed effective date.

A number of other questions have been raised regarding the application of these complex rules to other specific scenarios, such as to trusts with multiple beneficiaries. We believe that the Treasury/IRS will likely provide guidance in the form of a regulatory proposal, a format that facilitates the use of illustrative examples. These rules will be most impactful to beneficiary distributions beginning in 2021. Therefore, while regulations are not likely to be finalized prior to next year, the Treasury/IRS may need to provide for reliance on any proposal.

Penalty-free birth or adoption withdrawals

The new legislations permits qualified birth or adoption distributions from IRAs and retirement plans for distributions made after December 31, 2019. Such distributions are:

- Exempt from the 10% early distribution penalty, and
- Exempt from the mandatory 20% withholding and 402(f) notice requirements (for distributions from retirement plans).

Distributions must be taken within one year of birth or adoption and are limited to $5,000 per birth or adoption (per spouse). The adoption of anyone over 18 (other than an individual physically or mentally incapable of self-support) or the adoption of a spouse's child does not qualify. Distributions can be repaid to the plan from which the withdrawal was taken or to an IRA without regard to the 60-day limit for rollovers.

Immediate challenge

Recordkeeping systems will need to be programmed to capture and verify qualified birth or adoption distributions and permanently track those distributions for potential repayment.

Guidance needed
We believe that this feature is optional, but we need confirmation from regulators.

There are many outstanding questions as to how a plan administrator would need to verify that participants meet the requirements:

- Is documentation required regarding the birth or adoption, or is it sufficient for the participant to self-certify?
- Does the $5,000 limit apply to each pregnancy or each child (e.g., is $5,000 per child permitted with the birth of twins)?
- Are distributions permitted from all sources, including safe harbor contributions?
- Are plans required to accept repayment of distributions and can they impose a time limit if they accept recontributions?
- Should recontributions be accepted into their sources of origin, a rollover source, or other source, and do they have basis?
- Must a qualified birth or adoption distribution be taken prior to a hardship?

> Many of these questions have been brought to the attention of Treasury and the IRS, and we are hopeful that the guidance will be provided over the coming months.

- What is the impact on safe-harbor notices when a plan adds this provision, and is this a permissible mid-year change for a safe harbor plan?
- If the feature is optional and a plan does not permit the distributions, and a participant is otherwise eligible for a distribution (e.g., because of termination of employment or attainment of age 59½), must the plan treat the distribution as a qualified birth or adoption distribution if informed by the participant (i.e., withhold accordingly and prohibit rollovers to another plan or IRA)?
- If a plan administrator permits these distributions, is the distribution right a protect benefit which can never be eliminated (including when plan features are harmonized in a plan merger)?

Automatic enrollment safe harbor plans

The SECURE Act raises the cap from 10% to 15% on auto enrollment and auto escalation in automatic enrollment safe harbor plans known as qualified automatic contribution arrangements (QACAs). In the first year, the default contribution cannot exceed 10%.

Immediate challenge

While a 15% savings rate aligns with the target savings rate that T. Rowe Price believes is the likeliest to lead to successful outcomes, some recordkeeping systems may have limitations (in relation to the "uniformity" rules that apply to automatic contributions in QACAs) that need to be addressed before plans are encouraged to embrace higher automatic contribution rates in these types of plans.

Guidance needed

The change is likely to encourage plans that cut contributions off at the old limit to allow resumption of automatic increases up to the new maximum. It is not clear how the intersection of the uniformity rules with the automatic increase provisions will apply in the event of such an increase. Specifically, it will be difficult to create uniformity between those who have remained employed between the time they reach the old maximum and enactment, compared to those who terminated after reaching the maximum but rehired after enactment of the SECURE Act. Guidance will be helpful to ensure that plans do not create inadvertent foot faults if they want to take advantage of the new maximums.

More questions likely to emerge

As we continue to review the SECURE Act's immediately effective provisions, we will likely encounter additional areas where the rules are unclear. Provisions with later effective dates will similarly require additional guidance.

We'll continue to monitor developments on the interpretation of the SECURE Act and emerging guidance.

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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