Patterson Belknap Webb & Tyler LLP

Employee Benefits and Executive Compensation Alert November 9, 2020

# SECURE Act Update: Nondiscrimination Testing Relief Related to Frozen or Closed Defined Benefit Plans and Changes to Permissible In-Service Distribution Ages for Defined Benefit and Money Purchase Plans

As part of our series of continuing updates[1] on different aspects of The Setting Every Community Up For Retirement Enhancement Act of 2019 (the "SECURE Act") and related legislation that may impact (or provide opportunities for) employers that sponsor retirement plans, this alert provides an overview of changes to rules related to nondiscrimination testing where defined benefit plans have been frozen or closed to new participants under the SECURE Act, and a reduction in the minimum age for allowable in-service distributions from defined benefit and money purchase pension plans under the Bipartisan American Miners Act of 2019 (the "Miners Act").[2]

**Nondiscrimination, Coverage, and Participation Testing Relief Where Defined Benefit Plans Have Been Frozen or Closed to New Participants**

Many plan sponsors have, or desire to, close their defined benefit plans to new members or to freeze benefit accruals, often with the goal of providing more of their workforce's benefits through a defined contribution benefit plan. Where a plan sponsor closes a defined benefit plan to new members, it is common for nondiscrimination testing and participation rules that continue to apply to the defined benefit plan to be tougher, or sometimes impossible, to be satisfied, as the group of employees accruing benefits under the plan gets smaller over time (both in number and as a percentage of the employer's non-highly compensated workforce). In addition, it is also not uncommon for plan sponsors to desire to provide enhanced benefits under a defined contribution plan to some or all of their employees who had previously been accruing benefits under a frozen defined benefit plan (or for employees whose participation in the defined benefit plan ceased in order to enable the plan to meet coverage and nondiscrimination testing requirements). But the ability to provide those enhanced defined contribution benefits have been limited in light of nondiscrimination rules that apply to the defined contribution plan.

While the IRS had issued interim testing relief (temporarily, but extended so far to plan years beginning before 2021) for certain defined benefit plans that had closed to new participants through a plan amendment adopted before December 13, 2013, that relief was fairly limited in scope. The SECURE Act has provided additional relief from several of the nondiscrimination and testing rules that would otherwise apply where a group of individuals' benefit accruals under defined benefit plans have been limited. However, strict requirements apply in order for plans to be able to take advantage of that testing relief.

*Defined Benefit Plan Nondiscrimination Testing Relief*

To address situations where a defined benefit plan continues to provide for benefit accruals, but only for a closed group of participants, certain of the testing rules related to the benefits provided to the closed class of participants (including both certain of the overall requirements of Section 401(a)(4) of the Internal Revenue Code (the "Code"),

[1] Prior alerts in this series on the SECURE Act are available here, here, here, and here.
[2] Both the SECURE Act and the Miners Act were passed as part of the Further Consolidated Appropriations Act, 2020 ("FCAA").

and the benefits, rights and features provided to the closed class) can be deemed to be satisfied under special rules enacted under the SECURE Act if:

a. the plan passed the normally applicable rules for the year as of which the class of employees eligible for the plan's benefit accruals closed, and for the two subsequent plan years, the benefits, rights and features provided under the plan satisfied the 401(a)(4) nondiscrimination requirements (generally without regard to the SECURE Act relief);

b. after the class of employees eligible for the plan's benefit accruals closed, any plan amendment that modifies the closed class of participants or the benefits, rights and features provided to them does not discriminate significantly in favor of highly compensated employees; and

c. either the class of employees eligible for the plan's benefit accruals closed before April 5, 2017, or certain additional requirements have been met. Those additional requirements include a requirement that the plan was in effect for at least five years before the class of employees eligible for benefit accruals closed, and that during the five-year period before the class was closed, there had not been any substantial increase in the coverage or value of the benefits, rights or features provided to the closed class under the plan.[3]

The SECURE Act also permits certain defined benefit plans with closed classes of participants to be aggregated with certain defined contribution plans for both Code Section 401(a)(4) testing purposes (relating to benefits provided) and Code Section 410(b) testing purposes (relating to plan coverage), with the testing for those combined, aggregated plans to be run on a benefits basis, which can include defined contribution plans providing matching contributions, 403(b) plans (including such plans with matching and/or employer nonelective contributions), and ESOPs or tax credit employee stock ownership plans. There are special rules that apply where the defined benefit plan is desired to be tested on an aggregate basis with defined contribution plans providing matching contributions. This new aggregation rule appears to be able to be utilized without the need to satisfy some of the otherwise generally applicable plan aggregation rules (requiring, in some instances, certain levels of benefits for non-highly compensated employees, or that the benefits to be provided to at least 50% of the covered non-highly compensated employees be primarily derived from the defined benefit plan's benefits).

Defined benefit plans are only eligible for this expanded aggregation rule if, for the plan year in which the class closed and the two subsequent plan years, the defined benefit plan satisfied the coverage requirements of Code Section 410(b) and the nondiscrimination requirements of Code Section 401(a)(4) (without regard to these special aggregation rules), and after the date the plan was closed, there was no plan amendment modifying the closed class or the benefits provided to the closed class that discriminated significantly in favor of highly compensated employees. If the class of eligible participants closed on or after April 5, 2017, it is also required that the defined benefit plan was in effect for at least five years before the class of eligible participants closed, and during that five-year period before the class was closed, there was no substantial increase in the coverage or benefits provided under the plan.[4]

The SECURE Act also includes special rules that can enable the testing relief it provides to apply to plans after they have been spun-off to another employer, as well as certain special rules to apply in the event that an employer's employee population changed after a class of participating employees was closed, on account of a merger, acquisition, divestiture, or similar event.

[3] The SECURE Act includes detailed rules regarding the determination of whether there has been any such substantial increase.
[4] Additional detailed rules apply to this determination as well under the SECURE Act.

*Participation Testing Relief for Closed Defined Benefit Plans*

Under Section 401(a)(26) of the Code, defined benefit plans must provide meaningful accruals for not less than the lesser of (a) 50 employees or (b) the greater of 40% of an employer's workforce or two employees (one if there is only one employee), with certain rules available to not consider certain employees when running those tests.[5] After defined benefit plans are closed to new participants, for smaller employers (for whom the 50 employee threshold might not be met), over time it is not uncommon for that participation test to not be able to be met. The SECURE Act also includes relief for this requirement where the generally applicable rule had been met when the class of participants was closed, and if either the amendment closing the class of eligible participants was adopted before April 5, 2017, or if other detailed requirements have been met.

*Testing Relief for Defined Contribution Plans*

As noted above, it is not uncommon for a plan sponsor to cease benefit accruals under a defined benefit plan (for either all or a class of employees), and then to provide enhanced benefits to employees impacted by that benefit freeze under a defined contribution plan. While it is sometimes possible to run certain nondiscrimination tests that apply to the defined contribution plan on a combined basis with one or more other plans, including defined benefit plans (for which some of the testing relief described above can be helpful), many defined contribution plans need to separately pass nondiscrimination tests regarding their levels of employer contribution. In order to pass those tests, it is often helpful for defined contribution plans to be tested on an assumed benefits (rather than contribution) basis, but prior to the SECURE Act, the ability to do so was often limited to plans providing certain minimum levels of benefits for nonhighly-compensated employees.

The SECURE Act also provides relief with respect to those requirements, permitting certain defined contribution plans that provide "make-whole"[6] contributions to a closed class of participants whose accruals under a defined benefit plan have been reduced or eliminated to be tested on a benefits basis, without regard to some of the other requirements that normally apply. That relief is only available if for the plan year for which the class eligible to receive those make-whole contribution closes and the two subsequent plan years, the closed class of participants eligible for those make-whole contributions satisfies certain coverage tests, and after the class of such participants was closed, any plan amendment that modifies the closed class or the allocations, benefits, rights and features provided to the closed class does not discriminate significantly in favor of highly compensated employees. If the class was not closed before April 5, 2017, then the defined benefit plan that had had its accruals reduced or eliminated (to which the make-whole contributions relate) must have been in effect for at least five years before it's class of eligible participants was closed, and during that five-year period before the class was closed, there must have been no substantial increase in the coverage or benefits provided under the plan.[7] Special rules also apply under the SECURE Act to permit the related testing on a benefits basis of such defined contribution plans to be run after being aggregated with certain other defined contribution plans, including certain plans that include matching contributions, are 403(b) plans, or are ESOPs or tax credit employee stock ownership plans.

These special SECURE Act rules are generally available after the date of the enactment of the SECURE Act, but a plan sponsor can elect to apply them (and accordingly to cure certain testing failures that may have applied) to plan years beginning after December 31, 2013. In light of the enactment of these rules, and the expanded ability for certain

[5] An exception can apply if no highly compensated employees accrue benefits under the plan, so long as it is not top heavy and it is not aggregated with another plan to pass coverage or certain other nondiscrimination requirements.
[6] The SECURE Act defines "make-whole" contributions as employer nonelective contributions that are reasonably calculated (in a consistent manner) to replace some or all of the benefits that employee would have received under the defined benefit plan (or certain other plans) if no change had been made to the defined benefit plan and such other plans. (Further special rules apply if the classes of impacted participants closed on different dates.)
[7] Detailed rules apply to this determination.

plans to pass the impacted nondiscrimination and coverage tests, so long as detailed requirements are met, the SECURE Act also contemplates that certain eligible benefit plans may be amended to add certain benefits or participants back into the plan (for example, if they were excluded or their benefits curtailed in order to pass the previously applicable tests).

**Reduction in Minimum Age for Allowable In-Service Distributions from Defined Benefit and Money Purchase Pension Plans**

Code Section 401(a)(36) permits defined benefit and money purchase pension plans to allow participants who have attained a minimum age and who have not separated from employment to take in-service distributions. Prior to the enactment of the Miners Act, the minimum required age was 62; the Miners Act lowers the age to 59½. Similarly, Section 457(b) governmental plans have been permitted to allow participants to take in-service distributions in the calendar year in which they obtain age 70½; that age has also been lowered to age 59½ by the Miners Act.

These distributions can be made before a plan's normal retirement age (and, indeed many defined benefit plans would not be eligible to have a normal retirement age as low as 59½). Treasury regulations provide that a pension plan's normal retirement age not be earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed, but then allows age 62 as a safe harbor normal retirement age automatically deemed to meet that standard. Thus, while a pension plan may lower its in-service distribution age to 59 ½, it must also separately follow the requirements for normal retirement age under those regulations.[8]

Defined benefit and money purchase plans, however, continue to not be required to offer in-service distributions, or if they offer them, to lower the age at which in-services distributions can be taken.

This change in law applies to plan years beginning after December 31, 2019.[9]

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[8] Other special rules apply to governmental plans and plans primarily covering certain public safety officers.
[9] While it is not entirely clear, because this change in law was in the Miners Act, rather than the SECURE Act, our understanding is that formal amendments to lower the age for in-service distributions from defined benefit and money purchase pension plans generally would need to be adopted no later than the end of the plan year for which they are to be effective, and that absent further governmental relief, it is likely that the extended deadline available for certain plan amendments related to SECURE Act changes would not apply.