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Retirement Plan News

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DOL UPDATE: Lifetime Income Disclosures Required

Congress, the DOL, and the IRS have all made efforts over the past decade to evaluate the role of lifetime income strategies in defined contribution retirement plans. This is in part because defined contribution (e.g., 401(k)) plan participants bear the investment risk for their retirement savings, as well as the burden of determining how much they need to save and the amount and timing of withdrawals in retirement to protect against longevity risk. One of the changes made by the SECURE Act to help savers with these challenges is to require plan sponsors to provide projections to show workers how their retirement savings will translate into a stream of income in retirement, so they can increase their savings rate, if needed, while they're still working.

Under the SECURE Act, plan sponsors must add to their benefit statements, at least once every 12 months, a projection of the monthly amount a participant could receive in retirement based on their current account balance. The SECURE Act also requires the DOL to provide assumptions and a model disclosure that plan sponsors can use to satisfy this projection requirement with assurance that they will not be liable for estimates derived from the projections.

The DOL recently released the standard assumptions and model language plans may use to create these projections. For example:

- Payments will begin on the last day of the benefit statement period (for example, December 31 for a 4th quarter statement).
- The participant will be age 67 on the date payments will start, or his/her actual age if older.
- A single annuity will pay a fixed monthly amount for the life of the participant with no survivor benefit.
- A qualified joint and survivor annuity will pay a fixed monthly amount for the life of the participant and the same fixed monthly amount to a surviving spouse after the participant's death.

- The 10-year constant maturity Treasury securities rate as of the first business day of the last month of the statement period must be used to calculate the monthly payments. (This rate is similar to the rate used by insurance companies to price immediate annuities.)
- The participant's life expectancy will be determined based on the gender-neutral mortality table used to determine lump sum cashouts from pension plans.

Plan administrators must also include certain explanations with the projections to help participants better understand the projections. The DOL's rule provides a model disclosure that includes these participant-level explanations. If plan administrators use the DOL assumptions and model, they will also be relieved of liability for legal claims from participants whose actual income in retirement falls short of the projections provided.

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EXAMPLE:

Assume the participant is 40 years old and is not married. Her account balance is $125,000 on the statement ending date, December 31, 2022. Under the DOL's standard assumptions, the participant could expect her current account balance to provide $645 per month, beginning at age 67 and lasting throughout the rest of her life under a single life annuity. If she marries and purchases a QJSA instead, she would receive $533 per month during her lifetime, and a surviving spouse of the same age would receive $533 per month for the rest their lifetime.

This rule will be effective in one year. In the meantime, plan sponsors may want to discuss with their plan service providers the steps being taken to include the lifetime income disclosures on the plan's benefit statements.

IRS UPDATE: Updated 402(f) Distribution Notices

Plan sponsors are required to provide a written explanation of plan distribution options and tax consequences to participants who qualify to take a distribution from the plan that is eligible to be rolled over. This distribution notice (called a "402(f)" notice) must generally explain:

- Rollover rules
- Special tax treatment for certain lump-sum distributions
- Direct rollover options (and any default procedures)
- Mandatory 20% withholding rules
- How distributions from the plan receiving the rollover may have different restrictions and tax consequences than the plan from which the rollover is made

The IRS provides model notices that plan sponsors may use to satisfy the notice requirement. One version of the IRS model notice applies to distributions that include designated Roth contributions. Another version is designed for distributions that do not include designated Roth contributions. The IRS recently updated its model notices to include changes made by the SECURE Act including:

- The exception to the 10% early distribution tax for qualified birth or adoption distributions, and
- The increase to age 72 for RMDs for participants born after June 30, 1949.

Plan service providers typically update and prepare the 402(f) notice for plan sponsors. But plan sponsors may want to confirm their provider has updated their 402(f) distribution notices to include these changes and that the updated versions will be used as soon as possible.

New Guidance on "Qualified" Plan Loan Offsets

Despite the temporary relaxation of retirement savings distribution rules in response to the pandemic, Congress and regulatory agencies are generally concerned about the leakage of plan assets prior to participants' actual retirement. One way leakage can occur is when plan loans are defaulted. To help participants restore defaulted plan loans, the Tax Cuts and Jobs Act of 2017 provided an extended rollover period for "qualified" plan loan offsets (QPLO). The IRS recently proposed regulatory guidance to help plan sponsors implement this law change in compliance with the plan loan rules.

If a participant defaults on a loan and is eligible to take a distribution, the plan may offset the loan. A plan loan offset cannot occur prior to a distributable event. For example, if a participant has an outstanding loan and severs employment with the plan sponsor, the plan sponsor may choose to offset the loan immediately or wait until the participant

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requests a distribution or rollover. When the plan is ready to offset the loan, the plan account balance will be reduced (or offset) by the outstanding loan amount and the remaining balance in the account may be distributed. Because the loan offset is treated as an actual distribution, it is eligible to be rolled over—even though the participant doesn't receive the cash in hand as part of the distribution. (They received it back when the plan loan was initially taken.) This means the participant must come up with the loan offset amount out-of-pocket if they wish to roll it over to another plan or an IRA and avoid being taxed on that amount for the year. Typically, the participant has 60 days to complete this rollover.

Effective January 1, 2018, the TCJA extended the amount of time a participant has to complete a rollover of a plan loan offset if it is considered a QPLO. A QPLO only occurs when the loan is in good standing and the default occurs solely because the:

- Retirement plan is being terminated or
- Participant failed to meet the repayment terms of the loan after severing employment with the employer.

A QPLO must occur within 12 months of the default event.

If the offset is qualified, the participant has until their tax return due date, including extensions, for the tax year the offset occurred to complete the rollover. This gives participants more time to come up with the funds so they can preserve the assets for retirement and avoid taxation.

This material was prepared by LPL Financial, LLC.

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