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Senators Portman and Cardin Reintroduce Retirement Legislation

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June 27, 2019 TO: ICI Members
Pension Committee
Pension Operations Advisory Committee SUBJECTS: Pension RE: Senators Portman and Cardin Reintroduce Retirement Legislation

Senators Portman (R-OH) and Cardin (D-MD) recently introduced the Retirement Security and Savings Act of 2019 (S. 1431).[1] The bill includes more than 50 provisions intended to strengthen Americans' retirement security by expanding access to plans and maximizing security and flexibility in retirement.[2] The bill has been referred to the Senate Finance Committee.

The specific provisions are described in more detail below.

Timing of Retirement Savings Reforms

Senators Portman and Cardin appear interested in moving their bill forward once the House and Senate take action on their respective retirement bills (the Senate's Retirement Enhancement and Savings Act (RESA)[3] and the House's Setting Every Community Up for Retirement Enhancement Act of 2019 (the SECURE Act)[4]) and reconcile the two bills.

On May 14, 2019, the Senate Finance Committee held a hearing intended to generate bipartisan enthusiasm for RESA and to lay the groundwork for future bipartisan work on retirement issues, including the Portman-Cardin bill.[5] In his opening remarks, Chairman Grassley noted that passage of RESA is one of his top priorities and that the hearing "marks the start of [the Committee's] work on the next round of retirement savings reforms."

The House Ways and Means Committee approved the SECURE Act by voice vote on April 2, 2019, and the full House passed the bill on May 23, 2019 by a vote of 417-3. While the SECURE Act is similar to RESA, there are key differences that will have to be resolved before the bill is enacted. The Portman-Cardin retirement bill was drafted with the assumption that a version of the RESA/SECURE Act legislation will ultimately be passed.

Description of Portman-Cardin Bill Provisions

The Portman-Cardin Retirement Security and Savings Act of 2019 would do the following:

(1) Provisions Intended to Expand Coverage and Increase Retirement Savings

- Establish a new automatic enrollment safe harbor (§§101-103). The bill would create a new safe harbor for 401(k) plans (exempting the plan from nondiscrimination and top-heavy testing requirements) as an alternative to the existing automatic enrollment safe harbor plan design. Under the provision—
    - Employees must be automatically enrolled, with the initial default contribution set at six percent of compensation, increasing one percent each year, until the default reaches ten percent of compensation.[6]
    - Employers would be required to provide matching contributions equal to (a) a 100 percent match on the first two percent of pay contributed by the employee; (b) a 50 percent match on the next four percent contributed; and (c) a 20 percent match on the next four percent contributed.
    - Employers with 100 or fewer employees would receive a special tax credit when they adopt this new safe harbor, intended to account for the higher expense of the employer contribution compared to the formula under the existing safe harbor.

- Expand the Saver's Credit (§104). The bill would make the Saver's Credit refundable and would require that the credit be paid directly into a retirement plan or Roth IRA (contributions would be treated as Roth contributions, but would not apply toward contribution limits or for any testing requirements). The bill also would modify the eligibility formula to allow more individuals to qualify for a 20 percent credit (instead of a ten percent credit).
- Amend the coverage rules for long-term part-time workers (§105). The bill would not allow plans to exclude part-time employees (i.e., employees who work less than 1,000 hours annually), when those employees complete at least 500 hours of service for two consecutive years. Plans would be permitted to exclude these long-term part-time workers for plan testing purposes.
- Simplify top-heavy rules for defined contribution (DC) plans (§106). For DC plans that allow employees to participate without having met the statutory minimum age and service requirement (e.g., the long-term part-time workers described in §105 of the bill or employees under age 21), the bill would permit plans to apply the top-heavy testing rules separately for such participants.
- Allow non-spouse beneficiaries to roll over inherited IRAs (§107). The bill would allow non-spouse beneficiaries to utilize a 60-day rollover (also referred to as an indirect rollover) to move assets into an inherited IRA. This aligns the rules for spousal and non-spouse beneficiaries.
- Increase the age for beginning required minimum distributions (RMDs) (§108). The bill would change the age at which IRA owners and plan participants must begin taking RMDs, from age 70 ½ to age 72, beginning in 2023, and then to age 75, beginning in 2030.
- Require Treasury to update mortality tables (§109). The bill would direct Treasury to update the mortality tables on which the RMD regulations are based within one year of the bill's enactment and again every 10 years.
- Increase amount of the start-up credit (§110). The bill would modify the cap on the amount of the existing tax credit for small businesses that adopt a new qualified plan,

increasing the maximum credit amount from $500 to $5,000 per year.[7] For employers with no more than 25 employees, the credit would equal 75 percent (increased from 50 percent) of startup costs.

- Establish a credit for re-enrollment (§111). The bill would create a new $500 credit for small businesses that have employer plans that include an automatic enrollment feature. The new credit would be available for the first three years after the employer adds a new provision to re-enroll employees (at least every three years) who previously opted out of automatic enrollment or who opted to contribute a lower amount.

- Allow employer matching contributions based on student loan payments (§112). The bill would allow employers to modify their 401(k), 403(b), SIMPLE IRA, or 457(b) plans to provide that employer matching contributions under the plan will be made on behalf of employees who make payments on their student loans (to apply, for this purpose only, as if the employees had made elective deferrals). The employees must certify that they have made the loan payment.

- Allow tax exclusion for qualified retirement planning services (§113). The bill would modify the Internal Revenue Code (IRC) to provide that retirement planning services received in lieu of compensation would not be includible in the employee's income.

- Allow SIMPLE plan sponsors to make additional nonelective contributions (§114). The bill would allow employers who sponsor SIMPLE plans to make contributions in addition to the currently required three percent match or two percent nonelective contribution, as additional nonelective contributions of up to ten percent.[8] The bill would impose a new limit on total contributions made to a SIMPLE plan account, at half of the IRC § 415 limit for DC plans (i.e., for 2019, $28,000, half of $56,000).

- Expand EPCRS (§116). The bill would expand the IRS's Employee Plans Compliance Resolution System (EPCRS), deeming EPCRS amended, to allow plans to self-correct[9] all inadvertent plan violations, except where expressly prohibited by the IRS. Further, the bill directs IRS to expand EPCRS (1) to allow IRA custodians to address certain inadvertent failures for which the IRA owner was not at fault, and (2) to allow plans and IRAs to self-correct any inadvertent RMD failures, where a distribution is made no more than 180 days after it was required.

- Expand permissible 403(b) investments (§117). The bill would amend IRC section 403(b) to permit 403(b) custodial accounts to invest in group trusts (which include collective investment trusts) and insurance company separate accounts, in addition to regulated investment company stock. It would also amend the Investment Company Act of 1940 (1940 Act) to provide that 403(b) plans could invest in collective trusts and separate accounts without causing such trusts and accounts to lose their exclusions under the 1940 Act, provided that: (1) the 403(b) plan is subject to ERISA, (2) the employer making the 403(b) arrangement available agrees to serve as a fiduciary for selecting the investments under the plan, or (3) the plan is a governmental plan.

- Clarify eligibility for participation in 457(b) plans (§118). The bill provides that a participant's receipt of certain de minimis distributions from a 457 plan will not preclude the participant from participating in the plan.

- Allow small immediate financial incentives for contributing to a plan (§119). The bill would allow employers to offer small incentives (e.g., a gift card) to induce employees

to enroll in the plan.

- Index IRA limit for catch-up contributions (§120). The bill would require IRS to annually adjust the $1,000 limit for IRA catch-up contributions for increases in the cost of living, in the same manner as it adjusts the (non-catch-up) IRA contribution limit.
- Apply higher catch-up limit at age 60 (§121). The bill would increase the limit for catch-up contributions for participants who have reached age 60[10] (from $6,000 to $10,000 in the case of 401(k) and 403(b) plans; from $3,000 to $5,000 in the case of SIMPLE plans). The bill would also instruct IRS to adjust these higher catch-up contribution limits annually for increases in the cost of living.

(2) Provisions Intended to Promote Lifetime Income

- Modify QLAC rules (§201). The bill would direct Treasury to modify its regulations on qualifying longevity annuity contracts (QLACs) to do the following:

    - Remove the existing 25 percent limit and raise the current limit from$130,000 to $200,000 and to adjust this dollar limit for inflation (current rules limit the amount of QLAC annuity premiums that can be excluded from the RMD rules to the lesser of $130,000 (across all his or her IRAs or plan accounts) or 25 percent of the individual's IRA plan balance).
    - Allow variable and indexed annuities to qualify as QLACs, provided that they include certain guarantees.
    - Clarify that a QLAC may include a free look period of not more than 90 days.
    - Clarify the treatment of a divorce or separation for a joint and survivor annuity QLAC.

- Review RMD barriers for life annuities (§202). The bill would modify the statutory and regulatory RMD provisions that generally disallow annuities that provide payments that increase over time.

    - The bill would amend the statute to expressly permit, under the RMD rules, commercial annuities (i) whose payments increase by a constant percentage (less than five percent per year); (ii) which allow lump sum payments as a result of commutation or acceleration of the future payments; (iii) which pays a dividend or similar payments; or (iv) which provides certain lump sum return of premium death benefits.
    - The bill would direct Treasury to make certain changes to the regulations, including providing that a commercial annuity whose initial payment is as much or higher than the RMD amount that would be required under the DC plan RMD rules would be deemed to satisfy the RMD requirements.[11]

- Enhance RMD rules for partial annuitization (§203). The bill would direct Treasury to amend its regulations under the RMD rules to modify the treatment of partial annuitization. When a participant annuitizes a portion of his DC plan account, if the annuity payments paid in a calendar year exceed the amount that would be required to be distributed under the DC plan RMD rules based on the value of the annuity, then the excess annuity payment amount for a year could be applied towards the RMD

required with respect to the non-annuitized portion of the participant's account.

- Permit insurance-dedicated ETFs (§204). The bill would direct Treasury to modify its regulations to remove certain barriers that generally preclude ETFs from being available through variable annuities.

(3) Provisions Intended to Simplify and Clarify Retirement Plan Rules

- Require a report to Congress on reporting and disclosure requirements (§301). The bill would direct the Department of Labor (DOL), Treasury and the Pension Benefit Guaranty Corporation (PBGC) to review the reporting and disclosure requirements in ERISA and the IRC applicable to qualified plans and, within 18 months, to provide a joint report to Congress with recommendations to "consolidate, simplify, standardize, and improve" the requirements.

- Consolidate DC plan notices (§302). The bill would direct DOL and Treasury to adopt, within 18 months of the date the bill is enacted, regulations providing that a plan sponsor may consolidate two or more of the following notices:

  - The notice a plan must provide to a participant when it defaults the participant into a qualified default investment alternative (QDIA), in order for plan to receive fiduciary liability relief for the investment selected [ERISA §404(c)(5)(B)];
  - The notice required by ERISA when participants are automatically enrolled into a QDIA, in order for the plan to ensure that any state laws that may restrict automatic enrollment (e.g., wage laws) are preempted [ERISA §514(e)(3)];
  - The notice that safe harbor plans must provide to participants regarding the arrangement [IRC §401(k)(12)(D)];
  - The notice that automatic enrollment safe harbor plans must provide to participants [IRC §401(k)(13)(E)]; and
  - A notice that explains a participant's right to stop automatic enrollment and to withdraw contributions, without penalty, within 90 days of the first contribution [IRC §414(w)(4)].

- Modify the performance benchmarks for asset allocation funds (§303). The bill would direct DOL to modify its participant-level fee disclosure regulation—specifically, the requirement to compare each designated investment alternative against an appropriate broad-based securities market index. The change would allow investments such as target date funds, that include a mix of asset classes, to be benchmarked against a blend of broad-based securities market indices, provided certain conditions are met.

- Permit non-spousal beneficiaries to roll assets to plans (§304). The bill would permit non-spousal beneficiaries to roll inherited assets into a 457, 401(k) or 403(b) plan, in addition to the option to roll them into an IRA, which is currently permitted.

- Harmonize 457(b) deferral election rules with other DC plans (§305). The bill would remove the rule that 457(b) plan participants must request changes in their deferral rate prior to the beginning of the month in which the deferral will be made.

- Simplify 402(f) notices (§306). The bill would direct Treasury (in consultation with DOL and PBGC) to simplify the model 402(f) notice[12] to make it more understandable to participants. The model notice must explain how the different elections would affect spousal rights.

- Reduce barriers to termination of section 403(b) plans (§307). The bill would direct Treasury to issue guidance providing a mechanism for a plan sponsor to terminate a 403(b) plan and distribute the custodial accounts, without forcing the assets out of the custodial accounts, allowing the individual custodial accounts to preserve their tax-deferred treatment.
- Permit safe harbor plans to use base pay or rate of pay calculations (§308). The bill would direct Treasury to modify the rules for 401(k) safe harbor plans to provide that the use of base pay or rate of pay (i.e., without overtime or bonuses) to calculate contributions would not disqualify the employer from using the safe harbor, except for plans for which, on a consistent basis, overtime is a major component of the pay for non-highly compensated employees.
- Allow Roth in SIMPLE IRAs (§309). The bill would allow SIMPLE IRAs to be offered as Roth IRA accounts.
- Reduce excise tax for failure to take an RMD (§310). The bill would reduce the penalty for failure to take an RMD distribution from 50 percent to 25 percent.
- Clarify rules for catch-up contributions with respect to separate lines of business (§311). The bill would amend the rules for catch-up contributions, providing that a plan can permit catch-up contributions even if an affiliated plan in a separate line of business does not allow catch-up contributions.
- Clarify substantially equal periodic payment rule (§312). The bill would make the following clarifications regarding the application of the exception to the 10 percent early distribution penalty for a series of substantially equal periodic payments:
    - A rollover to another qualified plan or IRA would not constitute a "subsequent modification" that disqualifies the payment series from the exception to the 10 percent penalty.
    - Annuity payments can qualify for the substantially equal periodic payment exception and will be deemed to qualify for the exception to the ten percent penalty if they would satisfy the RMD requirement for qualified plans.
- Clarify treatment of distributions of annuity contracts (§313). The bill would clarity that the inclusion of an annuity contract within a lump sum distribution would not preclude the distributee from receiving the favorable tax treatment afforded distributions of company stock from a plan.
- Clarify rule for post-termination elective deferrals (§314). The bill would direct Treasury to amend its regulations to provide that employees who terminate employment can make post-termination contributions to a 401(k), 403(b) or 457 plan from severance pay and back pay.
- Encourage non-business contributions to a simplified employee pension (SEP) (§315). The bill would extend the exception from the 10 percent excise tax on nondeductible contributions to a retirement plan to also include SEPs (the exception currently covers contributions to a SIMPLE plan or a 401(k) plan).
- Allow certain plan transfers and mergers (§316). The bill would allow an employer to merge its 403(b) plan and its 401(a) plan.

- Create exception from RMD rule when aggregate retirement savings do not exceed $100,000 (§317). The bill would provide that a participant whose combined balance in his or her IRAs and retirement plans does not exceed $100,000 (indexed for inflation and subject to a $10,000 phase-out range), as of the December 31 of the year before attaining age 70 ½ would not be required to take RMDs. DB plans would be disregarded for this purpose. As long as the participant does not make additional contributions, the initial determination will continue to apply for all subsequent years, even if the account value appreciates. Plan providers could rely on a certification from the participant as to the total value of his or her accounts. This exclusion applies only the original account owner or plan participant, and not to beneficiaries.
- Harmonize hardship rules for 403(b) plans (§318). The bill would conform the hardship rules for 403(b) plans to the 401(k) hardship rules, aligning the changes made to the 401(k) plan hardship rules by the Bipartisan Budget Act of 2018.
- Encourage IRA preservation (§319). The bill would make the following changes to the IRA rules, to reduce the impact of punitive provisions:
    - Directs Treasury to make certain information available to the public, including an overview of the IRA rules, examples of common errors, and how to avoid such errors.
    - Reduces the excise tax on excess contributions from six percent to three percent, if the IRA owner corrects the excess contribution within the "correction window" (by the end of the second taxable year after the taxable in which the tax is first imposed; or earlier, in the event IRS discovers the error during audit).
    - Reduces the excise tax for failing to take an RMD to ten percent, if the IRA owner corrects the failure within the correction window.
    - Removes the penalty of disqualification for a prohibited transaction; however, a prohibited transaction excise tax would still apply.
    - Modifies the statute of limitation rules to ensure that the three-year statute of limitations begins running when a when an income tax return is filed (or would have been filed, if the individual is not required to file), for purposes of prohibited transactions, excess contributions, or RMD failures.
- Eliminate early distribution penalty on certain distributions (§320). The bill would modify the rules regarding the ten percent early withdrawal penalty to provide that the penalty would not apply to distribution of earnings on excess IRA contributions.
- Distributions to firefighters (§321). The bill would modify the rules regarding the ten percent early withdrawal penalty. The change would expand the existing exception for "distributions to qualified public safety employees in governmental plans" to include private sector firefighters who terminate after age 50 and take a distribution from a retirement plan.
- Eliminate unnecessary plan notices to unenrolled participants (§322). The bill would modify the notice requirements under ERISA and the IRC to provide that plans would not be required to provide certain notices to employees who are eligible to participant but have not been enrolled in the plan. The plan would have to provide such employees with notices required in connection with the employee's initial eligibility under the plan (including the summary plan description), and an annual notice reminding the employee that he or she is eligible to participate in the plan.

(4) Provisions Intended to Reform Plan Rules to Harmonize with IRA Rules

- Harmonize Roth plan distribution rules (§501). The bill would amend the RMD rules to exempt Roth amount in plans, aligning the treatment of RMDs in plan Roth accounts with Roth IRAs. RMD rules would apply to Roth accounts after the plan participant's death.
- Extend charitable distributions to plans (§502). The bill would extend the qualified charitable distributions under existing IRA rules to apply to employer plans as well. Like IRA owners, plan participants over age 70 ½ could direct up to $100,000 per year from the plan to be paid directly to a qualified charity, and such amounts would satisfy all or part of the amount of RMD required from the plan.
- Allow surviving spouse to elect to be treated as employee (§503). The bill would allow surviving spouse beneficiaries to elect to be treated as the plan participant for RMD purposes, if the plan permits it.
- Allow rollovers from Roth IRAs to plans (§504). The bill would amend the rollover rules to permit rollovers from Roth IRAs to Roth accounts in employer plans.

(5) Provision Related to Plan Amendments

- Provide time for plan amendments (§601). The bill would give plan sponsors would until the end of 2022 (2024 in the case of governmental plans) to amend the plan document for changes made by the bill.

In addition to the provisions described above, the bill also includes a number of DB plan reforms.

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endnotes

[1] The bill text is available here. Senators Portman and Cardin first introduced the bill in December 2018 as the Retirement Security and Savings Act of 2018 (S. 3781).

[2] See Senator Portman's press release describing the bill, available here.

[3] RESA (S. 972) was introduced on April 1, 2019. The Senate Finance Committee unanimously approved an earlier version of RESA (S. 3471, 114th Congress) in 2016. A companion bill (H.R. 1007) was introduced in the House on February 6, 2019.

[4] The SECURE Act (H.R. 1994) was introduced on April 2, 2019. For a description of the SECURE Act, see ICI Memorandum No. 31701, dated April 8, 2019. Available at https://www.ici.org/my_ici/memorandum/memo31701. Several provisions of the SECURE Act also are included in RESA. Some provisions of the SECURE Act also appeared in the Family Savings Act (H.R. 6757), which passed the House of Representatives in 2018. One point of contention is the fact that a provision was removed from the SECURE Act that would have allowed 529 plans to be used to pay for homeschooling expenses. This point

has prevented the Senate from acting on the bill by unanimous consent.

[5] The hearing was entitled “Challenges in the Retirement System.” A recording of the hearing and witness testimony is available at https://www.finance.senate.gov/hearings/challenges-in-the-retirement-system.

[6] Note that these percentages are the minimum defaults that must be used. Plans are permitted to apply a higher default percentage, but for the first year, the default percentage cannot be higher than 10 percent.

[7] Under the bill, the formula for the amount of the credit for small businesses would be: the greater of (1) $500, or (2) the lesser of (a) $250 for each non-highly compensated employee eligible to participate in the plan, or (b) $5,000.

[8] Under current law, SIMPLE plan sponsors are not permitted to make employer contributions in excess of the matching or nonelective employer contributions that are required.

[9] Corrections made under the self-correction portion of EPCRS do not require payment of a fee to the IRS nor a formal IRS submission.

[10] Individuals become eligible to make catch-up contributions in the year in which they attain age 50.

[11] Annuity payments paid from DC plans are tested under the RMD rules for defined benefit plans.

[12] The 402(f) notice provides an explanation of tax consequences when making distributions that are eligible for rollover.
