Defined Contribution Legislative and Regulatory Update

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FOR 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.

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From the Hill

The SECURE Act

At the beginning of the year we discussed the change in leadership on key House committees with jurisdiction over pension reform. In particular, we noted that Rep. Richard Neal (D-MA) was someone to watch closely as he assumed chairmanship of the House Ways and Means committee. Chairman Neal had indicated that pension reform was among his top priorities, and he wasted no time in proving that to be the case.

On February 6, the Ways and Means committee held a hearing entitled "Improving Retirement Security for America's Workers." In his opening statement Chairman Neal stated, "One of my priorities as Chairman of this committee is helping American workers of all ages prepare for a financially secure retirement." He further noted, "Increasing opportunities for employees to save through a plan at work could make a huge difference for families — having an employer-sponsored retirement plan is key to preparing for retirement."

On April 2, the Ways and Means committee took the next step toward pension reform. With unanimous support, the committee reported out the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE). It's worth noting that Rep. Kevin Brady (R-TX), the ranking Republican on Ways and Means, was one of the cosponsors, along with Chairman Neal, of SECURE.

The bill contains many of the provisions found in the Retirement Enhancement Savings Act (RESA) that was first introduced in the Senate in 2016. SECURE also includes some provisions found in the Retirement, Savings and Other Tax Relief Act of 2018, a House GOP version of RESA that was passed at the end of the year but was never considered by the Senate. On April 1, the day before the House markup of SECURE, Senator Chuck Grassley (R-IA), chairman of the Finance committee, and Senator Ron Wyden (D-OR), the ranking Democrat, reintroduced RESA in the Senate.

Select key provisions of SECURE also found in RESA

Open multiple-employer plans (Open MEPs): Open MEPs, one of the key elements of congressional pension reform efforts, is viewed as a way of encouraging small employers to sponsor plans. An MEP is a plan maintained by unrelated employers. Under current law, these may only be offered if there is some common interest between the participating employers. As a result they are typically offered by trade associations such as the American Bar Association. In addition, under IRS rules, if a single participating employer has a disqualifying event, the entire MEP is deemed disqualified (known as the "one bad apple" rule). SECURE would remove the commonality requirements and apply any disqualification only to the employer who had the disqualifying event. Several rules must be met for an open MEP:

- The MEP must have a Pooled Plan Provider (PPP). A PPP is a party named as a fiduciary under the plan that assumes responsibility for plan administration and must register with the Department of Labor.
- Each participating employer retains fiduciary responsibility for the selection and monitoring of the PPP. Participating employers also have fiduciary responsibility for investment and management of plan assets unless delegated.
- In order for the MEP to get relief from the "one bad apple" rule, assets of the offending employer would need to be spun off from the MEP.

Lifetime income provisions

- Participants in qualified defined contribution, 403(b) and governmental 457(b) plans can be allowed to take a distribution of a lifetime income investment option without regard to any IRS restrictions if that lifetime income investment is no longer authorized to be held in the plan. The distribution would have to be made via a direct rollover to an IRA or to another retirement plan or, in the case of an annuity contract, through direct distribution to the individual.
- A fiduciary safe harbor would be created for employers to use in selecting an annuity provider for their defined contribution plans. This would remove a barrier to access to in-plan lifetime income solutions for participants.

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- At least annually, plans would be required to provide each of their participants a lifetime income disclosure. This disclosure would project the lifetime income stream in retirement based upon the participant's account balance.

Expanded tax credits

- An expanded tax credit for small employers (100 or fewer employees) would increase the current annual cap on the tax credit for starting a plan from $500 to the lessor of $5,000 or $250 multiplied by the number of non-highly compensated employees.
- A new $500 tax credit would be created for small employers (with 100 or fewer employees) that adopt automatic enrollment.

Provisions of SECURE not found in RESA

- Employees who complete three consecutive years with at least 500 hours of service must be eligible to participate in the plan. The plan would not be required to make matching or non-elective contributions for these employees, and these employees would not be included for discrimination or top-heavy testing.
- Participants could take a penalty-free withdrawal of up to $5,000 upon the birth or adoption of a child. These distributions could be repaid to the plan.
- The age for required minimum distributions would be increased to 72. This would be effective for distributions required to be made after December 31, 2019.

Next steps

Chairman Neal has made clear his desire to put SECURE on a fast track for passage, and the bill could come up for a vote in the House soon. Depending on what happens in the House, the Senate could also move very quickly on their latest version of RESA. Should both bills pass their respective chambers — it should be noted that there is broad bipartisan support in both the House and the Senate — the next stop would be a conference committee to reconcile any differences between the two bills. As noted above, there are only a few differences between the bills, so the reconciliation process could move quickly.

Of course there are no guarantees that some version of SECURE/RESA will make it to the president's desk, but the efforts of Neal to move these reforms forward certainly increase the likelihood. The chairman has also indicated a desire to introduce a second pension reform bill later this year. That bill would most likely be some combination of the Retirement Plan Simplification and Enhancement Act that he introduced in 2017 and the Retirement Savings and Security Act that Senators Rob Portman (R-OH) and Ben Cardin (D-MD) having been working on in the Senate.

At Empower we will continue to monitor this and any other legislative activity and will keep you apprised of any new developments.

The Department of Labor's proposed rule on association retirement plans

In August 2018, President Trump issued an Executive Order, which, among other things, asked the DOL to expand circumstances in which small and mid-size employers can participate in a multiple-employer plan (MEP). The order also asked the DOL to look at increasing retirement security for gig economy workers (Uber drivers, independent contractors, etc.). One of the barriers to using MEPs is a DOL requirement stating that, in order for an MEP to be treated as a single ERISA plan with a single 5500 filing, etc., there must be some commonality among the employers joining the MEP other than their desire to be part of a pooled plan.

The DOL promptly responded by publishing a proposed rule in October 2018. While the proposed rule does provide some clarity regarding when a professional employer organization (PEO) can offer an MEP, as well as the conditions for sponsoring an association retirement plan, it unfortunately did not eliminate the commonality requirement.

In order for an entity to sponsor an association retirement plan, it must satisfy the following conditions:

- It must have at least one substantial business purpose unrelated to the goal of providing an MEP.
- Each participating employer must employ at least one employee participant (although owner-employees can act as both the employer and the employee for this purpose).
- There must be a formal organizational structure with a governing body and by-laws or similar indications of formality.

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- The plan and the activities of the entity generally must be controlled by its members.
- Employers joining the MEP must have a commonality of interest, which can be either participation in the same trade or business or geographic commonality (i.e., they operate in the same state or metropolitan area).
- Participation in the MEP can only be available to employees, former employees and beneficiaries of the association members.
- Service providers, including banks, insurance companies, broker-dealer firms, third-party administrators delete comma, and recordkeepers, cannot offer an association retirement plan.

In spite of the fact that the proposed rule did not eliminate the commonality requirement and prohibited financial service providers from offering an association retirement plan, it did generate some activity among associations interested in offering this benefit to their members. However, that interest may be curtailed because of a recent ruling from a DC district court that invalidated portions of the DOL's association health plan rule containing language virtually identical to the association retirement plan rule. The DOL may challenge this ruling, but, until this matter is resolved, it is likely the DOL will not act to finalize its proposed rule, and associations intending to rely on it may have to wait for more clarity.

From the Courts

Death benefits subject to state law claims after payment to beneficiary

In two recent cases, federal courts held that death benefits paid to a beneficiary under the terms of a plan were no longer subject to ERISA once paid from the plan. In both cases, the courts determined that state law claims brought by the estate of the deceased participant against the participant's designated beneficiary after the payment was made from the plan were not subject to ERISA.

In general, ERISA preempts any state law that relates to the administration of an employee benefit plan subject to ERISA. ERISA requires that benefits accrued under a plan must be paid under the terms of the plan. Under an ERISA plan, a participant may designate a person or persons as their beneficiary to receive their plan account upon death. With certain exceptions, a beneficiary designation remains in effect unless changed by the participant in a form and manner required under the plan. A divorce will not automatically revoke a spousal beneficiary designation unless specifically provided for under the terms of the plan or stated in a qualified domestic relations order (QDRO).

In both cases, the participants had designated their spouses as the beneficiaries to their plan accounts. The participants later divorced from their spouses but did not change their designated beneficiaries under the plan. As a result, the participants' ex-spouses were the designated beneficiaries of their accounts upon their deaths. In both cases, the participants' estates sued the ex-spouses in state court to recover the amounts paid to the ex-spouses from the plan. In response, the ex-spouses claimed that the payments were subject to and protected by ERISA.

In one of the cases, the ex-spouse received half of the participant's account as part of a divorce agreement. This was paid to her under a QDRO, but the participant had failed to remove her as his designated beneficiary after the divorce. After his death, the participant's estate sued the ex-spouse under state law, claiming the ex-spouse's receipt of the remaining amount in the participant's account had been unjust and an improper taking of the estate's property as the ex-spouse had previously relinquished her right to the remaining

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amount under the divorce agreement. In response, the ex-spouse claimed her rights to the participant's account were subject to ERISA and removed the case to federal court.

In review, the federal court noted that a claim filed in state court can be removed to federal court if the claim raises a federal question with regard to the laws of the United States. As ERISA is federal law, a state court claim can be removed to federal court if the claim relates to the administration of a plan subject to ERISA. But, in this case, the federal court found that the estate was not challenging the ex-spouse's designation as beneficiary or her right to receive the participant's account from the plan. Instead, the estate sued the ex-spouse with respect to her control of the assets after payment from the plan. The federal court sent the case back to the state court for determination since the claim did not involve ERISA.

In the other case, the participant and ex-spouse had agreed in their divorce decree that they would each retain sole ownership of their retirement accounts, and each had waived any future claims to the other's account. As a result, a QDRO was not issued in relation to the participant's account. Again, as in the prior case, the participant failed to remove his ex-spouse as his designated beneficiary after the divorce. After the participant's death, both the ex-spouse and estate filed a claim with the plan sponsor as beneficiary of the participant's account. As a result of the conflict, the plan sponsor transferred the participant's account to federal court to determine the appropriate beneficiary. During the federal court's review, the participant's estate filed a state law claim against the ex-spouse alleging that her receipt of the plan account is a breach of the divorce decree and requested that the court impose a constructive trust on the amounts she receives from the plan for the benefit of the estate.

The federal court concluded that a divorce decree without a QDRO did not have any effect on the participant's designation of his ex-spouse as his beneficiary under the terms of the plan, and that the account should be distributed to the ex-spouse as the beneficiary. But the federal court further noted that once plan assets are distributed from a plan to a beneficiary, they are subject to state law claims. The participant's estate subsequently filed a claim in state court. The state court concluded that the ex-spouse's right to the participant's account had been extinguished under the divorce decree and ordered the ex-spouse to pay the funds she received from the plan to the estate.

Practical considerations

In each of these cases, the terms of the divorce agreement between the participant and his ex-spouse did not have any effect on the participant's designation of his ex-spouse as beneficiary under the plan. In general, only the terms of a QDRO will impact a participant's account. In addition, although not an issue in these particular cases, the terms of a plan may automatically revoke the designation of a spouse as beneficiary upon divorce. These issues should be considered when making beneficiary determinations.

From the Regulatory Services Team

Avoiding compensation errors in governmental retirement plans

The definition of compensation is extremely important to every plan's design because it provides a basis for the calculation of employee deferrals and employer contributions. This article does not discuss the various definitions of compensation that a plan sponsor may elect to include in a governmental plan document. Employers would have had that discussion with the document provider when the plan document was adopted. If, however, you have any concern about whether the definitions of compensation in your document are proper, contact your document provider or legal advisor.

Using the wrong definition of compensation is one of the most common errors the IRS finds when it examines a retirement plan. Thus, our purpose in this article is to remind sponsors of the importance of knowing and understanding their plan documents' definitions of compensation and taking steps to ensure such definitions are being followed in operation. The failure to follow a plan's definitions of compensation can lead to costly operational failures that need to be corrected.

Errors related to compensation can occur when:

- The person calculating contributions does not know the plan's definition of compensation.
- The payroll processor does not know the plan's definition of compensation.
- The plan's definition of compensation is amended without notifying the person calculating contributions or the payroll processor.
- Payroll systems are not updated to reflect the revised definition.
- Payroll systems are not updated when the types of compensation paid change.

To ensure that compensation errors do not occur:

- Perform an annual review of your plan's operations to ensure contributions are made based on the definition of compensation contained in the plan document.
- When you amend or restate your plan, be sure the definition of compensation is the same as it was in the old plan document, or note any differences and notify all necessary parties, such as your payroll processor or third-party administrator.
- Don't start paying a new type of compensation, such as bonuses or overtime, without first checking your plan language to confirm the proper treatment of such payments under the plan's definition of compensation.
- When warranted, simplify your plan's definition of compensation.

Practical considerations

Periodically review your retirement plan for errors and fix them as quickly as possible. The IRS's 401(k) Plan Fix-it Guide describes how to correct different plan errors using the IRS's Employee Plans Compliance Resolution System (EPCRS) correction program. The guide can be found at irs.gov/pub/irs-tege/401k_mistakes.pdf. With respect to your governmental 457(b) plan, you have until the first day of the plan year that begins more than 180 days after the IRS notifies you of the failure to correct a governmental 457(b) plan failure. This generous correction period is stated in Code §457(b)(6) and Treas. Reg. §1.457-9(a).

IRS updates correction programs for 401(k) plans

IRS Revenue Procedure 2019-19, effective April 19, 2019, expands the types of plan document and operational failures, including some plan loan failures, that are eligible for self-correction. The updates made to the Employee Plans Compliance Resolution System (EPCRS) reduce the costs and the burdens of compliance for sponsors of 401(a)/(k), 403(a), 403(b), 408(k) or 408(p) retirement plans. Now, plan sponsors are allowed to self-correct certain plan failures with no requirement to make Voluntary Correction Program (VCP) filings with the IRS.

Self-correction program expansion for plan loans

The changes to EPCRS permit self-correction for a number of plan loan failures:

- **Missed payments**: If a participant fails to repay a plan loan in accordance with plan terms such that the loan would otherwise be defaulted for late, incorrect or no payments, self-correction is now available for corrective repayments of the loan. The Revenue Procedure allows these loans to be corrected by a single-sum repayment, reamortization of the outstanding loan balance or a combination of the two.

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- **Too many loans**: Plan sponsors who issued loans to participants when the plan document did not permit loans have been allowed to self-correct such errors. Self-correction was not previously available, however, when a participant was permitted to take out more loans than the number available under the plan. Under the new rules, the failure to properly restrict the number of loans may be corrected by a retroactive plan amendment to increase the number of loans allowed under the plan to the number that were erroneously made available if all of the following apply:
  - The amendment satisfies Code §401(a).
  - The plan would have satisfied Code §§72(p) and 401(a) had the amendment been a part of the plan when loans were first available.
  - The loans, including those in excess of the number permitted under the plan, were available to all participants (or only to one or more participants who were non-highly compensated employees).
- **Spousal consent**: For plans that require spousal consent, the failure to obtain such consent for a loan can now be self-corrected if the spouse is willing to grant consent for the loan. But, if consent cannot be obtained, any further correction must be made under the VCP or the Audit Closing Agreement Program (Audit CAP).
- **Reporting**: Welcome relief is provided in cases in which a participant loan is not fully corrected and the plan sponsor is required to report a "deemed" distribution on Form 1099-R. The Revenue Procedure allows the plan sponsor to report the deemed distribution in the year of correction, rather than the year of failure, without being required to file with the IRS using the VCP.

Loans that may not be self-corrected

If a loan violates the dollar limit, maximum loan period or level amortization requirements under Code §72(p)(2)(A), (B) or (C), the plan sponsor must still correct such failures using the VCP. Also, EPCRS does not provide relief from any prohibited transaction excise taxes.

Correcting certain retirement plan document failures

Sponsors of a qualified or 403(b) plan may now self-correct certain plan document failures in addition to an initial failure to adopt a qualified plan or the failure to adopt a written 403(b) plan document in a timely manner. For the first time, the failure to adopt required or interim amendments may be self-corrected. Self-correction for failures is allowed if all of the following apply:

- The plan is subject to a favorable IRS letter.
- The correction is made within the required time period for correcting significant failures through self-correction (generally two plan years).

The types of plan document failures that may be self-corrected do not, however, extend to discretionary plan amendments.

Self-correction expanded for certain operational failures

The Revenue Procedure offers limited relief for certain other operational failures to be corrected by retroactive plan amendment under the SCP. Such an amendment may be used to conform plan terms to plan operations if all of the following apply:

- The plan amendment would result in an increase of a benefit, right or feature.
- The increase in the benefit, right or feature is available to all eligible employees.
- The increase in the benefit, right or feature is permitted under the Code and satisfies the general correction principles of EPCRS, including nondiscrimination requirements.

Other insignificant plan operational errors

The Revenue Procedure includes a cross-reference to the "Correcting Plan Errors" webpage on the IRS website for additional examples of insignificant violations that can be self-corrected. This reference is intended to provide additional guidance to plan sponsors in making the facts and circumstances determination as to whether a plan error is eligible for self-correction.

Correcting governmental 457(b) plan errors

IRS guidance released on the IRS website on March 4, 2014, clarifies that (1) the IRS will not accept submissions for corrections that involve errors in the "form" of a written 457(b) plan; and (2) governmental 457(b) plan sponsors will often not have to submit a formal correction with the IRS for

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failures to comply with Code § 457(b) given the expansive self-correction provisions built into Code § 457(b) and related Treasury regulations. This guidance reminds governmental plan sponsors that they have until the first day of the plan year that begins more than 180 days after the IRS notifies them of the failure to correct a 457(b) plan failure. This generous correction period is stated in Code §457(b)(6) and Treas. Reg. §1.457-9(a).

Practical considerations

The introduction of the IRS expansion of self-correction under ECPRS is very welcome news to government sponsors of qualified 401(a) and grandfathered 401(k) plans. The ability to self-correct certain 401(k) failures should reduce the burden on plan sponsors and participants related to rather minor violations. The Revenue Procedure notes that the IRS and Treasury continue to consider whether to expand the self-correction program to cover plan overpayments. Importantly, the parameters of self-correction still apply, including the time period for correcting significant failures.

Additionally, with respect to governmental 457(b) plans, sponsors have the 180-day self-correction program discussed above, which is separate from ECPRS, to cure 457(b) plan defects.

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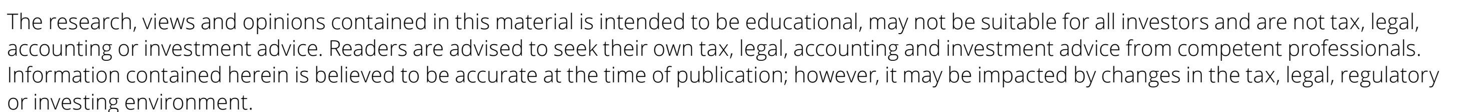
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