The SECURE Act – Plan Sponsor Impact – Part 3

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The Setting Every Community Up for Retirement Enhancement ("SECURE") Act which was signed into law in December of 2019 has enacted sweeping changes to the retirement plan industry. As a result, this is the third and final article in a series that are intended to summarize the most impactful aspects of the SECURE Act as they apply to tax-qualified retirement plan sponsors. If you would like to review prior articles in the series, please refer to our website at legacyrsllc.com/category/statutory-regulatory/.

It is important to understand that even though this legislation was only recently enacted, many of its provisions are already effective. Therefore, it is critical for retirement plan sponsors to take the time to educate themselves on the impact of these changes in order to help ensure the proper administration and operation of their retirement plans.

<u>Required Distributions for Designated Beneficiaries</u>

One of the more impactful provisions of the SECURE Act involves the timing of distributions that may be made from defined contribution plans following the death of the plan participant. More specifically, effective with regard to participant deaths that occur after December 31, 2019, distributions to "designated beneficiaries" must generally be made by no later than 10 years following the end of the year in which the participant dies ("10 Year Rule"). In this context a "designated beneficiary", is an individual formally designated by the participant as the beneficiary of his or her retirement plan account but who is <u>not</u> the participant's spouse.

Prior to the SECURE Act, designated beneficiaries were permitted to take a distribution of the decedent's plan account over the life expectancy of the designated beneficiary. Thus, in most circumstances, the prior rule would have granted greater flexibility to a designated beneficiary regarding his or her ability to delay the tax impact of an inherited retirement plan account. Presumably, the additional federal tax revenue generated by the implementation of this provision was intended to offset the loss in tax revenue resulting from other provisions of the SECURE Act. For example, the SECURE Act also increased the age that "required minimum distributions" ("RMDs") must begin from age 70-1/2 to age 72.

Notwithstanding the foregoing, several exceptions apply to the new 10 Year Rule. Most importantly, as suggested above, spouses are exempt from the 10 Year Rule and will remain able to receive distributions from their deceased spouse's retirement plan account over the surviving spouse's life expectancy. Also, in general, the following categories of designated beneficiaries are exempt from the 10 Year Rule: 1) disabled or chronically ill individuals; 2) someone who is not more than 10 years younger than the deceased participant; or 3) a minor child of the deceased participant. However, with respect to minor children eligible for the 10 Year Rule exception, the 10 Year Rule distribution period begins in the year after the year that such child reaches the age of majority.

Increased Penalties for Late Filed Forms 5500

Effective for Forms 5500, Annual Return/Report of Employee Benefit Plan, ("Form(s) 5500"), required to be filed after December 31, 2019, late filing penalties assessable by the Internal Revenue Service ("IRS") have increased to $250 per day up to a maximum of $150,000 per late filed return. This is a significant increase over the previously applicable IRS late filing penalties of $25 per day up to $15,000 per late filed return.

The new IRS late-filing penalty assessments associated with Form 5500 are severe. However, the establishment of "reasonable cause" to attempt to abate an IRS late-filing penalty assessment remains. In addition, at times the Department of Labor's ("DOL") "Delinquent Filer Voluntary Compliance Program" ("DFVC") may be available to eliminate an IRS assessed Form 5500 late-filing penalty. Finally, this increase to the IRS late-filed Form 5500 penalty amounts does not impact the DOL's ability to concurrently assess its own late filed Form 5500 penalties.

Portability of Lifetime Income Options

Effective for plan years beginning on or after December 31, 2019, a plan sponsor of a defined contribution plan generally is permitted to allow a participant without a distributable event to receive an "in-kind" distribution of a lifetime income investment product held under the plan. However, the ability to offer such a distribution is limited to situations where the lifetime income investment at issue is no longer authorized to be an investment under the plan.

As suggested by their name, lifetime income investment products generally are designed to be held by the owner for his or her lifetime. As such, lifetime income products generally include early sale / termination charges that are intended to encourage lengthy holding periods. In the situation where a plan sponsor decides to remove an existing lifetime income product from a plan's permissible investment menu, this has the potential to force a participant to liquidate, at significant expense, a lifetime income product that is no longer permitted as a plan investment. Thus, this new provision of the SECURE Act would allow a participant invested in a lifetime income product to obtain a distribution of the investment and avoid incurring the otherwise applicable fee or penalty.

Presumably, this provision of the SECURE Act will encourage more plan sponsors to offer lifetime income options within defined contribution plans. This is because this rule change will eliminate one of the perceived problems associated with offering lifetime income options within retirement plans.

Lifetime Income Provider Fiduciary Safe Harbor

Several of the provisions of the SECURE Act include at least tacit encouragement for defined contribution plan sponsors to offer lifetime income investment options to participants. However, a plan sponsor that decides to include a lifetime income investment product within a plan's investment menu is generally responsible on a fiduciary level for the selection of the insurance company offering such product. Further complicating such selection process is the realization that payments made under such investment product may not even begin until several decades after the initial selection process is completed and will likely continue for several decades after such payments begin. Thus, many plan sponsors are rightfully wary to act as a fiduciary while selecting an insurance company to offer an insurance product that may need to make payments to participants forty or more years into the future.

In order to attempt to alleviate this valid concern, the SECURE Act outlines a "safe harbor" process for a plan sponsor to follow in order to have certainty that it has satisfied its fiduciary duty of prudence when selecting an insurance provider to offer a lifetime income investment product within the plan. This provision was effective upon the date of enactment of the SECURE Act so it is currently effective.

In order to take advantage of the newly established safe harbor, the plan sponsor must first engage in an "objective, thorough, and analytical search for the purposes of identifying insurers." Then, subsequent to completing this due diligence obligation, the plan sponsor must consider the financial capabilities of each insurer with regard to its ability to satisfy its obligations under the lifetime income investment product and conclude that the insurer is financially able to satisfy those obligations. The SECURE Act states that a fiduciary will be deemed to satisfy this requirement if it obtains certain written representations specified under the SECURE Act from the insurers in question.

The plan sponsor must also consider the costs of the lifetime income product in relation to its benefits and conclude that the cost is "reasonable". Although the SECURE Act does not explicitly define what constitutes reasonable in this context, it does indicate that a plan sponsor is not required to select the lowest cost option. In addition, the SECURE Act specifies that a fiduciary does not have an on-going obligation to review the appropriateness of previously selected lifetime income products. Instead, such investment only needs to be approved at the time of purchase or initial selection.

SECURE Act Plan Amendment Deadline

Many of the provisions of the SECURE Act will result in the need to implement formal amendments to existing retirement plan documents. In this regard, the SECURE Act establishes a deadline to amend for the changes that it implements. That deadline is the end of the first plan year beginning on or after January 1, 2022. Thus, the earliest date that a plan would need to be amended in order to memorialize the changes required under the SECURE Act would be December 31, 2022. In addition, a delayed amendment deadline applies for collectively bargained and governmental plans.

We hope that this article helped you to better understand this topic. However, please be advised that it is not intended to serve as financial, tax or legal advice so it should not be construed as such. If you have questions about this topic, we strongly urge you to further discuss it with a qualified retirement plan professional. For more information about this topic, please contact our marketing department at 484-483-1044 or your administrator at Legacy.

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