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The SECURE Act's Impact on Employer-Sponsored Retirement Plans, Programs, and Arrangements

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On December 20, 2019, the president signed into law the "Setting Every Community Up for Retirement Enhancement Act of 2019"[1] (the "Act"). Known and referred to colloquially as the "SECURE Act," the law's stated purpose, among other things, is to increase the coverage of American workers in employer-sponsored savings arrangements. The Act enacts into law a series of retirement policy initiatives that have been circulating for several years.[2] It is organized into four titles:

- Title I: Expanding and Preserving Retirement Savings
- Title II: Administrative Improvements
- Title III: Other Benefits
- Title IV: Revenue Provisions

These provisions collectively modify and generally liberalize the tax rules governing employer-sponsored plans and individual retirement accounts (IRAs), among others. While most of the Act's changes are marginal or incremental, e.g., increasing the small business tax credit for plan startup costs, others may well prove game-changing, e.g., rules expanding access to certain §401(k) multiple-employer plans, a/k/a pooled employer plans.

Set out below is a summary of the key provisions of the Act of interest to employers that sponsor tax-qualified retirement plans.

CLOSED AND OPEN MEPS/POOLED EMPLOYER PLANS

Added in 1974 by the Employee Retirement Income Security Act of 1974 (ERISA),[3] I.R.C. §413 established rules governing so-called "multi-employer plans." In general, the tax-qualification rules under the Internal Revenue Code[4] treat a plan maintained by a group of related employers as maintained by a single employer for purposes of applying the long list of qualification requirements set out in §401(a). But the tax qualification rules are modified in certain respects in the case of a plan maintained by a group of unrelated employers, i.e., a "multiple employer plan" or "MEP" to apply employer-by-employer in most cases. Thus, for example, rules governing coverage, nondiscrimination, and vesting upon plan termination are applied separately to each employer's employees.[5] MEPs must not be confused with "multi-employer plans," which are collectively bargained retirement plans subject to §413(a).[6]

MEPs can be either defined benefit or defined contribution plans, and when properly structured are considered a single plan for which a single Form 5500 is filed. MEPs are often adopted by a group of employ-

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[1] The Act is a part of the Further Consolidated Appropriations Act, 2020, H.R. 1865, Pub. L. No. 116-94, Division O.

[2] *See, e.g.,* the Retirement Enhancement and Savings Act of 2019 (RESA) (S. 972).

[3] Pub. L. No. 93-406, 88 Stat. 829 (Sept. 2, 1974).

[4] Unless otherwise indicated, all section references herein are to provisions of the Internal Revenue Code of 1986 (the "Code"), as amended, and the regulations promulgated thereunder.

[5] Treas. Reg. §1.413-2(a)(3)(ii), §1.413-2(a)(3)(iii).

[6] *See generally* J. Toth, The Workinigs of the "Open" Multiple Employer 401(k) Plan, available at https://benefitslink.com/articles/guests/open-mult-employer-toth-2011-07.pdf.

ers with a common connection, such as membership in a trade or professional organization. Arrangements that fit this description are generically referred to as ''closed MEPs,'' to distinguish them from ''open MEPs.'' Open MEPs are MEPs in which members have no connection other than participation in a retirement savings plan, requiring each member to have and report on its own individual company plan. The regulators have traditionally been hostile to, or at least suspicious of, open MEPs.[7]

Prior to the Act, if any one MEP employer-member violated a tax qualification requirement, e.g., the top heavy or coverage rules, the *entire plan* was technically disqualified. This consequence is referred to as the ''one bad apple rule,'' and it served to limit the attractiveness of MEPs.

Endeavoring to make MEPs more generally attractive to small employers, the Act made the following changes for plan years beginning after December 31, 2020:

Relief From the "One Bad Apple Rule"

Act §101(a)(1), which adds new I.R.C. §413(e), provides that a MEP will not be treated as failing to meet applicable tax qualification requirements ''merely because one or more employers of employees covered by the plan fail to take such actions as are required of such employers for the plan to meet such requirements.'' Rather, it is the offending employer that is responsible for any associated liabilities resulting from the failure, provided that the plan assets attributable to the portion of the plan covering employees of the noncompliant employer are transferred to a plan maintained only by that employer (or its successor), to a tax-favored retirement plan for each individual whose account is transferred, or to any other arrangement that the IRS determines is appropriate, unless the IRS determines it is in the best interests of the employees of the noncompliant employer (and beneficiaries of such employees) to retain the assets in the plan. The noncompliant employer itself is thereupon liable for any resulting plan liabilities.

While the reference to an employer failing ''to take such actions as are required'' to satisfy the applicable tax qualification requirements appears straightforward, it remains to be seen how this rule will be dealt with by implementing regulations. It assumes, among other things, that it is a simple matter to determine what actions fit within the scope of the rule, and it may well be (simple). One wonders, though, how the regulators will treat problems that arise as result of a consequence of the MEP sponsor being complicit with offending employer. Would for example, a plan that violated coverage testing due to an error on the part of the MEP sponsor qualify for relief?

Enabling Open MEPs — Pooled Plans

Prior to the Act, an open MEP is treated as a collection of individual plans rather than a single plan. Act §101(a)(1) amends I.R.C. §413 by prescribing new qualification rules for multiple employer plans maintained by ''pooled plan providers''—i.e., ''pooled employer plans.'' A pooled employer plan does not include a plan maintained by employers that have a common interest other than having adopted the plan. Thus, the Act distinguishes between prior law, closed MEPs, and the newly sanctioned pooled employer plan.

A ''pooled employer plan'' must be an individual account (i.e., defined contribution) plan; and it must be established or maintained by two or more unrelated employers. In the parlance of prior law, pooled employer plans are ''open'' MEPs, which heretofore were treated as a collection of separate plans. Thus, a pooled employer plan is treated as a single employee pension benefit plan for ERISA purposes on par with closed MEPs. This means, among other things, that a pooled employer plan will file a single Form 5500 annual report.

The Act modifies the applicable annual reporting requirements as applied to <u>all</u> multiple employer plans, including pooled employer plans, to include a list of the employers in the plan, a good faith estimate of the percentage of total contributions made by such employers during the plan year, and the aggregate account balances attributable to each employer in the plan (determined as the sum of the account balances of the employees of each employer (and the beneficiaries of such employees)); and for a pooled employer plan, the identifying information for the person designated under the terms of the plan as the pooled plan provider.[8]

A pooled plan provider, which must be a person or entity that is the ERISA ''plan administrator,'' must broadly undertake responsibility for all aspects of plan maintenance and operation, including nondiscrimination testing. The pooled plan provider must also ensure that the plan satisfies the requirements of ERISA, including such reporting and disclosure obligations that are imposed by the Department of Labor (DOL). Before beginning operations, pooled plan providers must register as such with the DOL, provide such other information as the DOL might require, acknowledge its status as a named fiduciary (within the meaning of ERISA §402(a)(2)), and obtain a bond.

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[7] *See generally* DOL Advisory Opinion 2012-04A.

[8] Act §101(d)(1) adding ERISA §103(g)(1), ERISA §103(g)(2).

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Pooled employer plans are required to designate one or more trustees, who must "implement written contribution collection procedures that are reasonable, diligent, and systematic." Member employers retain fiduciary responsibility for the selection and monitoring of the pooled plan provider and any other person who, in addition to the pooled plan provider, is designated as a named fiduciary of the plan.

The Act establishes a series of requirements that pooled employer plans include in their plan documents. These include:[9]

> (i) Designate the pooled plan provider as a named fiduciary;
>
> (ii) Designate one or more trustees to be responsible for collecting contributions to, and holding the assets of, the plan, and further, require that the trustee(s) implement written contribution collection procedures that are reasonable, diligent, and systematic;
>
> (iii) Acknowledge that member/employers of the pooled employer plan retain fiduciary responsibility for:
>
> > (I) The selection and monitoring of the pooled plan provider and any other person designated as a named fiduciary of the plan, and
> >
> > (II) The investment and management of the portion of the plan's assets attributable to its employee participants (and their beneficiaries), unless those responsibilities have been delegated to another fiduciary;
>
> (iv) Provide that employers in the plan, and participants and beneficiaries, are not subject to unreasonable restrictions, fees, or penalties with regard to ceasing participation, receipt of distributions, or otherwise transferring assets from the plan;
>
> (v) Provide that the pooled plan provider is required to provide to participating employers any disclosures or other information IRS/Treasury Department or the DOL may require; and
>
> (vi) Require participating member/employers to take such actions as IRS/Treasury Department, the DOL, or the provider deems necessary to administer the plan or for the plan to meet any other applicable requirement of law.

Helpfully, the Act clarifies that required disclosures in (v) and (vi), above, may be provided electronically.[10]

The term "pooled employer plan" does not include a multiemployer plan," nor does it include a plan established before December 20, 2019, *unless* the plan administrator elects to have the plan treated as a pooled employer plan and the plan otherwise qualifies as such.[11]

SMALL EMPLOYER AUTOMATIC ENROLLMENT CREDIT

I.R.C. §38 provides a general business credit (GBC) with certain generous carrybacks and carry forwards. Pre-Act law includes a GBC for qualified start-up costs of eligible small employers that adopt a new "eligible plan," which includes commonly encountered retirement plans, provided the plan covers at least one non-highly compensated employee.[12] Prior law provided for no other retirement-plan-related credits.

Act §105(a) adds new I.R.C. §45T and makes conforming amendments to I.R.C. §38, which together provides "eligible employers" a $500 annual auto-enrollment credit during a "credit period." The term "eligible employer" means, with respect to any year, an employer that has no more than 100 employees who received at least $5,000 of compensation from the employer for the preceding year.[13] The credit period is the three-taxable-year period beginning with the first taxable year for which the employer includes an eligible "automatic contribution arrangement." An automatic contribution arrangement is defined in prior law regulations.[14] The credit is available only in a taxable year in which an eligible employer maintains the plan with the required auto-enrollment feature.

INCREASE IN THE SMALL BUSINESS CREDIT FOR SMALL EMPLOYER PLAN STARTUP COSTS

Section 45E permits "eligible employers" to take a general business credit of 50% or up to $1,000 of

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[9] Act §101(c)(1) adding ERISA §3(43)(B).

[10] Act §101(c)(1) adding ERISA §3(43)(B)(vi).

[11] Act §101(c)(1) adding ERISA §3(43)(C).

[12] I.R.C. §45E.

[13] *See* I.R.C. §408(p)(2)(C)(i).

[14] Treas. Reg. §1.414(w)-1(b) ("An eligible automatic contribution arrangement is an automatic contribution arrangement under an applicable employer plan that is intended to be an eligible automatic contribution arrangement for the plan year and that satisfies [a] uniformity requirement . . . and [a] notice requirement . . . . An eligible automatic contribution arrangement need not cover all employees who are eligible to elect to have contributions made on their behalf under the applicable employer plan.").

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"qualified startup costs" paid or incurred in the first credit year and each of the immediately following two tax years. "Eligible employer" has the meaning designated in §408(p)(2)(C)(i), i.e., with respect to any year, an employer that has no more than 100 employees who received at least $5,000 of compensation from the employer for the preceding year. Qualified startup costs include any ordinary and necessary expenses paid or incurred by an eligible employer in connection with the establishment or administration of an eligible plan or the retirement-related education of employees with respect to the plan.[15] An eligible plan must have at least one participant who is not a highly compensated employee.

The first credit year is the tax year the employer plan becomes effective. Where an employer is a member of a controlled group, the credit is allocated based on each member's proportionate share of the qualified startup costs. However, if the employer or any member of the same controlled group maintained a predecessor plan during the three years preceding the implementation of the plan for substantially the same employees, the employer is barred from taking the credit.[16]

Effective for plan years commencing after December 31, 2019, Act §104(a) increases the I.R.C. §45E credit to the lesser of $250 for each employee of the eligible employer who is not a highly compensated employee and who is eligible to participate in the eligible employer plan maintained by the eligible employer, or $5,000.

INCREASE IN THE MAXIMUM DEFAULT RATE UNDER THE AUTOMATIC ENROLLMENT SAFE HARBOR

The Pension Protection Act (the "PPA") of 2006[17] permits §401(k) retirement plans with an automatic enrollment feature that satisfy certain requirements to be treated as satisfying the nondiscrimination rules for deferrals and matching contributions and not subject to the top-heavy rules. The nondiscrimination rules refer here to the actual deferral percentage (the "ADP test") that applies to elective deferrals. The ADP test is deemed to be satisfied when the plan includes certain minimum matching or non-elective contributions under either of two safe harbor plan designs and meets certain other requirements. One of the safe harbor plans is an automatic enrollment safe harbor plan.

The PPA established an optional safe harbor exemption from annual compliance testing for automatic enrollment §401(k) plans that automatically enroll employees (requiring them to "opt out" rather than "opt in"). The PPA safe harbor imposes limits on employee contributions that top out at 10%. Act §102(a) amends I.R.C. §401(k)(13)(C)(iii) to increase the cap on the default rate under an automatic enrollment safe harbor plan from 10% to 15%, but only for years after the participant's first deemed election year. For the participant's first deemed election year the cap on the default rate remains at 10%.

REQUIRING §401(K) PLANS TO EXPAND COVERAGE FOR CERTAIN PART-TIME EMPLOYEES

I.R.C. §410(b) generally allows tax qualified plans to exclude from plan participation employees with fewer than 1,000 hours of service in a year. A plan can also delay participation based on attainment of age or completion of years of service but not beyond the later of completion of one year of service (i.e., a 12-month period with at least 1,000 hours of service) or attainment of age 21. Similarly, a plan can deny an employee nonelective or matching contributions for any plan year in which the participant fails to complete 1,000 hours of service during the plan year. Parallel exclusions apply under the vesting rules. A plan is generally required to credit a year of vesting service only when the participant completes 1,000 hours of service during the year.

Effective for plan years beginning after December 31, 2020, Act §112(a)(1) amends I.R.C. §412(k)(2)(D) to require §401(k) plans (other than collectively bargained arrangements) to allow an employee to make elective deferrals if the employee has worked at least 500 hours per year with the employer for at least three consecutive years and has attained age 21 by the end of the three consecutive year period. Such an employee is referred to as a "long-term part-time employee." Once an employee qualifies as a long-term part-time employee, he or she must be admitted to participation for purposes of making elective deferrals under the plan no later than the earlier of (i) the first day of the first plan year beginning after the date on which the employee satisfied the age and service requirements, or (ii) the date six months after the date on which the individual satisfied these requirements. There is no requirement that employers make nonelective or matching contributions on behalf of long-term part-time employees, even if these contributions are made on behalf of other eligible employees. Nor are employers required to allow long-term part-time employees to participate in design based safe harbors (e.g., auto-enrollment).

The Act provides limited nondiscrimination testing relief as well as relief from top-heavy vesting and top-

[15] I.R.C. §45E(d)(1)(A).

[16] I.R.C. §45E(c)(2).

[17] Pub. L. No. 109-280, 120 Stat. 780.

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heavy benefit requirements for long-term part-time employees that cease to be available once the employee becomes a full-time employee.[18]

RELAXED NOTICE REQUIREMENTS AND AMENDED TIMING RULES FOR CERTAIN §401(K) SAFE HARBOR PLANS

A ''safe harbor'' §401(k) plan is deemed to automatically satisfy the ADP test for elective contributions and/or the ACP test for matching contributions. Plan sponsors are free to select from among the following safe harbor options:[19]

- A nonelective contribution, 3% (or more) of compensation, regardless of salary deferrals;
- A basic match equal to 100% of the first 3% of compensation, plus 50% on the next 2% (4% of compensation total);
- An enhanced match, which is at least as much as the basic match at each tier of the match formula, e.g., 100% match on the first 4% of compensation.

A safe harbor plan must meet an annual notice requirement.[20] The annual notice requirement is satisfied if each employee eligible to participate is given written notice of the employee's rights and obligations under the plan, and the notice meets certain content and timing requirements. Generally, the safe harbor notice must be provided within a reasonable period before the beginning of the plan year. The timing requirement is deemed to be satisfied if the notice is provided at least 30 days (and not more than 90 days) before the beginning of each plan year.

Effective for plan years commencing after December 31, 2019, Act §103 eliminates the notice requirement for plans that elect the nonelective contribution safe harbor. Employers can wait until 30 days before the end of a plan year to adopt the 3% nonelective safe harbor.

[18] Act §112(a)(2) adding I.R.C. §401(k)(15).

[19] *See also* Treas. Reg. §1.401(k)-3(j). A ''qualified automatic contribution arrangement'' (QACA) is an enrollment feature that automatically enrolls any eligible employee that fails to make an affirmative enrollment election in the plan at a specified deferral rate. The QACA safe harbor matching contribution formula is a 100% match on the first 1% of compensation deferred and a 50% match on deferrals between 1% and 6% (3.5% total). The plan's default deferral rate must start at no less than 3% and increase at least 1% annually to no less than 6% (with a maximum of 10%). QACA safe harbor contributions can be subject to up to a two-year cliff vesting schedule.

[20] Treas. Reg. §1.401(k)-3(a), §1.401(k)-3(d)(3)(i).

PLANS BARRED FROM MAKING CREDIT CARD LOANS

In a trend that has proved worrisome to some policymakers, §401(k) plans have increasingly allowed participants to borrow against their retirement savings using a credit or debit card. Pre-Act law imposed no limit on the number of plan loans that could be made. There was, therefore nothing to prevent use of credit card loans that otherwise satisfied the requirements for a valid plan. Proponents of the trend note and claim as a benefit that these loans carry much lower interest rates, e.g. prime rate plus one percentage point, when compared to other consumer debt vehicles. The problem, of course, is that this trend has the capacity to derail retirement savings, and in some jurisdictions, credit card debt is more easily discharged in bankruptcy.

Effective for loans made after December 20, 2019, Act §108(a) amends and reorganizes I.R.C. §72(p) to provide any loan which is made through the use of a ''credit card or any similar arrangement'' does not qualify for non-distribution treatment under I.R.C. §72(p)(2)(A).

MODIFYING NONDISCRIMINATION RULES FOR CLOSED PLANS

A vexing issue involving frozen or ''closed'' defined benefit plan is how to apply the Code's nondiscrimination rules to older, long-serving employees. As these plans continue to operate, owing to higher turnover among non-highly compensated employees, the class of participants continuing to accrue benefits tends toward older, longer-serving, highly compensated employees. Where this occurs, plan sponsors routinely combined the frozen defined benefit plan with a defined contribution plan (usually a §401(k) plan), which is then tested in combination with the frozen plan on a benefit accrual basis under rules governing ''cross-testing.''[21] This solution has a downside, however, since the cross-testing can be expensive.

Under pre-Act law, aggregating a closed plan with a defined contribution plan was fraught with challenges. The combined plan had to pass minimum coverage under I.R.C. §410(b) and nondiscriminatory contributions or ''benefits, rights and features'' (BRF), under I.R.C. §401(a)(4). There was also the challenge of passing the minimum participation of I.R.C. §401(a)(26). Plan sponsors generally prefer to cross

[21] *See* I.R.C. §410(b)(6)(B) (providing that two or more plans may be aggregated for purposes of satisfying I.R.C. §410(b) if the plans are also aggregated for general nondiscrimination testing purposes under I.R.C. §401(a)(4)).

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test the aggregated plan on a ''benefits'' basis, which requires gateway contributions, which are typically on the order of 5% of compensation. Testing on the basis of benefits tends to overweight contributions made on behalf of younger, lower paid employees, thereby facilitating compliance by the aggregated plan. On the other hand, testing on the basis of contributions has none of this leverage. A defined benefit plan could be aggregated only with a defined contribution plan's nonelective contributions. Aggregation was not permitted with §401(k) matching contributions.

Notice 2014-5 first waived the requirement for a closed plan to satisfy the gateway test in certain, limited instances. This relief was extended from year to year, most recently in Notice 2019-49 through 2020. Prior to Notice 2019-49, there was no relief for BRF testing for plans that were closed before December 13, 2013, nor did the earlier relief offer help with the minimum participation requirements of I.R.C. §401(a)(26) or permit aggregating a closed plan with a plan that provided matching contributions under a §401(k) plan. Notice 2019-60 provided temporary relief from BRF testing for certain defined benefit plans that were closed under an amendment adopted before December 13, 2013. A BRF offered at the time an eligible plan was closed was deemed to pass testing if the plan complied with certain restrictions on post-closure changes to the BRF's eligibility requirements.

Effective (without regard to whether any plan modifications are adopted or effective before, on, or after) December 20, 2019 (or plan years beginning after December 31, 2013, if elected by the plan sponsor), Act §205(a) adds a new I.R.C. §401(o),[22] which prescribes rules designed to protect ''older, longer service employees.'' To be eligible for this relief, the plan must have either been closed before April 5, 2017, or have been in effect for at least five years without a substantial increase in coverage or the value of benefits in the last five years.[23]

Under the new provision, a defined benefit plan that provides benefits to a closed class of participants does not fail non-discrimination and minimum participation testing with respect to BRF provided to a closed class if certain requirements are satisfied. Special rules are provided to accommodate spun-off plans.[24]

The new rules make permanent relief provided earlier by Notice 2019-49,[25] which permits certain employers that sponsor a defined benefit/defined contribution plan arrangements that includes a closed defined benefit plan to demonstrate that the aggregated plans comply with the Code's general nondiscrimination requirements (I.R.C. §401(a)(4)) on the basis of equivalent benefits despite the aggregated plans not otherwise qualifying under existing testing rules. The Act also eliminates the pre-Act's requirement that plans must have the same plan year to be aggregated for testing purposes. The relief also extends to the minimum participation rules under I.R.C. §401(a)(26), which generally requires a plan to have at least 50 participants.

TREATMENT OF CUSTODIAL ACCOUNTS ON TERMINATION OF §403(B)

Act §110 directs the Secretary of the Treasury to issue guidance, ''[n]ot later than six months after the date of enactment of this Act,'' permitting the plan administrator or custodian of a §403(b) plan to distribute individual custodial accounts in kind to a participant or beneficiary in connection with the plan termination.

In Rev. Rul. 2011-7, the IRS addressed and approved the distribution of *annuity contracts* in connection with the termination of a §403(b) plan. Rev. Rul. 2011-7 concluded that termination was permissible provided that certain notice requirements were satisfied, and the plan sponsor delivered to participants fully paid individual annuity contracts or individual certificates under a group annuity contract.[26] The ruling did not address whether plan termination is possible for individually owned custodial accounts that prohibit (or are silent regarding) plan termination. The Act directs the IRS to permit the distribution of custodial accounts on termination on par with the termination of §403(b) plans funded with annuity contracts.

CONCLUSION

As is the case with any major piece of legislation targeting retirement plans, much work remains to be done. Implementing regulations will be critical in defining the contours of the new rules. These will take time.

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[22] And redesignates I.R.C. §401(o) as I.R.C. §401(p).

[23] Act §205(a)(2) adding I.R.C. §401(o)(1)(A)(iii).

[24] *See* I.R.C. §401(o)(1)(J).

[25] Notice 2019-49 extended the relief provided by Notice 2014-5 and subsequent notices. Notice 2019-60 provided additional temporary nondiscrimination relief for closed defined benefit plans that met the eligibility conditions for the relief provided in earlier notices.

[26] ''The delivery of a fully paid individual annuity contract to participants or beneficiaries, or of an individual certificate evidencing fully paid benefits under a group annuity contract, is not included in gross income until amounts are actually paid to the participant or beneficiary out of the contract, so long as the contract maintains its status as a[n I.R.C.] §403(b) contract.'' Rev. Rul. 2011-7.

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There is also the matter of the plan amendments required to conform plans to the new requirements. The Act provides for an extended remedial amendment period. Thus, while plans will need to comply in operation with the Act's various provisions commencing with each applicable effective date, the plan documents for plans maintained by private sector and other non-governmental employers need not be amended to come into compliance until last day of the first plan year beginning on or after January 1, 2022.[27] This date can be further delayed in instances in which the Secretary of Treasury provides an extension.[28] For governmental plans and collectively bargained plans, the deadline will be no later than January 1, 2024.[29]

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[27] Act §601(b)(1).

[28] Act §601(b)(1)(B).

[29] Act §601(b)(1) (flush language).

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