# RETIREMENT SECURITY & SAVINGS ACT OF 2018

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## *Expanding Coverage and Increasing Retirement Savings*

**Establish a new automatic enrollment safe harbor –** Under the current law automatic enrollment safe harbor, the automatic deferral must be at least three percent of salary during the first year. Some have been concerned that this provision has resulted in employers setting the deferral amount at three percent in the first year (even though they could set it higher), when most Americans should be saving more to ensure a financially secure retirement. Therefore, the legislation would establish a new automatic enrollment safe harbor -- in addition to the existing the existing automatic enrollment safe harbor. The features of the new safe harbor are:

- **Minimum levels of default contributions.** The minimum default level of contributions would be 6% in the first year, 7% in the second year, then 8% in the next year, 9% the following year, and 10% in all subsequent years. There would be a 10% cap on the default level of contributions in the first year but no cap would apply thereafter.
- **Matching contributions.** The employer would be required to make matching contributions on behalf of all eligible nonhighly compensated employees ("NHCEs") equal to (a) 100¢ on the dollar on employee or elective contributions up to 2% of pay, (b) 50¢ on the dollar on the next 4% of pay; and (c) 20¢ on the next 4% of pay, so that some level of matching contributions must be provided on employee or elective contributions up to 10% of pay. This structure ensures that the required matching contribution for all NHCEs under the new safe harbor will be at least equal to the required matching contribution for NHCEs under the existing safe harbor. Matching contributions with respect to employee or elective contributions above 10% of pay would not be permitted. For this new safe harbor, the nonelective contribution option available with respect to the existing automatic contribution safe harbor would not apply. The rationale is that employees should have an incentive to contribute up to 10%; if the employer could use the nonelective contribution option, that incentive would not exist.
- **Special tax credit.** A special tax credit would apply to small employers (i.e., employers with 100 or fewer employees) that adopt the new safe harbor. The purpose of the credit is that compared to the existing safe harbor, the new safe harbor will be more expensive. To address these additional costs, the tax credit would equal the matching contributions made on behalf of NHCEs, subject to two limits: (a) the credit with respect to any NHCE

would be limited to 2% of pay, and (b) the credit with respect to any NHCE would only apply for the NHCE's first five years of participation in the plan.
- Similar to the existing safe harbors, this new safe harbor arrangement would be exempt from nondiscrimination and top-heavy testing.

**Saver's Credit --** The bill would make the Saver's Credit refundable and would require that the credit be contributed directly to a retirement plan or Roth IRA. The individual would designate the plan or IRA to receive such contributions, except that no plan or Roth IRA would be required to accept the contributions. If the individual does not designate a plan or Roth IRA that accepts such contributions, the tax credit would be paid or credited under regulations prescribed by Treasury.

Such contributions would be treated as Roth contributions for purposes of the tax treatment of distributions of such amounts and earning thereon, but would not be taken into account in applying any applicable limitation or testing requirement.

The bill would also (1) expand the group eligible for a 20% credit (instead of a 10% credit), and (2) simplify the lookback period regarding distributions that offset contributions eligible for the credit.

**Amend DC elective deferral coverage rules for long-term part-time workers -** Under current law, employers generally may exclude part-time employees (employees who work less than 1,000 hours per year) when providing a defined contribution plan to their employees. As women are more likely than men to work part-time, these rules can be quite harmful for women in preparing for retirement. Except in the case of collectively bargained plans, the bill would require employers maintaining a 401(k) plan to 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 two consecutive years of service where the employee completes at least 500 hours of service. In the case of employees who are eligible solely by reason of the latter new rule, the employer may elect to exclude such employees from testing under the nondiscrimination and coverage rules, and from the application of the top-heavy rules.

**Amendment to top heavy rules to expand coverage -** In a top heavy plan, any participant who has completed an hour of service must receive a top heavy contribution – even if the employer allows employees to enter the plan before the law would require they be eligible to participate. As a result, small employers are discouraged from allowing early entry into 401(k) plans. The bill would allow employers to test participants who have not met the minimum statutory age and service requirements separately for determining required top heavy contribution requirements.

**Saver's Credit/1040-EZ –** The Saver's Credit provides millions of low and middle-income individuals with an incentive to save for retirement each year. Unfortunately, usage of the Saver's Credit is not nearly as high as it should be. One source of the problem is the fact that the Form 1040-EZ, the simplest tax return form and the one used by many intended users of the Saver's Credit, does not permit the Saver's Credit to be claimed. Under the bill, the Secretary would be directed to make the Saver's Credit available on the Form 1040-EZ.

**60-day rollover to inherited IRA of nonspouse beneficiary –** To eliminate a trap for the unwary and create parity between rollover methods available to spouse and non-spouse beneficiaries, the bill would expand the rollover options that are available to non-spouse beneficiaries to allow such beneficiaries to move assets via a 60-day rollover.

**Increase in age for required beginning date –** Under current law, under the required minimum distribution ("RMD") rules, participants are generally required to begin taking distributions from their retirement plan at age 70 ½. The policy behind this rule is to ensure that individuals spend their retirement savings during their lifetime and not use their retirement plans for estate planning purposes to transfer wealth to beneficiaries. However, the age 70 ½ was first applied in the retirement plan context in the early 1960s and has never been adjusted to take into account increases in life expectancy. Therefore, the bill would increase the RMD age from 70 ½ to 72 in 2023 and then to 75 in 2030. A transition rule would address the situation where an employee attains the RMD age and begins required distributions, and then the RMD age is increased and the employee has not attained the increased RMD age. Under the transition rule, the employee is no longer required to take minimum distributions until he or she attains the increased RMD age.

**Update the mortality rules underlying the RMD rules --** Under the bill, Treasury would be directed to update the mortality tables underlying the RMD regulations by the end of 2019 and every 10 years thereafter. By not updating them, Treasury is forcing individuals to withdraw their assets too quickly.

**Enhancement of the Start-Up Credit** – Current law offers a small business that adopts a new qualified plan a tax credit, which can apply for up to three years, equal to the lesser of (1) 50 percent of the employer's start-up costs, or (2) $500. Like the Retirement Enhancement and Savings Act of 2018 ("RESA"), the bill would modify the cap to be equal to the greater of (1) $500, or (2) the lesser of (a) $250 for each nonhighly compensated employee eligible to participate in the plan, or (b) $5,000. In addition to RESA, 50 percent would be increased to 75 percent in the case of employers with 25 or fewer employees.

**Encourage small businesses to adopt auto-re-enrollment --** Automatic enrollment has been a great success. One new feature that plans and policymakers are exploring is automatic re-enrollment. For example, assume that a plan has automatic enrollment at 6% and assume that new employee A opts out or elects to contribute less than 6%. Under automatic re-enrollment, employee A would again be automatically enrolled at 6%, subject to opting out, after one year, or two years, or three years, or more years, depending on the plan terms.

Under the bill, automatic re-enrollment at least every three years would be encouraged by the provision of an additional three-year $500 per year tax credit for small 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 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. The idea is that employees who are overwhelmed with student debt cannot realistically save for retirement, and

thus are missing out on available matching contributions. This proposal would allow them to receive those matches by reason of repaying their loan.

For almost all purposes, the student loan repayment would ***not*** be treated as an elective contribution to the plan, but any matching contribution made with respect to such repayment would be treated as a matching contribution for all purposes. The following rules would apply:

- The amount of student loan repayments taken into account for this purpose cannot exceed the applicable current law limit on the employee's elective contributions to the plan, reduced by the employee's actual elective contributions.
- The employee must provide evidence to the employer that he or she has a qualifying student loan and the amount of any repayment for which a matching contribution is sought.
- Matching contributions on student loan repayments can only be made:
    - On behalf of employees eligible to make elective contributions,
    - At the same rate as matching contributions on elective contributions, and
    - If all employees eligible for matches on elective contributions are also eligible for matches on student loan repayments.

Treasury is directed to prescribe regulations that:

- Set forth the conditions under which a plan administrator may rely on evidence submitted by an employee of qualified student loan payments, and
- Permit a plan to make matching contributions for qualified student loan repayments at a different frequency than matching contributions are otherwise made under the plan, provided that the frequency is not less than annually.

**Qualified retirement planning services** -- Under current law, retirement planning advice provided by a plan sponsor on a nondiscriminatory basis is excludable from income. Under the bill, an employee would not be taxed on the value of such advice even if he or she elected to receive the advice in lieu of an equivalent amount of his or her cash salary. For an employer not willing to pay to provide such advice to employees, such as advice regarding IRA investments or regarding nonqualified retirement savings, this would enable the employer to allow employees to pay for the advice with pre-tax dollars.

**Additional nonelective contributions permitted to SIMPLE plans** -- Under current law, an employer sponsoring a SIMPLE plan can make matching contributions up to 3% of pay or nonelective contributions of 2% of pay, but no other employer contributions are permitted. Under the bill, an employer would be permitted to make up to a 10% nonelective contribution on behalf of all eligible employees. There is no policy reason to preclude such contributions.

In light of this change, the bill applies an overall limit on the amount of contributions that are permitted to be made on behalf of an employee for a year. In order to maintain the incentive for a small employer to adopt a qualified plan, that limit is set at 50% of the limit applicable to defined contribution plans, i.e., $28,000 for 2019 (half of $56,000), subject to the increase for employees who have attained age 50 and are thus eligible for a catch-up contribution.

**Reform of minimum participation rule** -- Under the current law minimum participation rule, a defined benefit plan must cover the lesser of 50 employees or 40% of the employer's workforce. The 40% part of the rule applies to the entire controlled group, so that for example, the parent companies and all subsidiaries are aggregated in determining the number of employees to whom the 40% figure is applied. Under this proposal, Treasury is directed to issue regulations under which the minimum participation rule may be applied separately to "bona fide separate subsidiaries or divisions." For example, assume that a parent company with 1,000 employees has 10 subsidiaries with 30 employees each for a total employee population of 1,300. If one of those subsidiaries would like to establish and maintain a defined benefit plan, it could not do so because the plan would only cover 30 employees, which is less than the lesser of 50 employees or 40% of 1,300 (i.e., 520), which is 50. Under the bill, the subsidiary could maintain the plan because the plan would cover 100% of the subsidiary's employees.

**Correction of inadvertent plan violations** -- Under the bill, except as otherwise provided in regulations, all inadvertent plan violations may be self-corrected under the IRS' Employee Plans Compliance Resolution System ("EPCRS") (or any successor guidance) without a submission to the IRS, provided that this rule does not apply if the IRS discovers the violation on audit and the employer has not at that point taken actions that demonstrate a commitment to correct the violation. The IRS' authority to prohibit self-correction of inadvertent violations through regulations is intended to be narrowly interpreted to be limited to unusual circumstances where self-correction is clearly inappropriate; such authority is not intended to be used in a manner inconsistent with the purpose of the bill to allow all or substantially all inadvertent failures to be self-corrected.

For purposes of this rule, EPCRS is deemed amended to conform to this rule, so that, for example, the "correction period" under EPCRS section 9.02(1) and (2) (or any successor provision) for an inadvertent failure shall be indefinite, allowing self-correction without a time limit (other than the exception in the preceding paragraph for violations discovered by the IRS on audit).

Except as provided below, for purposes of this rule, a violation is only considered inadvertent if it occurs despite the existence of practices and procedures that (1) satisfy the standards set forth in EPCRS section 4.04 (or any successor provision), or (2) satisfy similar standards in the case of an individual retirement plan.

In the case of an inadvertent violation relating to a loan to a participant from a plan, such violation may, pursuant to the bill, be self-corrected by applying the provisions of EPCRS section 6.07 (or any successor provision), including the provisions related to whether a deemed distribution must be reported on Form 1099-R.

Employers may still make submissions to the IRS, which may occur if an employer wants comfort that its proposed correction is correct.

In addition, the bill would include:

- A direction to the IRS to publish additional safe harbor means of correcting an inadvertent violation, including how to determine lost earnings.
- Any plan loan violation that is corrected through the use of an IRS safe harbor method shall be treated as meeting the requirements of DOL's Voluntary Fiduciary Correction Program.
- Application of EPCRS to inadvertent IRA errors.
- Exemption of inadvertent failures to take required minimum distributions from the otherwise applicable excise tax if the failure is corrected within 180 days. Notwithstanding the definition above of an inadvertent failure, in the case of a correction by an IRA owner, a violation is considered inadvertent if it is due to reasonable cause.

**Allow 403(b) plans to invest in collective investment trusts** -- 403(b) plan investments are generally limited to annuity contracts and mutual funds, which appears to be an historical anomaly. This limitation cuts off 403(b) plan participants – generally employees of charities and educational organizations – from access to collective investment trusts, which are often used due to their lower fees.

Under the bill, 403(b) plans would be permitted to invest in collective investment trusts. In addition, the securities laws would be amended to treat 403(b) plans like 401(a) plans with respect to their ability to invest in such products, provided that (1) the plan sponsor accepts fiduciary responsibility for selecting the investments under the plan, or (2) the plan has a separate exemption from the securities rules, such as in the case of a governmental plan.

**457 eligibility** -- There is a rule permitting de minimis distributions from 457 plans. The bill provides that a participant who took such a distribution under the pre-1996 Act rules is not precluded from participating in the plan.

**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, employers should be able to offer small immediate incentives, like $25 gift cards. Under current law, 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 section 401(k)(4)(A) and from the corresponding rule under section 403(b). The bill also includes a conforming modification to the prohibited transaction rules.

**Indexing IRA catch-up contribution 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 in the same manner as the regular IRA limit, starting in 2020.

**Higher catch-up contribution for individuals who have attained 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 2018 is $6,000, 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, 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.

## ***Preservation of Income***

**Qualifying longevity annuity contract reforms --** In 2014, the Treasury Department and IRS published final regulations on 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 a very inexpensive way for retirees to hedge the risk of outliving their savings in defined contribution (DC) plans and IRAs.

The minimum distribution rules were an impediment to the growth of QLACs in DC plans and IRAs because those rules generally require payments to commence at age 70 ½, before QLACs begin payments. The 2014 regulations generally exempted QLACs from the minimum distribution rules until payments commence. However, due to a lack of statutory authority to provide a full exemption, the regulations imposed certain limits on the exemption that have prevented QLACs from achieving their intended purpose in providing longevity protection.

The QLAC regulations limit the premiums an individual can pay for a QLAC to the lesser of (1) $130,000 and (2) 25% of the individual's account balance under the plan or IRA. The $130,000 limit applies across all types of arrangements, whereas the 25% limit applies separately to each DC plan and collectively to all IRAs that an individual owns. For purposes of the 25% limit, the account balance of an IRA is determined as of December 31st of the previous calendar year. According to the regulatory preamble, the 25% limit was included because Treasury lacked the authority to exempt more than 25% of any account.

It is rare for a DC plan to offer a QLAC option directly. As a result, generally the only way for a DC plan participant to obtain a QLAC is by rolling money out of the plan to an IRA. QLACs are readily available in the IRA market.

Here is the problem: Assume that an individual has a $250,000 account balance in her former employer's DC plan. She wants to use 20% of that balance, or $50,000, to purchase a QLAC, but her plan does not offer one. She decides to roll the money from the plan to an IRA to purchase a QLAC. However, because the 25% limit on QLAC premiums applies based on her IRA account balance (which is zero), she will need to roll *$200,000* from her plan just to facilitate the $50,000 QLAC purchase. Moreover, because the regulations measure her IRA account balance as of the prior year-end (which, again, was zero), she will need to roll the $200,000 from the plan to an IRA, wait until the next year, then transfer $50,000 from the IRA to a QLAC that qualifies as an IRA annuity. After the transaction, the individual would own a QLAC that clearly complies with the intent of the premium limits, but would have unnecessarily moved $150,000 from her plan to an IRA.

- **Proposal to repeal the 25% limit.** In practice, this cumbersome process is severely slowing the growth of QLACs, and for no policy reason. The only reason for the 25% limit was Treasury's lack of statutory authority. Moreover, the adverse effects of the 25% limit are limited to low and middle-income individuals because for higher income

individuals with bigger accounts, the applicable limit is the $130,000 limit, not the 25% limit. Because there is no policy rationale for the 25% limit, and because it is having a very adverse effect on the growth of this helpful hedge against longevity, this bill would provide that the 25% limit is void and would direct Treasury to amend its regulations accordingly.

Deleting the 25% test would solve the current problems blocking the use of QLACs, For instance, in the above example, the individual would able to roll over $50,000 (not $200,000) and immediately purchase the QLAC (rather than wait a year). In other words, what the bill would do is effectively enable individuals to do is make QLAC purchases under the dollar limit without the need to roll over excess amounts or artificially wait a year to make a purchase that they are ready to make. In practice, this small change could make a very large difference in facilitating the purchase of QLACs that protect participants against the risk of outliving their retirement savings.

- **Proposal to raise the $130,000 limit to $200,000**. At age 65, $125,000 (the original limit before it was indexed to $130,000) would purchase a QLAC (with a 2% COLA and a return of premium death benefit) paying approximately $18,049 annually starting at age 80. This is not sufficient to protect a middle-income individual from the longevity risk. Under the bill, the limit would be increased to $200,000, which would increase the annual payment to $29,047. As under the current QLAC regulations, the $200,000 limit would be indexed.

- **Proposal to facilitate the sales of QLACs with spousal survivor rights.** The QLAC regulations prescribe very different rules depending upon whether the owner's beneficiary is his or her spouse, with much more restrictive rules on death benefits if the beneficiary is not the spouse.

  The regulations do not address how the QLAC death benefit rules apply if the beneficiary is the owner's spouse on the date the contract is issued but because of a subsequent divorce is no longer the owner's spouse when the annuity payments commence or when the owner dies. If a beneficiary's status as a spouse or non-spouse is determined after a QLAC is issued, *e.g.*, on the date annuity payments commence, a contract that was issued with permissible benefits might be viewed as providing impermissible benefits merely because of the divorce.

  To avoid this issue, some insurers have decided to just offer single life QLACs, which deprives spouses of important benefits.

  The bill's solution to this problem is to clarify that a divorce occurring after a QLAC is purchased but before payments commence will not affect the permissibility of the joint and survivor benefits previously purchased under the contract if a qualified domestic relations order ("QDRO") (in the case of a retirement plan) or a divorce or separation instrument (in the case of an IRA) either (1) provides that the former spouse is entitled to the promised spousal benefits under the QLAC, (2) does not modify the treatment of the former spouse as the beneficiary under the QLAC, or (3) does not modify the treatment

of the former spouse as the measuring life for the survivor benefits under the QLAC. This is consistent with the minimum distribution and QDRO rules, but the lack of clarity is adversely affecting the QLAC market.

- **Free-look period**. Generally, QLACs are prohibited from having any cash surrender value or similar right. There has been uncertainty about whether this rule would preclude the provision of free-look periods under which a purchaser may rescind a purchase within a short period after the purchase. The bill clarifies that such free-look periods are permitted, up to 90 days.

- **Proposal to facilitate indexed and variable contracts with guaranteed benefits.** The QLAC regulations do not permit a variable annuity, indexed annuity, or similar contract to be used as a QLAC, unless the IRS publishes guidance to the contrary. The preamble to the regulations explains this prohibition as primarily intending to ensure that a QLAC will provide a predictable stream of annuity payments. However, the prohibition also exposes individuals to inflation risk, which could significantly erode the purchasing power of their QLAC benefits – especially for QLACs purchased many years before retirement. The bill would direct Treasury to allow variable and indexed annuities to be used as QLACs, provided that the contract guarantees a minimum level of annuity payments irrespective of market or index performance. This will continue to ensure that QLACs provide a predictable stream of annuity payments while also facilitating the type of inflation protection that variable and indexed annuities can provide.

**Remove required minimum distribution ("RMD") 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. For example, guaranteed annual increases of only 1 or 2%, return of premium death benefits, and period certain guarantees for participating annuities are commonly prohibited by this test. Without these types of guarantees, many individuals are unwilling to elect a life annuity under a DC plan or IRA.

The bill would eliminate these barriers to annuity forms of payout by amending section 401(a)(9) of the Code to provide that certain types of annuity benefits that do not implicate concerns over excessive tax deferral are always permitted. This will exempt those types of benefits from the actuarial test in the regulations. The exempted benefits are (1) annuity payments that increase by less than 5% per year, (2) commutations or accelerations of future annuity payments determined in an actuarially reasonable manner, (3) participating annuities that provide dividends or similar payments determined in an actuarially reasonable manner, and (4) lump sum return of premium death benefits.

The bill also directs the Treasury Department to make three important changes to the regulations under Code section 401(a)(9). First, Treasury would be directed to conform the regulations to

the foregoing statutory amendments and thereby exempt the listed annuity benefits from the actuarial test in the regulations. Second, Treasury would be directed to amend the regulations to provide that any commercial annuity under which the initial payment is at least equal to the initial payment that would be required from an individual account will be deemed to satisfy the actuarial test in the regulations. Third, Treasury would be directed to amend the actuarial test in the regulations to provide that the calculations under the test are to be made using the reasonable tables or other actuarial assumptions that the issuing life insurance company actually uses in pricing the premiums and benefits under the contract, rather than the test being applied based on life expectancy tables in the regulations.

**Eliminating incentive not to partially annuitize --**The individual account rules under the RMD regulations do not account for the fact that in the vast majority of cases, annuity payments are in excess of the amounts that would have been required under the individual account rules. Hence, if an individual takes a portion of the interest in his or her retirement plan in the form of an annuity, the RMD for a year with respect to the remaining account balance is not reduced by the excess annuity payments for the year. As a result, the individual is required under the RMD regulations to distribute more than if he or she had not partially annuitized. This is an inappropriate result which can penalize individuals who partially annuitize their interests in retirement plans, materially discourage individuals from partially annuitizing their interests in plans, and take away significant financial flexibility.

Under the bill, the annuity rules in the RMD regulations would continue to apply to an interest in a retirement plan that is distributed in the form of an annuity. However, where a portion of an interest in a retirement plan is distributed in the form of annuity payments, and the annuity payments exceed the amount that would be required to be distributed under the individual account rules based on the value of the annuity, the excess annuity payment amount for a year could be applied towards the RMD for the year with respect to any remaining interest in the same retirement plan.

**Facilitate low-cost ETF investments within variable annuities –**

*The reason for change.* Exchange-traded funds (ETFs) are pooled investment vehicles that can provide instant access to a well-diversified portfolio. They are similar to mutual funds, except the shares can be traded throughout the day on the stock market, rather than having to be held until after the market closes. In addition, expense ratios for ETFs are generally very low. As a result, ETFs can provide a low-cost, high-value investment opportunity for individuals saving for retirement. 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.

Individual variable annuities help people achieve a more secure retirement by allowing them to invest in the market on a tax-deferred basis and to later use those savings to produce a lifetime income stream. During the savings phase, the owner chooses from a menu of investment options that the insurance company selects and makes available through a separate account. The goal of the proposal is to make ETFs available among those investment options and provide investors a desirable, low-cost investment vehicle for retirement savings.

*The concern.* Variable annuity investment options must satisfy the asset diversification requirements in Code section 817(h). In most cases, each investment option corresponds to a pooled investment vehicle, such as a mutual fund, that is "insurance dedicated." As long as the fund is insurance dedicated, a "look through" rule applies and the diversification test is based on the fund's assets rather than treating the fund as a single investment. "Insurance dedicated" means shares of the fund may be held only by insurance companies and certain other limited classes of institutional investors, i.e., the fund cannot be not "publicly available." The regulations pre-date ETFs, and there is a technical gap that precludes this look-through rule from applying to them.

Specifically, because of the way ETFs are structured, there are certain institutional investors that must be involved in creating the ETF shares and facilitating their availability on the stock exchange. These institutional investors are not listed in the diversification regulations as being allowed to invest in an otherwise "insurance-dedicated" fund. As a result, these institutional investors in an ETF preclude it from being "insurance dedicated," which means the ETF cannot satisfy the diversification test even though it may hold a highly diversified portfolio.

*Proposal.* The proposal would solve 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 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. The proposal 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 rules or related IRS rulings involving "investor control." This latter clarification is needed because there are likely to be similarities between existing ETFs and any new insurance-dedicated ETFs that are created.

## ***Simplification and Clarification of Qualified Retirement Plan Rules***

**Review by Treasury and Labor of reporting and disclosure requirements** - The 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.

**Consolidation of employee notices –** Over the years, Congress has created a number of notices that must be provided to participants in 401(k) and similar defined contribution plans. These notices must be provided upon enrollment and annually thereafter, with the precise timing requirements varying slightly in the implementing regulations. These notices include:

- Qualified default investment alternative notice. *(ERISA §§ 404(c)(5)(B), 514(e)(3))*: Explains how a participant's account will be invested in the absence of an affirmative election.
- Safe harbor notice. *(Code § 401(k)(12)(D))*: Informs participants that the employer will make matching or nonelective contributions to satisfy the Code's nondiscrimination testing safe harbor.

- Auto enrollment safe harbor notice. *(Code § 401(k)(13)(E))*: Informs participants that the employer will utilize auto enrollment, auto escalation and matching or nonelective contributions to satisfy the nondiscrimination testing safe harbor and about the employer contributions and the auto enrollment features.
- Permissive withdrawal notice. *(Code § 414(w)(4))*: Informs participants in auto enrollment plans about their right to stop automatic contributions and withdraw them within 90 days.

The bill would:

- Direct the Secretaries of Labor and the Treasury to adopt final regulations within 18 months of enactment providing that a plan may, but is not required to, consolidate two or more of the notices required under ERISA §§ 404(c)(5)(B) and 514(e)(3), and Internal Revenue Code §§ 401(k)(12)(D), 401(k)(13)(E), and 414(w)(4), into a single notice and/or consolidate such notices with the summary plan description or summary of material modifications described in ERISA § 104(b), so long as the combined notice, SPD, or SMM includes the required content, clearly identifies the issues addressed therein, is provided within the time required by law, and is presented in a manner that is understandable and does not obscure or fail to highlight important points for participants and beneficiaries.

**Making target date disclosure more effective –** The Department of Labor'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.

Target date funds offer a long-term investment strategy based on holding a mix of stocks, bonds and other investments that automatically changes over time. Comparing a target date fund to an index consisting solely of equities or bonds is inherently misleading because neither of these accurately reflects the risk/return profile of a target date fund. Further, the rule as written would allow a comparison solely against an index like a bond index that will make the target date fund appear to significantly beat its benchmark over time. DOL's benchmarking rule is based on a longstanding similar requirement under the securities laws for mutual fund prospectuses, which generally works well—but not in this circumstance.

In the preamble to the final regulation and a related Field Assistance Bulletin, DOL has indicated that a plan could provide the required benchmark and *additional* benchmarks in the disclosure, but this simply serves to further confuse participants and unnecessarily lengthen the disclosure.

Under the bill, DOL is 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 asset allocation over time, (b) the

index blend is reset at least once a year, (c) the underlying indices are appropriate for the investment's component asset classes and otherwise meet the rule's conditions for index benchmarks, and (d) the blend is presented in a manner that is reasonably designed to be understandable and helpful to participants and beneficiaries. (These conditions are important to prevent the blended benchmark from being manipulated and to ensure that it is helpful.) This change in the disclosure rule will allow better comparisons and aid participant decision-making. This change, including the conditions, would also apply to balanced funds and other asset allocation investments.

The bill also requires the Secretary of Labor to deliver a study to Congress by December 31, 2019 regarding the effectiveness of the regulatory benchmarking requirements.

**Permit non-spousal beneficiaries to roll assets to 457, 401(k) and 403(b) plans –** The Pension Protection Act of 2006 ("PPA) permitted non-spousal beneficiaries to roll assets they obtain as a beneficiary to an IRA but not to their 457(b), 401(k) or 403(b) accounts. EGTRRA acknowledged that the consolidation of retirement assets is valuable to those with multiple retirement savings accounts. The bill would permit non-spousal beneficiaries to consolidate their beneficiary assets in their 457(b), 401(k) or 403(b) accounts rather than forcing them to open an IRA and maintain multiple retirement savings accounts.

**Eliminate the "first day of the month" requirement --** Participants in a 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 rule does not exist for other defined contribution plans. This rule has a negative impact on participants and is no longer necessary to carry out the purposes of a 457(b) plan. The bill allows such elections to be made at any time prior to the date that the compensation being deferred is currently available, thus conforming the 457(b) rule to the 401(k) and 403(b) rule.

**Make 402(f) notices on rollover options more understandable to retirement savers –**There is widespread concern that the current model 402(f) notices, which provide information on rollover options and applicable tax consequences, are too long and confusing. As with any participant notice, if participants cannot readily understand a notice, they will disregard it. Under the bill, by December 31, 2019, Treasury, in consultation with DOL and PBGC, is directed to simplify the model 402(f) notices so that participants can better understand each of their distribution options and tax consequences. The notice must explain clearly the effect of different elections on spousal rights.

**Provide guidelines that address overpayment recoupment issues –** The Treasury Department and IRS should be commended for releasing guidance that clarifies proper recoupment procedures of overpayments of benefits to retirees by sponsors of retirement plans. However, additional guidance is needed. We have heard of situations where retirees found their retirement income zeroed-out because their employers reduced their benefits to zero to compensate for past overpayments. Ultimately, these retirees were placed in a precarious financial situation by no fault of their own but instead because of clerical errors by their employers.

Under the bill, by December 31, 2019, the Secretary would be directed to amend its correction programs to cease requiring employers to demand repayments from participants, thus permitting employers to elect to simply make the payment itself to make the plan whole (to the extent that any payment is required). In addition, the bill would:

- Direct the DOL to issue rules under which an employer that makes a make-whole contribution (or is not otherwise required to do so) and does not seek recoupment from an employee does not have any fiduciary liability for failing to seek recoupment.
- Where PBGC has made an overpayment, prohibit PBGC from reducing any future payment to an individual by more than 10%.
- Direct the Secretary of Treasury to amend EPCRS (the IRS' plan correction program referenced above) to provide that, except as provided by the Secretary, if the employer makes a "make-whole contribution" with respect to an inadvertent overpayment, and the employee had rolled over the excess to an IRA or plan, the IRS will not:
    - Treat the excess rollover as an excess contribution to an IRA subject to the 6% per year excise tax under §4973;
    - Treat the excess rollover to a plan as an impermissible contribution to the plan; or
    - Treat the excess rollover as taxable to the individual until distributed from the IRA or plan.

**Treatment of custodial accounts on termination of 403(b) plans –** Unlike most qualified defined contribution plans, under which assets are held in a trust, assets associated with section 403(b)(7) plans consist of mutual funds held in a custodial account in the participant's name. In many cases, this prevents an employer from distributing these assets in order to effectuate a plan termination. The bill provides a mechanism under which the plan termination may proceed without forcing assets out of the custodial account.

Under the provision, not later than six months after the date of enactment, Treasury shall issue guidance under which if an employer terminates a 403(b) custodial account, the distribution needed to effectuate the plan termination may be the distribution of an individual custodial account in kind to a participant or beneficiary. The individual custodial account shall be maintained on a tax-deferred basis as a 403(b) custodial account until paid out, subject to the 403(b) rules in effect at the time that the individual custodial account is distributed. The Treasury guidance shall be retroactively effective for taxable years beginning after December 31, 2008.

The bill also provides that distributions upon termination of a 403(b) plan are permissible, provided that the employer does not establish or maintain a successor 403(b) plan.

**Permitting plans to use base pay or rate of pay** –By the end of 2019, Treasury would be directed to facilitate the use of the 401(k) safe harbors by plans that base contributions on base pay or rate of pay (without, for example, overtime or bonuses), instead of total pay. This facilitation would not, however, apply in situations where overtime is a major component of the pay of nonhighly compensated employees.

Today, use of base pay or rate of pay is problematic, because depending on the amount of overtime or bonuses paid during a year, the employer may find out after the end of the year that use of base pay disqualified the employer from using a 401(k) safe harbor.

**Allowing SIMPLE IRAs to be offered on a Roth basis** -- 401(k) plans, 403(b) plans, 457(b) plans, and IRAs can be offered on a Roth basis. But SIMPLE IRAs cannot. There is no apparent rationale for this. The bill would allow SIMPLE IRAs to be offered on a Roth basis.

**Reducing 50% penalty tax --** Failures by an individual to take minimum distributions are subject to a 50% excise tax. The bill reduces that tax to 25%.

**Uniform availability of catch-up contributions** -- Under current law, an age 50 catch-up contribution to an employer's plan is only permitted to the extent that all employees who have attained age 50 and are eligible to participate in any plan of the same employer are permitted to make the same catch-up contribution. The bill allows catch-up contributions even if an affiliated plan in a separate line of business does not permit catch-contributions.

**SEPP exception from 10% early distribution tax** – Under current law, taxable distributions from a qualified plan or IRA before age 59½ generally are subject to a 10% additional tax, with several exceptions. One exception is for a series of substantially equal periodic payments (SEPPs). The proposal would clarify two aspects of the SEPP exception. First, it would clarify that the exception is not necessarily violated by a tax-free rollover or transfer to another qualified plan or IRA, as long as the combined distributions from the plan(s) or IRA(s) continue to satisfy the exception. For information reporting purposes, all persons, such as plan administrators and IRA issuers, could reasonably rely on employee certifications that the SEPP requirements will continue to be met in such circumstances. Second, the proposal would clarify that annuity payments can be SEPPs and that such payments will be deemed to be SEPPs if they satisfy the minimum distribution requirements for qualified plans, which generally limit the extent to which annuity payments can increase. The proposal also would extend both of these clarifications to non-qualified annuity contracts, which are subject to similar SEPP rules under the Code.

Because current law is unclear regarding the issues addressed by these changes, the bill provides that no inference is intended with respect to the law in effect prior to these provisions taking effect.

**Lump sum clarification** --To get favorable tax treatment of distributions of company stock from a plan, the distribution has to be a lump sum distribution. This proposal clarifies that a distribution of an annuity contract can be part of a lump sum distribution.

**Post-termination plan contributions** -- Certain types of post-termination pay can be used by an employee to make 401(k), 403(b), and 457 contributions, such as accumulated sick leave or vacation pay. This provision would broaden this ability to include severance pay.

**Helping household employers provide SEP benefits** -- Under current law, there is a 10% excise tax on nondeductible contributions to a retirement plan. There is an exception to this tax for non-business contributions to a SIMPLE plan or a 401(k) plan. This helps, for example,

household employers set up plans for their employees. The bill would expand this exception be expanded to cover SEPs too.

**Allowing mergers of 401(a) plans and 403(b) plans** -- The bill would allow an employer to merge its 403(b) and 401(a) plan. The rules applicable to the merged plan would generally be the rules applicable to the plan into which the other plan was merged. However, all legal rights, such as the spousal consent rules and anti-cutback protection, from either plan would be preserved.

**Exception from RMD rules when retirement savings do not exceed $100,000 –** Under current law, participants are generally required to begin taking distributions from their retirement plan at age 70 ½, an age that was set in 1962. 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, for most Americans, unfortunately, they do not have large retirement account balances and will need their retirement savings during their lifetimes. Furthermore, the age 70 1/2 was never adjusted (prior to this bill) and so with Americans living longer, it does not seem to make good policy sense to require most people to begin spending down their retirement savings at age 70 1/2 when they could live another 20 years or more.

The bill would provide that participants are not required to comply with the RMD rules if they have a balance in their retirement plans and IRAs of not more than $100,000 (indexed and subject to a $10,000 phase-out range) on December 31 of the year before they attain 70 ½ (or such later age applicable for required minimum distribution purposes under the bill). For purposes of this provision, the following special rules apply:

- The provision would not apply to distributions from defined benefit plans, and the value of defined benefit plan benefits would be disregarded in determining whether an individual's balance exceeds $100,000.
- Plan providers would be permitted to rely on certifications from participants regarding whether their other savings cause their total balance to exceed $100,000. Any such certification applies (1) to all future years in the absence of a contrary certification from the participant, and (2) to the current year if made by March 15 of such year.
- Plan participants may rely on their most recent account statement for a year in determining their total balance, in order to avoid any new reporting obligations.
- As noted, the determination of whether a participant's total retirement savings exceed $100,000 is made as of December 31 of the year before the RMD age. In the absence of additional contributions, rollovers, or transfers to a plan or IRA, the initial determination continues to apply in all subsequent years, regardless of appreciation in the accounts. In the case of beneficiaries, this means that unless they add to their inherited accounts (which is certainly not common), they can continue to use the participant's exemption indefinitely.

**Conforming hardship distribution rules** -- Under 401(k) and 403(b) plans, hardship distributions are permitted if the distribution (1) is made on account of an immediate and heavy financial need, and (2) is necessary to satisfy the need. Prior to the Bipartisan Budget Act of

2018 ("BBA"), there was a safe harbor means of satisfying the second requirement. That safe harbor had three requirements:

- The employee has obtained all other currently available distributions under the plan and all other plans maintained by the employer.
- The employee has obtained all nontaxable loans under the plan and all other plans maintained by the employer.
- The employee must be prohibited from making contributions to any plan of the employer for six months.

The BBA directed Treasury to (1) delete the six-month prohibition and (2) make any other regulatory changes to the safe harbor as are necessary to carry out the purposes of the law. This change automatically applied to both 401(k) and 403(b) plans.

Prior to the BBA, under 401(k) and 403(b) plans, upon hardship, elective deferrals may be withdrawn, but the earnings attributable to such elective deferrals could not be withdrawn. In addition, matching or nonelective employer contributions that meet certain requirements are deemed to be "qualified matching contributions" ("QMACs") or "qualified nonelective contributions" ("QNECs") and can be used to help the plan meet certain nondiscrimination tests. QMACs and QNECs are subject to the withdrawal restrictions applicable to elective deferrals, but these amounts could not be withdrawn on account of hardship.

Under the BBA, under a 401(k) plan, earnings on elective deferrals, QMACs (and related earnings), and QNECs (and related earnings) may be withdrawn upon hardship. The BBA did not apply this change to 403(b) plans. This bill would conform the 403(b) rules to the 401(k) rules in this regard.

Also, under the BBA, a distribution shall not fail to be a hardship distribution solely because the employee does not take any available loan under the plan. This modifies the current-law safe harbor described above, as well as the non-safe harbor general rule regarding how to show a distribution is necessary to satisfy a specified need. The bill confirms that this change applies to 403(b) plans as well as 401(k) plans.

These provisions apply to plan years beginning after December 31, 2018.

**Updating IRA rules** – Under the proposal:

- Treasury would be directed to make available to the public an overview of the IRA rules, including examples of common errors and instructions on how to avoid such errors.
- If an excess contribution to an IRA or similar vehicle is corrected in a timely manner, the excise tax on the excess contribution is reduced from 6% to 3%.
- If a failure to take a required minimum distribution from an IRA is corrected in a timely manner, the excise tax on the failure is reduced from 25% to 10%.
- Under current law, if an IRA owner or his or her beneficiary engages in a prohibited transaction, (1) there is a prohibited transaction excise tax, (2) the IRA ceases to be qualified as an IRA, and (3) all of the IRA's assets are deemed to be distributed. This set

of rules, which also applies to vehicles similar to IRAs, is punitive in combination. The bill deletes the last two sanctions.

- 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 in 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). This bill addresses the current-law problem under which the statute of limitations could never start in the absent of the filing of a return regarding a violation that a taxpayer may not be aware of.

**No penalty tax on distributions of income on excess IRA contributions** – The 10% penalty tax would not apply to distributions of earnings on excess IRA contributions.

## ***Defined Benefit Plan Reforms***

**Cash balance clarification –** This provision clarifies the application of Code and ERISA rules, such as backloading and section 415 (in the case of the Code only), as they relate to hybrid plans that credit variable interest. Specifically, the provision would clarify that, for purposes of all of the applicable Code and ERISA rules, the interest crediting rate that is treated as in effect and as the projected interest crediting rate is a reasonable projection of such variable interest rate, subject to a maximum of 6 percent. This clarification will allow plan sponsors to provide larger pay credits for older longer service workers.

**Parity for employers that provide more generous lump sum benefits –** Code section 417(e) provides a ceiling on the interest rates that can be used to value distributions, such as lump sum distributions. The ceiling is generally based on the interest rates required for funding purposes. In determining these interest rates, employers are permitted to use a "lookback month" that is up to five months before the beginning of the year. So for 2019, the lookback month can be any month during the August to December of 2018 period. Generally, the anti-cutback rules prohibit changing the lookback month, but a special rule permits a change in the lookback month if for the next year the plan compares the new and old lookback month and uses the more generous interest rate.

Although section 417(e) provides a ceiling on interest rates, employers are permitted to establish lower interest rates by, for example, providing that distributions will be valued using the lesser of the "applicable interest rate" (as defined in Code section 417(e)(3)(C)) or a specified other rate. Some employers have used this ability to use a lower interest rate to, for example, grandfather benefits from changes in the applicable interest rate under Code section 417(e). For example, the Pension Protection Act of 2006 changed the section 417(e) rate from the 30-year Treasury rate to the first, second, and third segment rates. To avoid reducing benefits, some employers grandfathered existing benefits from this change. Other companies have simply picked a different set of assumptions and provide a value equal to the greater of the value using the plan's assumptions or the value under the assumptions under section 417(e)(3).

Employers in these situations may want to change the lookback month for determining their non-417(e)(3) interest rates, such as the 30-year Treasury rate to, for example, an earlier date so as to facilitate communications to participants well before the beginning of the plan year. Although

this is permitted for 417(e) interest rates, as discussed above, it is not permitted for the more generous non-417(e) interest rates, which does not make policy sense.

Under the bill, the option to change the lookback month would be permitted for not just the 417(e) rates, but also the 30-year Treasury rate, PBGC-based rates, or any other rates used by the plan, as long as the amendment has a delayed effective date of at least one year, so as to protect participants from sudden changes. After any such change in the lookback month, the lookback month may not be changed again for five years without IRS consent.

**Correcting errors in new mortality regulations** -- On October 3, 2017, the Treasury Department and the IRS finalized regulations to update the mortality tables for purposes of the pension rules, including funding obligations, benefit restrictions on future benefit payments and accruals for participants, and PBGC premiums. Treasury and the IRS have estimated that the 10-year cost to employers of their increased plan contributions attributable to the regulations will be over $36 billion.

The mortality tables clearly needed to be updated. But in the rush to get this done in 2017, the Treasury and IRS regulations unfortunately included significant errors that need to be corrected by legislation. The bill provision has two parts:

- Treasury and the IRS stated that, in drafting the regulations, they relied on mortality tables developed by the Society of Actuaries (the "SOA"). The SOA has now acknowledged that the tables relied on by Treasury and the IRS incorrectly overstate pension obligations. The bill would direct Treasury and the IRS to correct the tables accordingly.
- Treasury and the IRS use a higher rate of future mortality improvement than has been used by the Social Security Administration ("SSA") or any other administrative agency. The bill would direct Treasury not to use an assumed rate of mortality improvement that is higher than the weighted average used by the SSA (which is .78%).

To address the fact that some employers have already completed their valuations for 2018, and may not want to redo those valuations, the bill provides an option not to apply these changes for 2018.

**Cease indexing the variable rate PBGC premium --** PBGC's flat rate premium is indexed, which makes sense. PBGC's variable rate premium ("VRP") is also indexed, but that does not make sense. The VRP is calculated as a percentage of a plan's underfunding, so every year, without indexing, the VRP is automatically adjusted to take into account the size of the underfunding. By indexing the percentage, we will eventually get to the point, where companies owe 100% or 200% or 300% of their underfunding as a VRP. This does not make sense.

One possible analogy could be to homeowner's insurance. The cost of homeowner's insurance is based on a number of factors, including the value of the home. Assume, for example, that the cost is .1% of the value of the home. What sense would it make to index that .1%? Eventually, many years later, the premium would exceed the value of the home, which does not make sense.

The bill would freeze the VRP rate at the 2018 level.

## ***Reforming Plan Rules to Harmonize with IRA Rules.***

**RMD treatment of plan Roth amounts --** Roth IRAs are exempt from the pre-death required minimum distribution ("RMD") rules. Under the bill, the exemption would be extended to Roth amounts in plans.

**Allow plan participants to make charitable distributions** -- Certain IRA distributions to a charity can be excluded from income up to $100,000. In light of the increase in the standard deduction, this exclusion is far more valuable now than it was before. Under the bill, the same exclusion would apply to plans.

**Allow spousal beneficiaries to treat accounts as their own** -- Spousal beneficiaries may elect to treat a deceased IRA owner's IRA as their own for purposes of the RMD rules. Under the bill, this treatment would be extended to spousal beneficiaries in plans. Thus, if permitted by the plan, a spousal beneficiary under a qualified plan, 403(b) plan, or governmental 457(b) plan could elect to be treated like the employee for purposes of the RMD rules.

**Rolling Roth amounts to plans** -- Under the bill, Roth IRA amounts would be permitted to be rolled to plans, which is not permitted today.

## ***Plan Amendments***

The bill allows plan amendments made pursuant to this bill to be made by the end of 2021 (2023 in the case of governmental plans) as long as the plan operates in accordance with such amendments as of the effective date of a bill requirement or amendment.