

The SECURE Act did affect defined benefit plans: A summary of possible actions for DB plan sponsors

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Headlines for the Setting Every Community Up for Retirement Enhancement (SECURE) Act, which affects federal laws for employer-sponsored retirement benefit programs, are dominated by changes in employers' defined contribution (DC) plans. This article confirms that certain defined benefit (DB) pension plan changes included in SECURE may lead to technical and administrative concerns for DB plan sponsors as well, who should be prepared to address them after careful inspection of the new law.

For plan sponsors, there are actions they must take (mandatory changes from SECURE) and others they may take (voluntary options under SECURE). Routine and/or complex changes to human resources (HR) administration systems and DB plan calculation engines may be called for. We leave it to the reader to evaluate the urgency or lack of it in addressing issues raised by SECURE, which was enacted on December 20, 2019. This article looks at key considerations for employers and other DB plan sponsors.

Increase to age 72 from age 70½ for required minimum distributions (RMDs)

Age 72 is the revised age at which DB plan participants born after June 30, 1949, and who have not yet commenced their pensions, must begin to take an RMD. (SECURE equivalently states that 72 is the revised RMD age if a participant attains age 70½ after December 31, 2019.) Consistent with pension law prior to SECURE, RMDs are due to begin in the year in which a participant attains age 72 (instead of 70½), but may be deferred to no later than April 1 of the following year.

Plan sponsors and their third-party administrators (TPAs) must still pay participants who had started their DB plan RMDs before January 1, 2020, but no later than April 1, 2020, even if these participants are younger than 72 in 2020. While there may be a high likelihood that the plan sponsor will not need to pay as many initial RMDs in 2021, care should be taken to review the dates of birth for participants who terminate during transitional years. Participants born before July 1, 1949, who terminate employment in 2020 will be due an RMD for 2020 no later than April 1, 2021.

One likely concern is that the change in law could lead to incorrect Form 1099-R reporting for participants who terminate and receive distributions in 2020. If a portion of the distribution for these participants is an RMD, care should be taken to ensure that the participant is notified that the RMD portion is not eligible for rollover to another qualified retirement program, such as an IRA.

If there is an error on Form 1099-R, correction will be necessary as it could result in errors in an individual's personal federal and/or state tax liability, and a requirement to file amended tax returns.

Regarding SECURE formal plan amendments for this RMD age change, plan sponsors may wish to defer making formal plan document amendments until the Internal Revenue Service (IRS) provides further guidance. DB plans must be amended by the last day of the plan year that begins in 2022 for the change in the RMD age. There is an exception for governmental and collectively bargained plans, which must be amended by the last day of the plan year that begins in 2024.

Actuarial Increase in accrued pension benefits for participants who work past age 70½

While SECURE did amend the RMD age to 72 from 70½, SECURE did not amend the section of the Internal Revenue Code that requires an actuarial increase of the DB annuity for participants who work past age 70½. The pension community is expressing concern (and some confusion) on whether or not this was the intent of the new statute or a technical drafting error. Incorrect pension benefit calculations could result. Some practitioners are advocating for an IRS technical correction or for Congress to enact a legislative amendment (if it should come to that), but at the very least, some guidance from the IRS is necessary so calculations for affected participants can be certified and finalized.

As a best practice, a plan sponsor should identify all of their affected participants under this provision, consult with ERISA counsel, and provide their defined benefit TPAs written explanations of how to proceed in what appears to be a regulatory vacuum.

In-service distributions age for DB plans lowered to as early as age 59½ from 62

The IRS has issued regulations in the past—last time under the Pension Protection Act of 2006 (PPA)—that granted employers safe harbor guidance regarding paying accrued DB plan benefits during active employment. The PPA law and regulations permitted employers to lower the age at which “in-service distributions” were permissible to as early as age 62.

SECURE now permits an employer to amend the DB plan so that in-service distributions are permissible as early as age 59½ using a regulatory safe harbor. While it is difficult to collect data regarding how many employers changed their plans to permit in-service distributions as early as age 62 under the PPA after 2006, we suspect use of this voluntary option has been fairly uncommon among DB plans before SECURE.

We are reticent to estimate how many employers may exercise this new provision for in-service distributions as early as age 59½ but will speculate that it could be a catalyst for further pension de-risking strategies. In effect, this SECURE provision could facilitate a path to voluntary plan terminations without the requirement of all remaining participants terminating employment with the plan sponsor.

For plan sponsors opting for the in-service distribution change to age 59½, a discretionary plan amendment is required. Therefore, this provision is not covered under the SECURE remedial amendment period afforded to the RMD change.

Plan amendments and documentation

The IRS could issue “safe-harbor amendment language” for SECURE provisions. If a plan sponsor makes a decision regarding plan administration but intends to defer formal plan document amendments, the employee benefit committee or other governing committee at the employer should formally document the decision.

Special tax notice

Plan sponsors and administrators must provide an updated rollover and distribution notice (often referred to as the IRC §402(f) special tax notice) to participants who receive plan distributions. The IRS has not yet issued updated notice language, and transitional relief has not been provided for failure to provide updated notices. Absent direction from the IRS, these notices should be reviewed and updated to reflect the new SECURE provisions.

The SECURE Act provisions affecting defined benefit plans add complexity to benefit calculation and distribution procedures. (SECURE also led to confusion by not amending a section of the IRS code pertaining to actuarial increases after age 70½.)

Plan sponsors and administrators should proceed with caution as they evaluate their administration procedures while waiting for further guidance from the IRS. As part of that caution, consultation with ERISA counsel is highly recommended.



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