Legislative and regulatory bulletin

3Q 2019

How the SECURE Act would impact 401(k)s

After many years, significant retirement plan legislation is moving forward in Congress. On May 23, the House of Representatives passed the Setting Every Community Up for Retirement Enhancement (SECURE) Act[1] by a vote of 417 to 3. The Retirement Enhancement and Savings Act (RESA)—a bipartisan bill with many of the same provisions—is pending in the Senate, but the Senate is considering whether to take up SECURE instead. Many believe there is a very good chance that the SECURE Act will pass the Senate and be signed into law by the president during this session of Congress. If that happens, the new legislation will usher in the most important changes to the retirement plan landscape in 13 years.

Legislation would prompt new plan formation

A key goal of Congress is to encourage employers that do not maintain retirement plans for their employees to set them up. One way the SECURE Act could accomplish this is by permitting unrelated employers to band together and participate in "open" multiple employer plans, taking advantage of economies of scale and potentially reduced fiduciary liability. In our 1Q 2019 Legislative and Regulatory Bulletin, we described open multiple employer plans and their possible impact on the U.S retirement system. The Act would encourage small employers (those with 100 or fewer employees) to establish plans by increasing an existing tax credit that helps offset plan start-up costs from $500 to a maximum of $5,000 per year for the first three years. In addition, it would permit qualified plans to be adopted for a year as late as the due date of the employer's tax return for that year (including extensions).

[1]H.R. 1994

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Changes affecting existing 401(k)s

But there are a number of ways the SECURE Act would impact existing 401(k)s. We highlight some of the key provisions below. We also show the effective dates as reflected in the Act. Bear in mind that these dates could change before the legislation is ultimately signed into law.

Participation by long-term part-time employees. The Act would require 401(k) plans to permit employees who work at least 500 but less than 1,000 hours in three consecutive 12-month periods to contribute to the plan. These individuals could be excluded for nondiscrimination and top-heavy testing purposes, and the employer would not be required to make matching or other employer contributions for them. *Effective for plan years beginning after 2020.*

Lifetime income disclosure on participant statements. Participant statements would have to include an estimate of the monthly amount a participant could receive as a single or joint life annuity, based on the participant's current account balance. The Act requires the Department of Labor (DOL) to provide the assumptions plans could use and issue a model disclosure. *Effective 12 months after the DOL provides guidance.*

Penalty-free withdrawals for birth or adoption expenses. The Act would allow individuals to withdraw up to $5,000 from their retirement accounts for expenses related to the birth or adoption of a child without the 10% early withdrawal penalty. A plan could permit birth or adoption distributions even if it did not otherwise permit in-service withdrawals. *Effective for distributions made after 2019.*

Fiduciary safe harbor for selecting insurer to provide lifetime income. If certain conditions are met, the SECURE Act would protect plan fiduciaries who select an insurance company to provide guaranteed retirement income contracts in the event that the insurer is unable to satisfy its obligations under the contracts. Among other requirements, the fiduciary would have to obtain written representations from the insurer that it was in compliance with all legal requirements. This provision would not relieve fiduciaries of their obligation to determine that the insurance contract is appropriate for participants and that its fees are reasonable. *Effective on the date of enactment of the SECURE Act.*

Portability of lifetime income options. If a plan sponsor eliminates a guaranteed lifetime income investment as an option under the plan, the Act would permit participants to transfer the investment to another plan or IRA. *Effective for plan years beginning after 2019.*

Credit for small employers that add automatic enrollment. The Act would provide a tax credit of up to $500 per year for three years to employers with 100 or fewer employees that add an automatic enrollment feature to their 401(k) plans. *Effective for taxable years beginning after 2019.*

Increase in the automatic escalation cap in the automatic enrollment safe harbor. The Act would raise the current 10% of compensation cap on automatic contribution escalation in the 401(k) automatic enrollment nondiscrimination safe harbor to 15%. *Effective for plan years beginning after 2019.*

Simplification of the rules for nonelective safe harbor 401(k) plans. The Act would give plan sponsors more time to elect safe harbor status if they satisfy the required employer contribution by making nonelective rather than matching contributions (that is, a nonelective safe harbor 401(k)). Specifically, a plan could be amended to become a nonelective safe harbor 401(k) for a plan year any time before the 30th day before the end of the plan year. Plans could even be amended to become nonelective safe harbor 401(k)s as late as the end of the following plan year, provided the employer makes a nonelective contribution of 4% of compensation rather than the usual 3%. The SECURE Act would also eliminate the requirement to provide a safe harbor notice to participants in nonelective safe harbor 401(k) plans. *Effective for plan years beginning after 2019.*

Increase in the age when distributions must begin. The SECURE Act would raise the starting age for required minimum distributions from 70½ to 72. *Effective for individuals turning 70½ after 2019.*

Changes to the required minimum distribution rules for nonspouse beneficiaries. The SECURE Act would require the nonspouse beneficiary of a deceased participant to withdraw the balance in the decedent's account within 10 years of death, with some exceptions including disabled beneficiaries. *Effective with respect to participants who die after 2019.*

Plans would need to address these changes

Some of the SECURE Act's provisions would require 401(k) plan sponsors to make changes to their plans and their administrative processes. Others would provide plan sponsors with the opportunity to rethink plan features. We will continue to monitor the SECURE Act and other retirement plan-related legislative activity in Congress, and will keep you informed of any significant developments.

CONTACT US

To learn more about our ***Legislative and Regulatory Program*** or any of our other Retirement Insights programs, contact your J.P. Morgan representative.

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