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White paper

The Securing a Strong Retirement Act of 2021

Also known as "SECURE Act 2.0"

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Key highlights

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- Expanding coverage and increasing retirement savings
- Preservation of income
- Simplification and clarification of certain retirement plan rules
- Technical amendments and administrative provisions
- Conclusion

In a nutshell

Members of the Ways and Means Committee of the U.S. House of Representatives, on October 27, 2020, released a proposed retirement reform Bill called "Securing a Strong Retirement Act of 2020" (hereafter, referred to as the "Bill"). The popular press frequently refers to the Act as the "SECURE Act 2.0." The proposed Bill was introduced by Ways and Means Committee Chairman Richard Neal (D-Mass) and Ranking Member Kevin Brady (R-Texas). Like that of the Setting Every Community Up for Retirement Enhancement Act of 2019 (hereafter, referred to as "SECURE Act"), this legislation continues to advocate for providing American workers and savers with a strong financial future.

Some of the goals of the Bill include:

- Allow people who have saved too little to set more aside for their retirement
- Offer low- and moderate-income workers a tax credit for contributions to a 401(k) or similar plan
- Help people with student loans save by letting employers make retirement plan contributions equal to what an employee pays on their loans; and
- Further support the use of annuities that provide guaranteed lifetime income in retirement.[1]

Expanding coverage and increasing retirement savings

Expanding automatic enrollment in retirement plans

The summary points to statistical data that shows automatic enrollment provisions increase the likelihood that employees who are participants in their respective employers' plans will save more for their retirement. In order to increase the effectiveness of automatic enrollment as a tool to increase retirement savings, the Bill would

require Internal Revenue Code ("Code") section 401(k), 403(b), and SIMPLE plans to automatically enroll participants in the plans upon becoming eligible (and the employees may opt out of coverage). The initial automatic enrollment amount is at least 3% but no more than 10%. And then each year that amount is increased by 1% until it reaches 10%. All current Code section 401(k), 403(b), and SIMPLE plans are grandfathered. There is an exception for small businesses with 10 or fewer employees, new businesses (i.e., have been in business for less than three years), church plans, and governmental plans.

Modification of credit small employer pension plan startup costs

The three-year small business start-up credit is currently 50% of administrative costs, up to an annual cap of $5,000. Under the Bill, the 50% would be increased to 100% for employers with up to 50 employees. Except in the case of defined benefit plans, an additional credit would be provided equal to the applicable percentage of the amount contributed by the employer on behalf of employees, up to a per-employee cap of $1,000. This full additional credit would be limited to employers with 50 or fewer employees and it would be out for employers with between 51 and 100 employees. The applicable percentage would be 100% in the first and second years, 75% in the third year, 50% in the fourth year, 25% in the fifth year — and no credit for tax years thereafter.

Simplification and increase in Saver's Credit

The Saver's Credit provides millions of low- and middle-income individuals with an incentive to save for retirement each year. However, the current credit is complicated and not easy to understand. The Bill amends the Saver's Credit to create a single credit rate of 50% (currently there is a tiered structure of a 10%, 20% and 50% credit). The Bill also would increase the maximum credit amount from $2,000 to $3,000 and would increase the maximum income eligibility amount. The Bill also would index for inflation the creditable contribution amount.

Enhancement of Code section 403(b)

Code section 403(b) plan investments are generally limited to annuity contracts and mutual funds held in custodial accounts. Under the Bill, Code section 403(b) custodial accounts would be permitted to invest in collective investment trusts and the appropriate changes to the securities laws would be made to permit this.

Increase in age for required beginning date for mandatory distributions

Under current law, participants are generally required to begin taking distributions from their retirement plans at age 72, as implemented by the SECURE Act for persons turning age 70½ after December 2019. The Bill would increase the required minimum distribution age further to 75.

Deferral of tax for certain sales of employer stock to employee stock ownership plan (ESOP) sponsored by S corporations

The Bill would extend Code section 1042 to sales of employer stock to S corporation ESOPs (it currently only applies to C corporation ESOPs). Under Code section 1042, an individual owner of stock in a non-publicly traded C corporation that sponsors an ESOP may elect to defer the recognition of gain from the sale of such stock to the ESOP if the seller reinvests the sales proceeds into "qualified replacement property," i.e., stock or other securities issued by a U.S. operating corporation. After the sale the ESOP owner must own at least 30% of the employer corporation's stock.

Indexing IRA catch-up limit

Under current law, the limit on IRA contributions is increased by $1,000 (not indexed) for individuals who have attained age 50. The Bill would index such limit starting in 2022.

Higher catch-up contributions to apply at age 60

Under current law, employees who have attained age 50 are permitted to make catch-up contributions under a retirement plan in excess of the otherwise applicable limits. The limit on catch-up contributions for 2020 is $6,500, except in the case of SIMPLE plans for which the limit is $3,000. The Bill would increase these limits to $10,000 and $5,000 (both indexed), respectively, for individuals who have attained age 60. Individuals who have attained age 60 have a shorter time to save for retirement, making a higher limit appropriate.

Multiple Employer 403(b) plans

Multiple employer plans ("MEPs") provide an opportunity for small employers to band together to obtain more favorable retirement plan investment results and more efficient and less expensive management services. The SECURE Act made MEPs more attractive by eliminating outdated barriers to the use of MEPs and improving the quality of MEP

service providers. The Bill would allow Code section 403(b) plans to participate in MEPs, generally under the SECURE Act rules, including relief from the one bad apple rule so that the violations of one employer do not affect the tax treatment of employees of compliant employers.

Treatment of student loan payments as elective deferrals for purposes of matching contributions

Under the Bill, an employer would be permitted to make matching contributions under a Code section 401(k) plan, 403(b) plan, or SIMPLE IRA with respect to "qualified student loan payments," the definition of which is broadly defined as any indebtedness incurred by the employee solely to pay qualified higher education expenses of the employee. Governmental employers would also be permitted to make matching contributions in a Code section 457(b) plan or another plan with respect to such repayments. The idea is that employees who are overwhelmed with student debt may not realistically be able to save for retirement, and thus are missing out on available matching contributions. This Bill would allow them to receive those matching contributions by repaying their loan.

Application of credit for small employer pension plan startup costs to employers which join an existing plan

Under both pre- and post- SECURE law, the startup tax credit only applies for the first three years that a plan is in existence. So, for example, if a small business joins a MEP that has already been in existence for three years, the startup credit is not available. If, for example, the MEP has been in existence for one or two years when a small business joins, the small business may be able to claim the credit for two or one years, respectively. The Bill would fix this issue and employers joining a MEP (which includes PEPs) would be eligible for the credit for all three years.

Military spouse retirement plan eligibility credit for small employers

Military spouses often do not remain employed long enough to become eligible for their employer's plan or to vest in employer contributions. Under the Bill, small employers would be eligible for a tax credit with respect to their defined contribution plans if they:

1. make military spouses immediately eligible for plan participation within two months of hire,
2. upon plan eligibility, make the military spouse eligible for any matching or nonelective contribution that they would have been eligible for otherwise at two years of service, and
3. make the military spouse 100% immediately vested in all employer contributions.

The tax credit would equal the sum of (1) $250 per military spouse, and (2) 100% immediately vested in all employer contributions (up to $250) made on behalf of the military spouse, for a maximum tax credit of $500. This credit would apply for three years with respect to each military spouse — and would apply to nonhighly compensated employees only. An employer may rely on an employee's certification that such employee's spouse is a member of the uniformed services.

Small immediate financial incentives for contributing to a plan

Commentators have noted that individuals can be especially motivated by immediate financial incentives. So in addition to providing matching contributions as a long-term incentive for employees to contribute to a 401(k) plan, it might be helpful for employers to be able to offer small immediate incentives, like gift cards in small amounts. However, such immediate incentives are prohibited by the rule in Code section 401(k)(4)(A) generally prohibiting any incentives other than matching contributions. Under the Bill, de minimis financial incentives would be exempted from Code section 401(k)(4)(A) and from the corresponding rule under Code section 403(b). The Bill also includes a conforming modification to the prohibited transaction rules.

Safe harbor for corrections of employee elective deferral failures

Employers, including small employers, that adopt a retirement plan with automatic enrollment and automatic escalation features could be subject to significant penalties if even honest mistakes are made. The Bill would ease these concerns by allowing for a grace period to correct, without penalty, reasonable errors in administering these automatic enrollment and automatic escalation features. The errors must be corrected prior to 9½ months after the end of the plan year in which the mistakes were made.

One-year reduction in period of service requirement for long-term part-time workers

The SECURE Act requires employers to allow long-term part-time workers to participate in their 401(k) plans. As women are more likely to work part-time than men, this provision is particularly important for women in the workforce. The SECURE Act provision essentially provides that except in the case of collectively bargained plans, employers maintaining a Code section 401(k) plan must have a dual eligibility requirement under which an employee must complete either a one year of service requirement (with the 1,000-hour rule) or three consecutive years of service where the employee completes at least 500 hours of service. The Bill reduces the three-year rule to two years.

Governmental pension plans may include certain firefighters, emergency medical technicians, and paramedics

Many state political subdivisions contract with tax-exempt public safety agencies to provide firefighting and out-of-hospital emergency medical services. The Bill clarifies that governmental plans also include a plan which is maintained by such agencies, so that the agencies' employees can be treated in the same manner as other emergency personnel employed directly by the government.

Preservation of income

Remove required minimum distribution barriers for life annuities

The Bill would eliminate certain barriers to the availability of life annuities in qualified plans and IRAs that arise under current law due to an actuarial test in the required minimum distribution regulations (Q&A-14(c) of Treas. Reg § 1.401(a)(9)-6). The test is intended to limit tax deferral by precluding commercial annuities from providing payments that start out small and increase excessively over time. In operation, however, the test commonly prohibits many important guarantees that provide only modest benefit increases under life annuities.

Qualifying longevity annuity contracts ("QLACs")

QLACs are generally deferred annuities that begin payment at the end of an individual's life expectancy. Because payments start so late, QLACs are an inexpensive way for retirees to hedge the risk of outliving their savings in defined contribution plans and IRAs. Treasury regulations issued in 2014 generally exempted QLACs from the minimum distribution rules until payments commence. However, due to a lack of statutory authority to provide full exemption, the regulations imposed certain dollar and percentage limits on the premiums paid for QLACs that have prevented QLACs from achieving their intended purpose in providing longevity protection.

The dollar limitation is an amount equal to the excess of

- (A) $100,000 (adjusted for inflation to currently $135,000), over
- (B) the sum of
  - i. the premiums paid before that date under the contract that is intended to be a QLAC.

The percentage limitation is an amount equal to the excess of

- (A) 25% of the employee's account balance under the plan determined on that date, over
- (B) the sum of
  - i. the premiums paid before that date under the contract, and
  - ii. the premium paid on or before that date under any other contract that is intended to be a QLAC and that is held or was purchased for the employee under the plan.

The Bill would address these limitations by repealing the 25% limit and raising the $135,000 to $200,000. The Bill also would facilitate the sales of QLACs with spousal survival rights — and clarify that free-lock periods are permitted up to 90 days.

Insurance-dedicated exchange-traded funds

Exchange-traded funds ("ETFs") are pooled investment vehicles that are traded on stock exchanges. They are similar to mutual funds, except the share can be traded throughout the day on the stock market, rather than having to be held until after the market closes. ETFs are widely available through retirement plans, IRAs, and taxable investment accounts. However, outdated Treasury regulations have prevented ETFs from being widely available through individual variable annuities. Simply because the regulations were written before ETFs existed, ETFs cannot satisfy the regulatory requirements to be "insurance-dedicated." The Bill would address this problem by directing Treasury to update the regulations to reflect the ETF structure. The update would provide that ownership of an ETF's shares by certain types of institutions that are not

necessary to the ETF's structure would not preclude look-through treatment for the ETF, as long as it otherwise satisfies the current-law requirements for look-through treatment. This essentially would facilitate the creation of a new type of ETF that is "insurance-dedicated." The Bill also would clarify that similarities between an insurance-dedicated fund and another fund will not cause the insurance-dedicated fund to be treated as "publicly available" under the diversification rule or related IRS rulings involving "investor control."

Simplification and clarification of certain retirement plan rules

Recovery of retirement plan overpayments

Sometimes retirees mistakenly receive more money than they are owed under their retirement plans. These mistakes cause problems when they occur over time, and plan fiduciaries later seek to recover the overpayments from unsuspecting retirees. When an overpayment has lasted for years, plans often compel retirees to repay the amount of the overpayment, plus interest, which can be substantial. Even small overpayment amounts can create a hardship for a retiree living on a fixed income. The Bill would allow retirement plan fiduciaries the latitude to decide not to recoup overpayments that were mistakenly made to retirees. If plan fiduciaries choose to recoup overpayments, limitations and protections apply to safeguard innocent retirees. This protects both the benefits of future retirees and the benefits of current retirees. In addition, rollovers of the overpayments would remain valid, which is another important protection for participants.

Reduction in excise tax on certain accumulations in qualified retirement plans

The Bill would reduce the penalty for failure to take required minimum distributions from 50 to 25%. If a failure to take a required minimum distribution from an IRA is corrected in a timely manner (as defined under the Bill), the excise tax on the failure is further reduced from 25% to 10%.

Performance benchmarks for asset allocation funds

The Labor Department's participant disclosure regulation requires that each designated investment alternative's historical performance be compared to an appropriate broad-based securities market index. Thus, for example, if the plan offers an equity fund on its menu, the plan will show participants the 1-, 5-, and 10-year returns of the equity fund and the returns of an appropriate index like the S&P 500®, because the S&P 500 represents an index of the same asset class. Unfortunately, the rule does not adequately address increasingly popular investments like target date funds that include a mix of asset classes. Under the Bill, DOL would be directed to modify its regulations so that an investment that uses a mix of asset classes can be benchmarked against a blend of broad-based securities market indices, provided

(A) the index blend reasonably matches the fund's assets allocation over time,
(B) the index blend is reset at least once a year, and
(C) the underlying indices are appropriate for the investment's component asset classes and otherwise meet the rule's conditions for index benchmarks.

This change in the disclosure rule would allow better comparisons and aid participant decision-making.

Review and report to the Congress relating to reporting and disclosure requirements

This Bill would direct Treasury, DOL and PBGC to review the current ERISA and Code reporting and disclosure requirements and make recommendations to Congress to consolidate, simplify, standardize and improve such requirements.

Eliminate unnecessary plan requirements related to unenrolled participants

Under current law, employees eligible to participate in a retirement plan are required to receive a broad array of notices that are intended to inform them of their various options and rights under the plan. In the case of eligible employees who have not elected to participate in the plan ("unenrolled participants"), these notices, such as notices regarding the different investment options available under the plan, are generally unnecessary, and can even have adverse effects on savings and coverage. Under the Bill, defined contribution plans would cease to be required to provide intermittent ERISA or Code notices to unenrolled participants. However, to further encourage participation of unenrolled participants, the plan would still be required to send

1. an annual reminder notice of the participant's eligibility to participate in the plan and any applicable election deadlines, and

2. any otherwise required document requested at any time by the participant.

This rule would only apply with respect to an unenrolled participant who received all required notices, including the summary plan description, in connection with initial eligibility under the plan.

Retirement savings lost and found

Every year, thousands of people approach retirement but are unable to find and receive the benefits that they earned often because the company they worked for moved, changed its name, or merged with a different company. Similarly, every year there are employers around the country ready to pay benefits to retirees but they are unable to find the retirees because the former employees changed their names or addresses. The Bill would use data that employers are already required to report to the Treasury Department to create a national, online, lost and found for Americans' retirement accounts.

Exemption from required minimum distribution rules for individuals with certain account balances

Under current law, participants are generally required to begin taking distributions from their retirement plan at age 72. The policy behind this rule is to ensure that individuals use their retirement savings during their lifetime — and not use their retirement plans for estate planning purposes to transfer wealth to beneficiaries. However, most Americans unfortunately do not have large retirement account balances and will need their retirement savings during their lifetimes. The Bill would provide that participants are not required to comply with the lifetime RMD rules (other than with respect to defined benefit plans) if they have a balance in their retirement plans and IRAs (other than defined benefit plans) of not more than $100,000 (indexed) on December 31 of the year before they attain 75. Plans would be entitled to rely on certifications from participants regarding whether their other savings in IRAs or with other employers cause their total balance to exceed $100,000.

Expansion of Employee Plans Compliance Resolution System ("EPCRS")

Because of the ever-growing complexity of retirement plan administration, the Bill would expand the EPCRS to

1. allow more types of errors to be corrected internally through self-correction,
2. apply to inadvertent IRA errors, and
3. exempt certain failures to make required minimum distributions from the otherwise applicable excise tax.

For example, the Bill would allow for correction of many plan loan errors through self-correction. These are a frequent area of error and it can be burdensome to go to the IRS to correct a single loan error.

Eliminate the "first day of the month" requirement for governmental section 457(b) plans

Participants in a governmental 457(b) plan must request changes in their deferral rate prior to the beginning of the month in which the deferral will be made. This role does not exist for other defined contribution plans. The Bill would allow such elections to be made at any time prior to the date that the compensation being deferred is available.

One-time election for qualified charitable distribution to split-interest entity

The Bill expands the IRA charitable distribution provision to allow for one-time distributions to charities through charitable gift annuities, charitable remainder unitrusts, and charitable remainder annuity trusts. The Bill also increases the annual IRA charitable distribution limit from $100,000 to $130,000.

Retirement plan distributions for charitable purposes

The Bill would expand the IRA charitable distribution provision, as modified above, to also include distributions from qualified plans.

Distribution to firefighters

Under current law, if an employee terminates employment after age 55 and takes a distribution from a retirement plan, the 10% early distribution tax does not apply. However, there is a special rule for "qualified public safety employees" in governmental plans, under which age 50 is substituted for age 55 for purposes of this exception from the 10% tax. This exemption applies to public sector firefighters, but not private sector firefighters. The Bill would extend the age 50 rule to private sector firefighters, who merit the same treatment.

Exclusion of certain disability-related first responder retirement payments

The Bill would allow first responders to exclude service-connected disability payments from gross income after reaching retirement age.

Individual retirement plan statute of limitations for excise tax on excess contributions, certain accumulations, and prohibited transactions

The statute of limitations for taxes for prohibited transactions, excess contributions, or required minimum distribution failures shall start as of the date that an income tax return is filed for the year the violation occurred (or the date that such return would have been due in the case of a person not required to file a return). The Bill addresses the current-law problem under which the statute of limitations could never start in the absence of the filing of a return regarding a violation that a taxpayer may not be aware of.

Requirement to provide paper statements in certain cases

The Bill amends ERISA to generally provide that with respect to defined contribution plans, unless a participant elects otherwise, the plan is required to provide a paper benefit statement at least once annually. The other three quarterly statements required under ERISA are not subject to this rule (i.e., they can be provided electronically). For defined contribution plans, unless a participant elects otherwise, the statement that must be provided once every three years under ERISA must be a paper statement.

Technical amendments and administrative provisions

Certain technical amendments of the SECURE Act are included in the Bill, along with administrative provisions relating to plan amendments to incorporate the changes wrought by the Bill.

Conclusion

We will monitor the status of this piece of legislation and follow up with a modification of this paper once it has been signed into law.

[1] American Council of Life Insurance (Oct. 27, 2020).

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