EMPOWER RETIREMENT®

Defined Contribution Legislative and Regulatory Update

We are committed to providing the information and tools you need to 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

FROM **THE HILL**

SECURE update

In our last update, we discussed the origins of the **Setting Every Community Up for Retirement Enhancement (SECURE) Act** and its journey through Congress. As of this writing, SECURE remains stalled in the Senate. Senate leadership continues to prefer unanimous consent as the method of moving SECURE forward, but with objections being raised by Senators Ted Cruz (R-Texas), Pat Toomey (R-Pa.) and Mike Lee (R-Utah), that does not appear to be a viable option.

While there remains a chance that the three senators' holds could be cleared, the more likely path forward is attaching SECURE to a year-end budget bill. On September 27, 2019, President Trump signed a continuing resolution that extended funding for federal government agencies through November 21, 2019. At that point, Congress must either agree on an appropriations package or pass another continuing resolution to send to the president's desk. Failure to reach a budget agreement or pass another extension would result in a government shutdown.

In the past, these must-pass measures have served as vehicles for other pieces of legislation. Given the broad bipartisan support for SECURE, it could be a candidate for inclusion. A complicating factor is the impeachment inquiry opened by the House in late September. Depending upon when the inquiry ends and the scheduling of any subsequent activity, moving a legislative package forward may become more difficult.

The weeks ahead will be crucial in determining the near-term fate of SECURE. As always, we at Empower Retirement will be keeping a close eye on the situation and will keep you apprised of any new developments.

Multiple-employer plans: Association MEP final regulations and DOL RFI

Multiple-employer plan (MEP) arrangements continue to be a hot topic in Washington. MEPs are considered an important mechanism to potentially increase retirement plan coverage in America by allowing multiple smaller plans to pool assets and administration together into a single plan. However, current law and regulations are not conducive to, and sometimes outright hinder, MEP creation and expansion. Last quarter, we focused on the IRS's proposed regulation addressing the one bad apple rule. This proposed regulation allows MEPs to spin off non-compliant participating plans without jeopardizing overall MEP plan qualification. The one bad apple rule represents one of three releases from the IRS and the Department of Labor (DOL) addressing MEPs.

A few weeks after the IRS released its one bad apple rule, the DOL released its final rule on Association Retirement Plans and Other Multiple Employer Plans (Association Rule) and then

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concurrently released a request for information (RFI) seeking feedback from stakeholders about ways to update existing regulations to facilitate open MEPs. These IRS and DOL MEP releases signify the federal government's interest in expanding retirement coverage through MEPs. However, the language of the releases separately illustrates the shared DOL and IRS belief that they have limited power to expand MEP programs under existing federal law. In other words, MEP programs can only expand with new legislation.

The final Association Rule marginally expands the definition of employer in ERISA. The DOL clarifies the circumstances of when an employer group or association or professional employer organization (PEO) can sponsor a single workplace plan. Under the final Association Rule, the group or association must be bona fide. The DOL laid out the following requirements for groups or associations to be considered bona fide. They must:

- Have at least one substantial business purpose unrelated to offering and providing MEP coverage to employee members and employees;
- Ensure that each participating employer member is acting directly as an employer for at least one employee MEP participant;
- Have a formal organizational structure through formation documents;
- Be controlled by the participating employers;
- Have participating employer members with a commonality of interest (e.g., be in the same trade, industry or line of business or have a principal place of business in the same state or metro area);
- Limit participation in the MEP to employees of the participating employer members; and
- Not be a financial services firm.

The Association Rule also sets rules for PEO MEP sponsorship. As in the group of bona fide rules, PEOs must also meet certain criteria for sponsorship. They must:

- Perform substantial employment functions on behalf of client employers (e.g. payment of wages; tax reporting and withholding; hiring/firing);
- Have substantial control over functions and activities of the MEP and assume plan sponsor, plan administrator and named fiduciary responsibilities;
- Ensure that each participating employer is acting directly as the employer for at least one employee covered under the MEP;
- Limit participation in the MEP only to the employees and former employees of the participating employers.

The common theme in these requirements is the DOL's focus on having some kind of correlation between the sponsor and the employers and the employers tacitly correlated with each other (e.g., similar industry).

As noted above, the RFI questions are focused on open MEPs. Open MEPs would eliminate this correlation requirement and essentially create a platform of unaffiliated employers to pool assets and administration into one plan. An open MEP platform can create incentives for small employers to sponsor plans. But the open MEP framework highlights administrative challenges. Financial services companies are likely in the best position to fill those roles. Because of this, a majority of the RFI questions focus on the ability of financial services companies to serve as open MEP sponsors.

Inherent in these questions are the DOL's concerns with financial services sponsorship under existing ERISA regulations. Through these questions, the DOL is seeking information about what they can and must do from a regulatory perspective to support open MEPs assuming the SECURE Act passes. The comment period closed on October 29. We expect a number of financial industry stakeholders to have commented on these questions.

DOL challenges state auto-IRA program

In recent years, many states have developed retirement initiatives intended to address coverage gaps among employees within their states. California began rolling out its program, CalSavers, in July 2019. Under that program, employers must either offer their employees a retirement plan or participate in the CalSavers automatic IRA program whereby salary deferrals equaling 5% of pay will be deposited into an IRA unless the employee opts out or selects a different rate. The program is voluntary at this point but will become mandatary for employers with 100 or more employees on June 30, 2020, and it will eventually become mandatory for employers with five or more employees as of June 30, 2022.

In establishing these programs, one of the issues states needed to address was whether they would be affected by Section 514(a) of ERISA, which says that ERISA supersedes, or preempts, all state laws that relate to an employee benefit plan. During the Obama administration, the DOL published guidance saying that these state programs were not preempted by ERISA. That guidance was rescinded by the Trump administration. The Trump administration also recently reinforced its view that pre-emption does apply by filing a Statement of Interest in a lawsuit challenging the CalSavers program.

In the Statement of Interest, the Department of Justice, joined by the Department of Labor, takes the position that ERISA preempts the CalSavers program. One of the arguments made by the government is that the mandatory nature of the CalSavers program is in conflict with

a core policy underlying ERISA — i.e., that offering a retirement program to one's employees should be voluntary.

The next step is for the District Court to rule on the amended complaint after taking into account the DOL's filing. Regardless of which way the court rules, there is likely to be an appeal of its decision. While all this is occurring, California and other states will need to decide how to respond to the fact that the DOL clearly intends to challenge these programs and require that they be treated as ERISA plans subject to ERISA's fiduciary and other requirements. The CalSavers program, like some other state programs, specifically contains language stating that the program will not be implemented if it is determined that it would be subject to ERISA.

Practical considerations

More than 30 states are at some stage of considering a state-run retirement program that would be affected by the pre-emption decision. Six states (California, Oregon, Illinois, Massachusetts, Connecticut and Maryland) have already enacted legislation. It is likely that the DOL's intervention in the CalSavers lawsuit will slow down the development of these programs until the pre-emption issue has been resolved.

FROM **THE COURTS**

Ninth Circuit upholds plan administrator's interpretation of plan benefits

The Ninth Circuit Court of Appeals recently ruled that the administrator of an ERISA-covered multi-employer pension plan did not abuse its discretion in interpreting the plan to preclude a participant's claim for early retirement benefits. Although this case dealt with an ERISA plan, it may provide some insight for governmental plan sponsors.

The case is helpful to plan administrators as it illustrates the significant deference the court was willing to extend to the plan administrator's interpretation of an ambiguous provision, given that the interpretation did not conflict with the plain language of the plan or otherwise invalidate other plan provisions.

The plan provided for an early retirement benefit for participants who attain age 55 and complete at least 10 years of covered service. At issue in the case was the plan administrator's broad interpretation of a plan provision that suspends early retirement benefits for any month in which a participant worked in "prohibited employment," which the plan defined as "the performance of services in any capacity in the Electrical Industry." The term "Electrical Industry" is defined as "all branches of the Electrical Trade in the United States," but the plan does not in turn define "Electrical Trade."

The plan terms granted the plan administrator with exclusive power and discretion to interpret the plan, to make benefit determinations and to determine all questions arising under the plan, including eligibility for benefits. In 2014, the plan administrator interpreted the plan's suspension of benefits provision to preclude a claim for early retirement benefits made by a participant who provided administrative services to an electrical union at the time the claim was made. The plan administrator ultimately determined that under its interpretation of "Electrical Trade," the participant's work for the electrical union came within the plan's "prohibited employment" definition and triggered the plan's suspension of benefits provision.

After the claim was again denied by the plan administrator on appeal in 2016, the participant sued the plan and the plan administrator, claiming he was entitled to the early retirement benefit under ERISA. The parties stipulated that the participant's services to the union did not include traditional work as an electrician and that the participant met all other eligibility requirements for the early retirement benefit under the plan aside from the suspension of benefits provision. The federal district court ruled in favor of the plan administrator, holding that its interpretation of "prohibited employment" under the plan was not an abuse of discretion because both parties' interpretations were reasonable. The participant appealed the decision to the Ninth Circuit Court of Appeals in a timely manner.

The participant had argued that the plan administrator acted as an adversary toward his claim rather than a neutral arbitrator acting in the plan's best interest, and therefore the plan administrator abused its discretion in interpreting the plan to deny the claim. Consistent with

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its own previous case precedent, the Ninth Circuit concluded that because the plan specifically granted discretionary authority for interpretation to the plan administrator, the appropriate standard of review was an abuse of discretion standard rather than a de novo standard. The court also concluded that any procedural irregularities do not alter the standard of review except where they are so substantial as to make doing so necessary, such as where the plan administrator "engages in wholesale and flagrant violations of the procedural requirements of ERISA" and thus "acts in utter disregard of the underlying purpose of the plan."

Ultimately, the court considered the participant's arguments and concluded the procedural irregularities were not enough to weigh in the participant's favor in either finding that the plan administrator abused its discretion in denying the claim or altering the review standard.

The court next considered whether the plan administrator abused its discretion by interpreting the plan to preclude a claim for early retirement benefits based on the participant's administrative work for an electrical union. In analyzing the issue, the court applied a three-part test. The Ninth Circuit reasoned that although the participant's argument was a reasonable and competing interpretation of the plan's suspension of benefits provision, the plan administrator's broad interpretation was both reasonable and not an abuse of discretion because it did not clearly conflict with the plain language, did not invalidate another plan provision and was rationally related to the purpose of the plan.

FROM **THE REGULATORY SERVICES TEAM**

Final guidance on hardship distributions from 401(k) and 403(b) plans

Great news! The IRS has provided its formal final guidance with regard to recent changes related to hardship distributions. Below are some questions and answers to help plan sponsors understand the details of what has changed, what will change and when different elements are effective.

As described in prior Empower communications to our plan sponsor and advisor communities, there has been a significant expansion of available plan options with regard to participant requests for hardship distributions as a result of the Bipartisan Budget Act of 2018 (BBA) and IRS proposed regulations on hardship distributions issued in November 2018. The final regulations issued in September 2019 are substantially similar to the proposed regulations.

The changes were generally effective January 1, 2019 (or the first day of the 2019 plan year, as applicable). However there are a few additional changes effective on January 1, 2020, which are discussed in the Q&A.

Plan sponsors who are not using Empower's pre-approved plan document should contact their plan document provider to ensure their plan is updated in a timely manner. Also, plan sponsors should review the plan's administrative procedures and other materials regarding hardships to align with the changes to plan administration required by the final regulations. Please contact your Empower client service representative if you have any additional questions.

Q: What has changed with the most recent IRS final regulations on hardship distributions?

A: On September 23, 2019, the IRS issued final regulations on hardship distributions from 401(k) and 403(b) plans. The final hardship regulations largely mirror the proposed hardship regulations that had been issued previously on November 9, 2018. Here are the key items that were changed or confirmed by the final regulations:

- 401(k) and 403(b) plans are required to cease administering a six-month suspension of participant contributions following the issuance of a hardship distribution made on or after January 1, 2020. Many sponsors administered their plan to reflect the removal of this requirement as of January 1, 2019, but, for any plans still applying the suspension following hardships issued in 2019, the plan administrator must implement this change for hardships issued on or after January 1, 2020.

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- The final hardship regulations also clarify that the elimination of the six-month participant contribution suspension period following a hardship, as applied to "all other plans" of the employer under the regulations, does not include a nonqualified plan (i.e., 409A plans), which may still suspend contributions.
- The final regulations confirmed that participants are no longer required to take an available loan first before the plan may issue a hardship distribution. Note, however, the final regulations did provide that a plan sponsor may choose to retain such a requirement as an additional condition for the plan's issuance of a hardship distribution.
  - The regulations confirmed in accordance with the BBA that 401(k) plans may make additional contribution sources available for a hardship distribution. The additional contribution sources consist of QNECs, including both traditional and QACA safe harbor matching and non-elective contributions, QMACs and earnings on participant elective deferrals. If such additional sources are made available as an administrative matter, then the terms of the plan will also need to reflect the change, which may require an amendment. Please note, however, that 403(b) plan rules were not similarly amended by the BBA, and these sources are not available for hardship distributions from a 403(b) plan.
- The final regulations also made amendments to the list of safe harbor hardship events:
  - A plan is permitted to treat a participant's "primary beneficiary under the plan" as an individual for whom qualifying medical, educational and funeral expenses may be incurred by the participant for hardship purposes. This change has been in effect since 2006 but is now reflected in the final regulations.
  - The regulations permit a hardship distribution to be issued due to a "casualty loss" as defined in Internal Revenue Code section 165. A provision of the BBA had the unintended consequence of limiting the casualty loss safe harbor under the hardship rules to losses incurred due to a federally declared disaster. The final regulations clarify that this change does not apply for hardship distribution purposes, and hardships made due to a casualty loss may include damage to a participant's home from causes other than a federally declared disaster.
  - The final regulations separately expanded the list of deemed hardship events under the safe harbor to include expenses incurred as a result of a federally declared disaster. Instead of continuing to issue individualized guidance following a federally declared disaster, the IRS amended the regulations to eliminate uncertainty and delay to allow for a hardship distribution on account of a financial loss incurred by a participant whose principal residence or place of employment is within the disaster area designated for individual assistance by the Federal Emergency Management Agency.

FROM **THE REGULATORY SERVICES TEAM**

- Plan document amendments
- The deadline to adopt an amendment will depend in part on whether your plan uses an IRS pre-approved plan document or an individually designed document.
  - The deadline to amend for an individually designed qualified plan (that is not a governmental plan) is the end of the second calendar year that begins after the IRS issues the Required Amendments List (RAL) that includes the change. If the final regulations are included in the 2019 RAL, the deadline would be December 31, 2021.
  - For a 403(b) plan, the amendment due date is December 31, 2020 (this same date applies to both pre-approved and individually designed 403(b) plans).
- If Empower Retirement is providing plan document services for your plan using our pre-approved document, a plan document amendment will be required.
- As the pre-approved plan sponsor, Empower will execute an amendment on behalf of all adopting plan sponsors consistent with the default elections discussed above.
- If you made a separate election to override any default election, the plan sponsor will need to separately execute a plan amendment.
- We intend to provide the amendment, a summary of material modifications (SMM) and additional details in the first part of 2020.
  - Your plan document does not need to be amended before the changes are implemented from a recordkeeping standpoint.

Q: Has Empower implemented administrative defaults for these hardship changes?

A: Yes. As we have previously communicated, Empower implemented certain administrative defaults from a recordkeeping perspective with respect to the hardship distribution changes described in the proposed regulations effective January 1, 2019 (or, if later, the first day of the 2019 plan year). These recordkeeping changes were implemented regardless of whether the plan administrator utilizes an Empower pre-approved plan document unless the plan administrator provided alternate direction for hardships issued in 2019 via an election form. The Empower defaults are described in the table on the next page.

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HARDSHIP CHANGE UNDER THE REGULATIONS	EMPOWER DEFAULT	OPTIONS FOR PLAN SPONSORS	CHANGE TO PLAN DOCUMENT REQUIRED
Removal of the six-month (or in certain cases a 12-month) deferral suspension.	Remove the six-month or 12-month deferral suspension for plan years beginning on or after 1/1/2019.	Plan sponsors are allowed to choose to delay implementation of this provision until 1/1/2020, when the change becomes mandatory.	Yes. Empower will update its pre-approved documents. For plan sponsors using individually designed plan documents, an amendment generally is necessary.
Removal of the requirement under the safe harbor for a participant to take an available plan loan that did not increase the amount of the participant's financial need prior to the issuance of a hardship.	A plan may now issue a hardship without first requiring a participant to take an available plan loan as of 1/1/2019.	Plan sponsors can elect to require that an available loan be taken prior to hardship.	Yes. Empower will update its pre-approved documents. For plan sponsors using individually designed plan documents, an amendment generally is necessary.
Allowance of earnings on deferrals to be included in the hardship calculation for 401(k) plans.	Earnings on deferrals are now factored into the calculation for an available hardship from a 401(k) plan as of 1/1/2019.	QNECs, QMACs and safe harbor contributions (including QACAs) can also be added with their associated earnings. This is purely optional for 401(k) plans only and is not part of the Empower defaults being applied.	Yes. Empower will update its pre-approved qualified plan documents to reflect the inclusion of earnings on elective deferrals in the hardship calculation. For plan sponsors using individually designed plan documents, an amendment generally is necessary.
The final regulations reflect a new financial needs test for all hardships issued by a 401(k) or 403(b) plan	Empower will update hardship distribution forms to include a participant representation of hardship need as described in the final regulations as of 1/1/2020.	None	Yes. Empower will update its pre-approved documents. For plan sponsors using individually designed plan documents, an amendment generally is necessary.
The final regulations expand the list of deemed hardship events under the safe harbor to include expenses incurred as a result of a federally declared disaster.	Empower will update hardship distribution forms to reflect this new option.	None	Yes. Empower will update its pre-approved documents. For plan sponsors using individually designed plan documents, an amendment generally is necessary.
The financial need of a participant's primary beneficiary may qualify the participant for certain safe harbor hardship distributions	Empower's hardship distribution forms reflect this provision.	None	Empower's pre-approved document can accommodate this provision (this provision has been an option since 2006). For plan sponsors using individually designed plan documents, an amendment is generally necessary if the plan does not currently have this provision.
Changes to the issuance of a safe harbor hardship distribution under the regulations due to a "casualty loss" as defined under IRC Section 165(h) (without regard to whether the financial loss was incurred due to a federally declared disaster).	Empower has updated hardship distribution forms to include this provision.	None	Yes. Empower will update its pre-approved documents. For plan sponsors using individually designed plan documents, an amendment generally is necessary.

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