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Spotlight on Senator Hatch's Retirement Reform Proposal

Congress returned from its election recess this Wednesday and will spend the next several weeks organizing itself for the next Congress — scheduled to begin in January 2015. This week we focus on a retirement reform proposal introduced by Senator Orrin Hatch (R-UT) last year — the SAFE Retirement Act. Senator Hatch is expected to be the next chairman of the Finance Committee — the tax-writing committee in the Senate. The bill contains a number of proposals and reforms applicable to governmental and private employers who sponsor retirement plans.

Background

Senator Hatch introduced the Secure Annuities for Employee (SAFE) Retirement Act in July 2013 — S. 1270. The bill's various proposals and reforms relate to the following five areas:

- Creation of a new type of pension plan for governmental employers
- Reforms intended to expand private sector retirement plan coverage
- Simplification of current retirement plan rules
- Reforms to enhance longevity protections
- Modifications to ERISA disclosure rules

The bill would also transfer authority for the prohibited transaction rules for IRAs back to the Department of Treasury, and would require joint Treasury and DOL prohibited transaction rule-making for employer sponsored plans. A plain English summary of the bill has been prepared by Senator Hatch's staff.

Annuities for Public Pension Plans

The bill would create a new type of pension plan — an "annuity accumulation retirement plan." Sponsorship of this new type of plan would be limited to state and local governments. Plan benefits and assets would consist solely of "qualified individual deferred fixed income annuity contracts." No other plan benefits or assets would be permitted.

Governmental employers, however, would be permitted to establish other, separate plans — such as defined contribution or traditional defined benefit pension plans, or welfare benefit plans.

An annuity accumulation plan generally would be treated as a defined benefit plan for tax code purposes, and the otherwise applicable tax qualification rules would generally not apply to such a plan.

A qualified individual deferred fixed income annuity contract would be defined as a contract that provides monthly annuity payments in equal installments, with the amount fixed at the time of purchase. Benefits must be paid in the form of a single life annuity, with benefit commencement generally at age 67 — reduced to 57 in the case of a public safety officer. An employee's rights to the contract would generally be nonforfeitable, and no loan would be permitted from the contract. However, a participant's interest in the contract could be offset for unpaid federal tax liabilities, certain federal criminal penalties or restitution orders, or as required under state criminal, tax, or domestic relations laws.

Why create a new type of retirement plan?

The summary of the bill explains that the new type of pension plan is designed to deliver lifetime, defined benefit retirement income for employees with stable, predictable costs for employers and taxpayers. Pension plan underfunding would not be possible with the new type of plan.

Elective salary deferral contributions would not be permitted to be made by participants to an annuity accumulation retirement plan. Employer contributions would be made by the governmental employer as a specified percentage of each participating employee's compensation — limited to 20% of compensation, and increased to 30% for public safety officers. Higher limits would apply for employees age 50 or older — 35% for public safety officers and 25% for others. The section 401(a)(17) compensation limit would apply when calculating contributions — currently the limit is $265,000 for 2015.

The bill also specifies procedures for purchasing annuity contracts. For example, competitive bids must be obtained under a state law procurement process that requires institutional pricing on a group contract basis from multiple annuity providers who are vetted by a state insurance regulator.

Coverage Reforms

For the most part, the SAFE Retirement Act would include a number of new and enhanced plan options aimed at increasing coverage for employees of small employers — such as the creation of a new safe-harbor "starter" 401(k) plan permitting only elective salary deferrals with much lower contributions limits — $8,000, as opposed to $18,000 for 2015 for 401(k) plans. The bill would encourage the formation of defined contribution multiple employer plans (MEPs). The bill would permit the creation of such plans by "designated plan providers" — even if there is no common interest among the sponsoring employers other than plan sponsorship. Plan sponsors would be responsible for selecting and monitoring the designated plan provider, and a MEP would not be permitted to impose unreasonable restrictions, fees, or penalties in the event that a sponsoring employer decides to leave a MEP. The bill would also provide that a plan qualification failure on the part of one sponsoring employer does not disqualify the entire MEP.

A designated plan provider would be defined as the person specified by the MEP as responsible for all plan administrative duties reasonably necessary to ensure compliance with the plan qualification requirements. Such a provider would be required to register with the Treasury secretary and consent to audits by the secretary to ensure that the provider's duties are being fulfilled.

Of interest to small and large employers alike, the bill would also remove the 10% cap on the 401(k) automatic enrollment safe harbor.

Simplification

The bill would make a number of simplifications and other reforms to the existing tax qualification rules for retirement plans, including:

- **Required plan amendments.** Plan amendments required because of statutory and regulatory changes generally would be permitted to be adopted at any time prior to the due date of a plan's cyclical determination letter application to the IRS — provided the plan is operated in accordance with the amendments. Anti-cutback relief would be provided. Discretionary amendments could be adopted up to the due date, with extensions, of the employer tax return for the year in which the plan year ends. No anti-cutback exception would be offered for discretionary amendments.
- **Top-heavy rules.** The top-heavy plan rules would be repealed. If a plan was top-heavy prior to repeal, then the top-heavy vesting rules would continue to apply to accruals earned while the plan was top-heavy.
- **Safe harbor 401(k) plans.** The bill would make a number of changes for safe harbor 401(k) plans. Amendments, other than amendments reducing an employer's matching contribution, would be permitted to be made to safe harbor 401(k) plans during a plan year. The bill would also allow forfeitures to be used to fund employer matching or nonelective contributions to safe harbor 401(k) plans. Additionally, a new automatic enrollment safe harbor would be created — with minimum employee deferrals of 6% in the first year, 8% in the second, and 10% in later years, and employer matching contributions of 50% on the first 2% deferred and 30% on the next 8% deferred.
- **QPSA notices.** QPSA notices could be provided to participants within a reasonable period after commencing plan participation. In addition, the notice could be provided in the SPD.
- **Minimum participation tests.** The bill would provide relief for closed defined benefit plans from the section 401(a)(26) minimum participation tests by allowing aggregation of NHCEs from other controlled group defined benefit and defined contribution plans that are tested together for nondiscrimination and coverage purposes. Relief would also be provided for non-closed plans — but would require a 7.5% of compensation contribution to a defined contribution plan.

The bill would also simplify the rules on hardship distributions, direct the DOL and IRS to consolidate participant directed investment and safe harbor 401(k) plan notices, instruct the DOL to revise the content of certain target date fund notices (relating to benchmarks), and direct the IRS to expand the EPCRS program (for example to include governmental 457(b) plans). The bill would provide that the discontinuation of an investment option under a defined contribution plan that provides lifetime income (such as an investment in an annuity contract) would be treated as a distributable event (so that participants would be able to preserve their guarantee by rolling over the contract to an IRA).

Longevity

The SAFE Retirement Act would make a number of changes to current law designed to encourage lifetime income and longevity protections in retirement plans, including:

- Giving additional statutory authority to recent IRS regulations on longevity annuities (see our July 10, 2014 *For Your Information*), the bill would permit a participant in a defined contribution plan to use up to 25% of his or her account balance to purchase one deferred joint and survivor annuity (commencing no later than age 85). The required minimum distribution rules would not apply to that annuity.
- The IRS would be required to update the mortality tables under the required minimum distribution regulations every five years. This would reduce the amount required to be distributed currently so that available funds are distributed over a longer period of time.
- A defined contribution plan subject to the minimum survivor annuity requirements would be permitted to transfer liability for any failure to meet those requirements to certain annuity providers. Generally, transfer would be permitted to a state licensed annuity provider that agrees to meet the plan qualification requirements relating to survivor annuities, including the provision of annuities in the proper form, and providing participants and spouses with notices and elections. The plan sponsor would still be liable for prudent selection of the annuity provider and periodic monitoring of that provider's performance.
- For the selection of an annuity provider under a defined contribution plan, the bill would deem a sponsor's fiduciary responsibility to be satisfied — in determining whether the annuity provider is able to make payments under the contract — to the extent that the payments are guaranteed by a state guaranty association as of the date the contract is issued.

Disclosure Reforms

The bill would also generally permit all participant disclosures to be made electronically — with a paper notice opt-out option — and would modify the frequency of SPD updates.

In Closing

Senator Hatch is expected to become the next chair of the Finance Committee — the tax writing committee in the Senate and one of two committees in that chamber with legislative jurisdiction over retirement plans — and he is expected to pursue tax reform in 2015. It remains to be seen whether his SAFE Retirement Act will be part of those reform efforts.

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