# Defined Contribution Legislative and Regulatory Update

OCTOBER 2018

GOVERNMENT PLANS

We are committed to providing you with the information and tools you need to help you meet your fiduciary responsibilities as a plan sponsor and offer your employees an exceptional retirement plan. This newsletter is designed to inform you about the latest legislative and regulatory developments that may affect your plan.

## IN THIS ISSUE



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# From the Hill

## Family and Savings Act of 2018

As part of the "Tax Reform 2.0" legislative initiative, the House of Representatives recently passed a bill, the Family and Savings Act of 2018 (FSA), that would make a number of changes to retirement plan rules. Following are highlights of the parts of the FSA that impact defined contribution plans. The FSA also contains provisions impacting defined benefit plans, IRAs and Section 529 plans.

**Enhanced availability of multiple-employer plans**: Multiple-employer plans allow individual employers to join a pooled plan arrangement that typically offers reduced cost, time and fiduciary liability to participating employers compared to individual plans. Currently, regulatory barriers limit the availability and attractiveness of these types of plans. The FSA would remove those barriers and create a new designation of "pooled plan provider" to enhance the protections for plan participants in these arrangements.

**Portability of lifetime income investments**: The FSA would give participants the ability to transfer a lifetime income investment to another plan or an IRA in the event the investment can no longer be held in their current plan.

**Fiduciary Safe Harbor for Selection of Lifetime Income Products**: The FSA would amend ERISA to allow plan fiduciaries to rely on the determinations of state insurance commissioners about the financial stability of an annuity provider when selecting certain guaranteed income products for their plans.

**Changes to required minimum distribution rules**: The FSA would not require distributions for individuals with an aggregated retirement plan and an IRA balance of $50,000 or less.

**Election of 401(k) safe harbor status**: The FSA would add some flexibility to the safe harbor process.

**Prohibition on credit card loans**: The FSA would prevent the distribution of plan loans through credit cards.

**Penalty-free withdrawals for birth or adoption**: The FSA would permit plans to make tax-free distributions of up to $7,500 with a repayment option for the birth or adoption of a child.

**Extended date for plan adoption**: The FSA would allow plans to be treated as adopted for a tax year if adopted before the due date (including extensions) of the tax return for that year.

Other provisions that would impact defined contribution plans include:

- Allowing military reservists to maximize benefits in both private sector and reservist plans.
- Creating a new option for governmental plan participants when two benefit formulas are available.
- Clarifying who can be covered in plans maintained by church-controlled organizations.

Treatment of custodial accounts upon termination of a Section 403(b) plan would also be affected.

- 403(b) custodial accounts held by IRS-approved nonbank trustees would be deemed to be IRAs.
- 403(b) custodial accounts that are designated Roth accounts would be treated as Roth IRAs.
- 403(b) assets that cannot otherwise be distributed upon termination, such as annuity contracts or mutual funds held in a participant's name, would be preserved in a tax-favored retirement savings vehicle.

The FSA would also create a new savings vehicle called a universal savings account that would allow individuals to contribute up to $2,500 annually to a trust and take a distribution at any time and for any purpose without paying tax on earnings generated.

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While these changes may be of great interest to many, it is important to keep the FSA in perspective. In order to become law this bill would need to be passed by the House and the Senate and signed by the president. At this point the Senate does not have a companion bill under consideration. There is a bill in the Senate, the Retirement Enhancement Security Act of 2018 (RESA,) that contains some of the same provisions as the FSA so it's possible the House and the Senate could collaborate in a conference committee and produce final legislation that would pass both houses. It remains to be seen, however, whether or when that will happen and what the final bill will say. We will keep you apprised of any significant developments as they occur.

**Practical implications**

Both President Trump and Congress are currently focused on retirement issues. We have not seen major retirement legislation since the Pension Protection Act of 2006 and, while the FSA is not likely to be the final word, many of its provisions have already garnered support in both the House and Senate, so it is worth keeping an eye on.

## Recent retirement legislative initiatives

In July, Senators Tom Cotton (R-AR), Todd Young (R-IN), Heidi Heitkamp (R-ND) and Cory Booker (D-NJ) introduced a series of four bills aimed at increasing access and coverage of workplace retirement saving arrangements and helping workers establish emergency savings accounts. The bills drew from recommendations made by the Bipartisan Policy Center in its June 2016 Report of the Commission on Retirement Security and Personal Savings. Each of the senators in the bipartisan group served as the lead sponsor on one of the bills and as co-sponsors on the others. The bills would provide as follows:

### The Small Business Employees Retirement Enhancement Act (S.3219) – Lead Sponsor: Senator Tom Cotton

This bill incorporates many of the provisions from the Retirement Enhancement and Savings Act (RESA) around "open" multiple-employer plans (MEPs). RESA was first introduced in 2016 and received unanimous bipartisan support from the Senate Finance Committee. The bill would encourage open MEPs by eliminating the Department of Labor (DOL) rule that participating employers must share a common nexus and the IRS rule holding that if a single employer violates a qualification requirement under the plan, the entire plan is disqualified (commonly known as the "one bad apple" rule). In order to take advantage of these relaxed requirements, the open MEP would have to be administered by a "pooled plan provider" who acts as a named fiduciary and assumes many of the day-to-day administrative duties.

In a departure from RESA, Senator Cotton's bill would provide for a limitation on employer fiduciary liability in certain circumstances in which the employers are participating in a "registered pooled employer" plan. The requirements include:

- Each participating employer must have no more than 100 employees who received compensation in excess of $5,000 for the preceding year.
- The plan must be registered on a DOL website that allows interested employers to select a plan from it.
- The pooled plan provider:
  - — Must be a named fiduciary under the plan.
  - — Must have fiduciary liability insurance of at least the greater of 5% of plan assets or $1 million or be a bank, savings and loan, insurance company, or registered investment adviser subject to regulatory oversight and meeting certain capital requirements and asset levels.
- The provider must receive no more than reasonable compensation.

If these requirements are met, the participating employer is relieved of fiduciary responsibility, including the selection and monitoring of investments under the plan. The employer does retain responsibility for monitoring enrollment requirements and remitting contributions in a timely manner.

### The Retirement Security Flexibility Act (S.3221) – Lead Sponsor: Senator Todd Young

Senator Young's bill would create a new automatic enrollment/acceleration safe harbor for non-discrimination testing. The current automatic enrollment/acceleration safe harbor provides for employees to be automatically enrolled at

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a deferral rate of at least 3%, and that would be increased by 1% increments until it hit a deferral rate of at least 6%. Employees may be enrolled at higher deferral rates up to a maximum limit of 10%. There are required matching contributions for non-highly compensated employees (NHCEs) of at least 100% on the first 1% of deferrals and 50% on the next 5% of deferrals. The safe harbor could also be satisfied by a qualified nonelective contribution (QNEC) of 3% of an NHCE's total compensation.

The Young bill would also raise the maximum limit on automatic enrollment deferrals from 10% to 15%. The bill would allow sponsors to lower or even eliminate the need for any employer contribution, but doing so would lower the amount participants could contribute. In 2018 the limit is $18,500 with the ability to make an additional $6,000 catch-up contribution if the investor is at least age 50. The table below illustrates the newly proposed safe harbor:

| AMOUNT OF EMPLOYER CONTRIBUTION | LIMIT ON EMPLOYEE DEFERRALS |
|---|---|
| No employer contributions | Employees may defer 40% of the applicable limit |
| 100% match on first 1% of deferrals and 50% match on next 1% of deferrals or a 1% QNEC | Employees may defer 60% of the applicable limit |
| 100% match on first 1% of deferrals and 50% match on next 3% of deferrals or a 2% QNEC | Employees may defer 80% of the applicable limit |

The bill also provides for automatically reenrolling eligible employees who are not participating or are deferring at a rate of less than 3% once every three years. These employees would be automatically reenrolled at the plan's default rate.

### Strengthening Financial Security Through Short-Term Savings Act (S.3218) – Lead Sponsor: Senator Heidi Heitkamp

Senator Heitkamp's proposal would allow employers to help employees establish an emergency savings account. The bill would extend the current preemption of any state laws restricting automatic-enrollment 401(k) plans to short-term savings account programs that an employer could elect to offer. There could be no fees associated with the accounts, and the maximum balance would be limited to $10,000.

The bill would also direct the Department of the Treasury to, within one year, issue guidance facilitating the offering of short-term savings accounts as part of a 401(k) plan.

### The Refund to Rainy Day Savings Act (S.3220) – Lead Sponsor: Senator Cory Booker

Senator Booker's bill would not have the direct, or even indirect, nexus that the other bills would have, but it was part of the overall package introduced. The bill would allow taxpayers to defer 20% of any tax refunds due to them. The monies would accumulate interest in an account managed by the U.S. Treasury, and each participating taxpayer's deferred funds, plus interest, would be transferred to their designated savings account after six months.

As far as retirement reform is concerned, the Senate remains focused on getting RESA signed into law. At best these four bills would be considered after the passage of RESA. We will continue to keep you apprised of any new developments.

## Presidential executive order

On August 31 President Trump signed an executive order (EO) directing the Department of Labor (DOL) and the Treasury to review and consider modifying or eliminating certain rules related to retirement savings. Specifically the EO addressed:

- Expanding access to multiple-employer plans.The plan must be registered on a DOL website that allows interested employers to select a plan from it.
- Improving the effectiveness and decreasing the cost of required notices and disclosures.
- Updating the age 70½ required minimum distribution rule.

More information may be found here: Focus on 457.

# From the Regulatory Services Team

## Administrative complexities regarding student loan repayment: IRS Private Letter Ruling guidance

Early this year student loan debt in the United States officially topped out at $1.5 trillion, overtaking both consumer credit card and auto loan debt according to the Federal Reserve, with the mean level of student loan debt rising to nearly $33,000 per American worker.

In response employers are beginning to look for new ways to help employees manage mounting student loan debt while also finding new ways to attract and retain talent. One such effort took the form of a novel plan design that sought to explore student loan repayment options through a 401(k) plan and was the subject of a recent Private Letter Ruling by the IRS.

Private Letter Ruling (PLR) 201833012, released August 17, 2018, examined one proposed employer plan design providing for an employer contribution in lieu of a company match for employees in active repayment of student loans.

Unfortunately, for sponsors who would like to follow suit and set up a similar plan structure, PLRs are strictly limited in their scope to only apply to the plan and situation raised in the related letter request. That means that, while this PLR provides a valuable window into IRS thinking, it cannot be used as precedent to support any other plan or its design or situation. The IRS may only provide specific and targeted responses to questions and fact patterns posed by drafting parties (typically plan sponsors), often yielding only limited information and guidance for the industry and plan sponsors to rely upon.

Within days of the release of this PLR's August 17, 2018, publication, industry leaders released public requests urging the IRS to issue additional guidance in an official, more expansive ruling on the topic. If such guidance is issued, it may apply to grandfathered governmental 401(k) plans but not 457(b) plans, which generally do not have the benefit of employer-matching or employer nonelective contributions.

### The proposed plan structure in the PLR

It is first important to understand the plan proposed in the PLR would not provide employees with cash in hand to service student loan debt. Rather, it would allow employees to continue to capture maximum employer contributions through their retirement plans without having to make elective deferrals as well as student loan payments. The intent is to help employees strike a balance between paying loan servicers and saving for their retirement.

The PLR request contemplates the following specific plan design: Any eligible employee who makes an elective deferral of at least 2% of eligible compensation is entitled to a 5% employer match per payroll period. Under the proposed student loan repayment (SLR) program, an employee making a student loan repayment during a pay period of at least 2% of eligible compensation would be entitled to a 5% nonelective contribution. The nonelective contribution would be made "as soon as practicable" after the plan year.

The voluntary program would require an employee to opt in, although it would not be necessary for the employee to make a qualified student loan payment each pay period. If the employee does not, yet still makes an elective contribution of at least 2% of compensation during the pay period, the employer would make a "true-up" matching contribution equal to the 5% matching contribution for the pay period.

Employer contributions would remain subject to any last-day and vesting requirements consistent with the plan design.

### The contingent benefit prohibition

The PLR primarily focused on a single issue: whether the proposed SLR plan would violate the "contingent benefit prohibition" under IRC 401(k)(4)(A) and 401(k)-1(e)(6) of the Income Tax Regulations. These provisions prohibit an employer from withholding or limiting employer contributions on the condition that the employee contributes elective deferrals under the plan. Employer-matching contributions on elective deferrals are the clear exception to this rule.

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The IRS opined that the proposed plan design did not violate the contingent benefit prohibition because it preserved the ability of the employee to make elective contributions to the plan, which is not conditioned on whether the employee is making student loan repayments during the pay period. In other words, the plan design must not limit the ability of the employee to contribute to their 401(k) account because they are receiving the SLR contributions. The IRS also stipulated that the ruling was based on the assumption that the employer will not extend any student loans directly to employees.

## Testing issues

The PLR notes that annual plan testing is required, but no detailed guidance is provided other than to state that the SLR nonelective contribution is not treated as a matching contribution for testing purposes. On top of the normal actual contribution percentage (ACP) nondiscrimination test generally required of a plan with a match feature, a plan that implements the nonelective contribution will likely need to incorporate that contribution into other testing such as 410(b) coverage testing and possibly the 401(a)(4) general test for nonelective contributions.

Plan sponsors, except sponsors of governmental 401(k) plans that are exempt from nondiscrimination testing, will want to consider testing impact questions, including but not limited to the following:

- Will we have a plan testing issue if the majority of the employees receiving the SLR nonelective contribution are highly compensated employees?
- If employees receive the SLR nonelective contribution at different levels of their compensation, are we prepared for the additional plan testing requirements that are present where contributions are not uniform among highly and non-highly compensated employees?
- Are we inadvertently creating a 401(k) match testing issue as employees who would have received a match are now being reflected in the ACP test as receiving 0% match?

## Practical considerations and unanswered questions

While the PLR has jump-started industry-wide discussion on the topic of employee student loan debt burdens, it falls short of firm guidance in several crucial administrative, logistical and practical areas, leaving industry leaders and plan sponsors unsure whether to explore similar plan designs.

The IRS has avoided discussing any specific substantiation or verification requirements of the proposed SLR plan. It is unclear at this point whether employers will bear the burden of obtaining third-party documentation evidencing the payment of student loans and, if they do, at what frequency and to what extent.

Additional guidance is also needed to determine whether student loan repayments on behalf of a spouse, child, beneficiary or otherwise qualified dependent would be considered permissible as well.

Plan sponsors would also likely need to revisit any plan enrollment materials in order to satisfy the opt-in requirements referenced in the PLR and amend any existing plan documentation and summary plan descriptions. Such requirements may cause headaches for all plans with regard to both prototype and custom documents.

Plan sponsors offering automatic enrollment and/or safe harbor plan designs also may face administrative hurdles with regard to notice timing and language requirements as they strive to incorporate the proposed plan design.

## Conclusion

Though presently in its infancy, student loan repayment programs within 401(k) plans are certainly something the industry will watch closely in coming months and years. It is important to consider a plan's current design and the impact of adding such a feature on the many aspects of the plan when determining whether or not to add such a provision. Additional guidance — whether in the form of additional private letter rulings, revenue rulings by the IRS or legislation — can only help shape the future of these programs for plan sponsors.

# From the Regulatory Services Team

## Automatic contribution options

We all know automatic contribution arrangements play a significant role in raising participation and savings rates in ERISA defined contribution plans. Unfortunately, governmental 457(b) plans may only use automatic enrollment if permitted to do so under state law.

For those plan sponsors in states that permit non-ERISA plans to use automatic enrollment, the charts below are intended to provide an overview of some of the distinctions between basic automatic contribution arrangements (ACAs) and eligible automatic contribution arrangements (EACAs).

| DESIGN TOPIC | AUTOMATIC CONTRIBUTION ARRANGEMENT (ACA) | ELIGIBLE AUTOMATIC CONTRIBUTION ARRANGEMENT (EACA) |
|---|---|---|
| What laws and/or rulings apply to the respective automatic enrollment arrangements? | Revenue Rulings 2000-8 and 2009-30 provide limited guidance on ACAs.<br>*[Note: The final regulations for EACA do not apply to plans that are not an EACA (but may be followed).]* | Internal Revenue Code Section 414(w) |
| When can the arrangement begin? | Anytime during the plan year. | Generally must start at the beginning of the plan year. |
| Which employees must be covered and therefore automatically enrolled? | A plan may elect to cover new hires only, apply automatic enrollment to all employees eligible to make a deferral election under the plan or generally cover any sub-grouping the employer desires. | A plan may cover new hires only or apply automatic enrollment to all employees eligible to make a deferral election under the plan. |
| What are the initial notice timing requirements?<br>*[Note: Generally, employees must have a “reasonable” period between the receipt of the notice and the first deferral in order to opt out or elect another rate.]* | Not specified, but generally 30 days’ prior notice is acceptable | Notice must be supplied within a “reasonable” period prior to eligibility; at least 30 but no more than 90 days, and generally no later than the date the employee becomes eligible. With immediate eligibility, notice must be provided prior to the pay date for the payroll period that includes the date the employee becomes eligible.<br>*[Note: This may be very challenging for immediate or short eligibility periods.]* |

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| DESIGN TOPIC | AUTOMATIC CONTRIBUTION ARRANGEMENT (ACA) | ELIGIBLE AUTOMATIC CONTRIBUTION ARRANGEMENT (EACA) |
|---|---|---|
| What rate is required initially for employee deferrals, and to whom must it apply? | No required rate | No required rate |
| When must the first default contribution be deducted from pay? | Not specified, but participant must receive notice and have a reasonable period of time (prior to the compensation becoming currently available) to make a different election. | While the regulations do not specifically set out these rules for EACA, the IRS has informally indicated that the QACA rules apply to EACAs.<br>*[Note: This may be very challenging for immediate or short eligibility periods.]* |
| How is automatic increase applied? | Optional provision | Optional provision |
| When must automatic increases be applied? | No required date | Uniformity requirements point to a single day in the plan year to increase deferral rates. |
| Is a qualified default investment alternative (QDIA) required? | Optional<br>*[Note: If used, notice requirements apply and may be combined with other required notices.]* | Optional<br>*[Note: If used, notice requirements apply and may be combined with other required notices.]* |
| What are the annual notice timing requirements? | Not specified, but a participant must receive notice and have a reasonable period of time before the compensation is currently available (please note that 30-90 days prior to the beginning of each plan year is deemed reasonable). | At least 30 but no more than 90 days prior to the beginning of each plan year. |
| Is the 90-day permissible withdrawal available? | Not allowed | Optional provision: If the plan allows, participants may request a withdrawal of default contributions made in the first 90 days (or as few as 30 days) after the first default contribution would have been included in pay. Any associated match is forfeited.<br>*[Note: Refunds are taxable to participants in the year distributed; 10% penalty does not apply.]* |
| Are employer contributions required? | No | No |

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