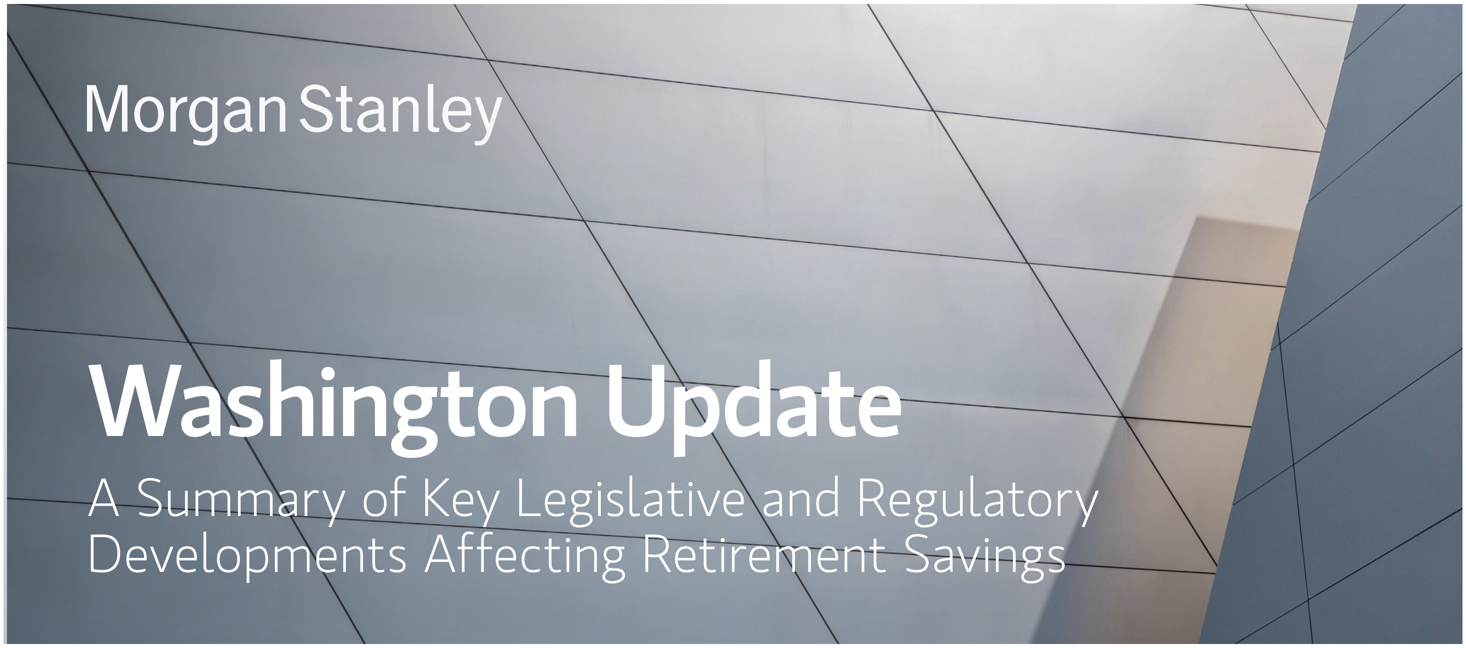

Morgan Stanley

Washington Update

A Summary of Key Legislative and Regulatory Developments Affecting Retirement Savings

JUNE 2017

Welcome to the inaugural edition of the Washington Update for the 115th Congress. The goal of this publication is to keep you abreast of legislative and/or regulatory developments affecting or having the potential to affect employer-sponsored retirement savings plans and Individual Retirement Accounts (IRAs). We will highlight key developments within both the legislative and executive branches related to the 115th Congress as well as any judicial decisions that may be issued that pertain to retirement savings.

Legislative

Items Carried Over From the 114th Congress

During the final year of the Obama Administration, the Department of Labor ("DoL") promulgated two separate safe harbor regulations that would permit states and certain larger cities to design and operate payroll savings arrangements for private sector employers in a manner that would allow such programs to avoid being subject to ERISA. Because these rules were finalized in the later part of 2016, timing issues made them subject to review by this Congress via the Congressional Review Act ("CRA"), to determine whether they should be "disapproved—essentially nullified. Utilizing the CRA, the 115th Congress voted to disapprove these rules as follows:

- H.J. Res. 67—after passage by both the House and Senate, on April 13, President Trump signed into law this resolution of disapproval (i.e., nullification) of DoL's final rule that pertains to payroll deduction IRA programs created by larger cities and localities. The rule is now treated as if it had never taken effect.
- H.J. Res. 66—similarly, on May 17, President Trump signed into law this resolution of disapproval (i.e., nullification) of the DoL's final rule that pertains to payroll deduction IRA programs created by state governments. The rule is now treated as if it had never taken effect.

Beyond these carryover items from the last Administration that have nullified two DoL rules, and the Department of Labor's Fiduciary rule which is discussed below, the policy agenda begins anew with this Congress, and somewhat anew with the incoming Trump Administration (although some regulatory initiatives that are already far along in the regulatory process could, at the discretion of the new Administration, be allowed to proceed, be subjected to further review, and/or be withdrawn from consideration).

The Trump Administration and the 115th Congress—Tax Reform and Retirement Savings

One of the top policy priorities of both the Trump Administration and Congress is accomplishing tax reform during the 115th Congress.[1] There are several options under consideration for moving tax legislation through Congress this or next year—one would be to go big, and engage in fundamental tax reform; the other would be to focus on providing across-the-board tax cuts to both individuals and businesses. Should Congress be able to move forward with fundamental tax reform, a restructuring of the Internal Revenue Code that would lower tax rates while broadening the tax base, the effort is likely to have implications for retirement savings. Such reform is likely also to be enacted in such a way that it can be a permanent change in law. However, should Congress be unable to move forward on fundamental tax reform, but rather simply focus on an across the board cut in tax rates, it is less likely that retirement savings becomes a focus therein.

While it is early in the 115th Congress and the path forward is not necessarily clear at this point in time, a substantial opportunity does exist for Congress to move fundamental tax reform though to enactment later this year or possibly early in 2018. The likely path forward will involve Republicans in the House and Senate moving tax reform through via a Congressional budget procedure called "Reconciliation."[2]

As you will see below, both the Trump Administration and House Republicans have both released tax reform proposals that will form the basis for moving forward (the Senate is expected to release a draft tax reform proposal shortly). Below, we highlight each proposal, as the discussions regarding tax reform will revolve around these proposals.[3] The discussion on tax reform begins with these two proposals. To the extent that there have been discussions regarding retirement savings, we address them below. In that regard, it is the House Blueprint and, namely, more discussions with staff over the past several months that inform our understanding of the proposed changes to retirement savings that may appear therein.

PRESIDENT TRUMP

While President Trump released his latest tax reform outline on April 26, it was short on detail. Moreover, there was no mention of the Administration's policy goals as they pertain to retirement savings.

Consistent with his campaign pronouncements, the broad outlines of his proposal are (not inclusive) as follows:

- A business tax rate of 15%
- Consolidate individual marginal rates into three tax brackets 10%, 25% and 35%
- Repeal the estate tax
- Repeal the Alternative Minimum Tax (AMT)
- Increase the standard deduction for both individuals and joint filers
- Repeal the 3.8% net investment income tax
- Protect the home ownership and charitable giving deductions
- Provide tax relief for families with child and dependent care expenses

HOUSE REPUBLICANS

That House Blueprint remains their template for moving forward on reform this year. While similar in many ways with the Trump proposal on the tax rates for corporations and individuals, it however also included a brief discussion of retirement savings, in particular enumerating several policy goals sought to be achieved via reform:

- Explore the creation of more general "universal" savings vehicles, using retirement accounts as a model
- Continue the current tax incentives for savings
- Consolidate and reform the multiple different retirement savings provisions in the Internal Revenue Code to make the system more efficient

While the above principles are broad, details have begun to emerge that inform these policy goals via discussions with key staff. The broad takeaway is that Congress (at least the House) is contemplating moving the private-sector retirement system (employer-sponsored plans and Individual Retirement Accounts) towards a Roth model for all retirement savings. Under this new system, all employee contributions into a plan or an IRA would be with after-tax dollars, while any employer contributions would remain tax deferred.

While any changes described above and below pertaining to retirement savings are simply discussion items at this point, subject to change or elimination as the process moves forward, they are worth mentioning as potential changes that could have substantial implications for the private-sector retirement systems. And, the fact that they are listed below is an indication that some members have an interest in the particular proposed change—which becomes important as the legislative process moves forward. Remember, beyond moving all retirement savings to Roth, the ideas under consideration would also do the following:

PLANS

- Increase the contribution to $24,000 and the catch-up contribution to $8,000 (indexed)
- Increase the defined contribution limit to $70,000 (indexed)
- Increase the overall compensation limit to $363,000 (indexed)
- Increase the Savers Credit[4] and its income eligibility limits
- Employer contributions—remain under a deferral system
- Expand small business retirement coverage (e.g., allow open MEPs; create a starter 401(k) plan; beef up the small employer startup credit)
- Increase auto-enrollment contribution limit safe harbor
- E-delivery of participant benefit statements as the default
- Address current complexities surrounding the form 5500 data and filing requirements for plans with a focus on easing small business compliance

IRAs

- Create a new universal Roth Saving Account with no income eligibility limits
- Increase the contribution limit to $7,000 and the catch-up contribution to $1,500 (indexed)
- Eliminate the age 59½ age restriction for withdrawals
- Modify the rules for inherited IRAs (likely—elimination of the stretch IRA, although not specifically spelled out)
- Tax-free distributions for assets held at least five years

MISCELLANEOUS

- Increase the required minimum distribution (RMD) beginning date to age 75

With the potential for these changes to raise a significant amount of revenue, it is not inconceivable that at least some of these ideas are considered in fundamental tax reform, should that be the path that Congress ultimately takes (as opposed to pivoting to a simple tax cut for both businesses and individuals).

Link to House Blueprint:

https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf

Should Congress be unable to achieve fundamental tax reform, and pivot to a pure tax cut proposal, the prospects for retirement savings changes may diminish, and become less of a consideration.[5]

Other Legislative Items

Each Congress, thousands of bills are introduced that cover every imaginable issue, yet only a handful ever get across the finish line and are signed into law. This also pertains to retirement plan policies, where legislative changes to our retirement laws are infrequent, yet numerous bills are introduced each Congress. On a go-forward basis, beginning with the publication of this Update, we will simply provide updates on retirement legislation that is actually moving through committee and to the floor for consideration by the full House or Senate.

In that regard, there is little to report on in this Update. To the extent distinct retirement issues become policy priorities, outside of tax reform, we will provide updates accordingly. Until then, it's safe to assume that, if it is not included here, then it likely is not seriously under consideration for passage at this time.

Here is the link to Congress' official website, where information on particular bills and resolutions can be accessed:

https://www.congress.gov/

Regulatory

Starting with the 115th Congress and the new Trump Administration, updates on regulatory guidance will focus on providing links to federal agency rulemaking proceedings, rather than a lengthy description of each possible regulatory item. In that regard, links to both the Department of Labor (EBSA) and the Treasury Department's Priority Guidance Plan, will direct readers to either agency websites, or in the case of the priority guidance plan, a description of the items upon which Treasury/IRS intends to work in the coming 12-month period (released quarterly).

Department of Labor (DoL) — Fiduciary

On April 6, 2016, the DoL published a final rule amending the regulatory definition of "fiduciary" under ERISA and the Internal Revenue Code to define who is a fiduciary as a result of giving investment advice to a plan, or its participants or beneficiaries, as well as to an IRA or IRA owner. The final rule was effective June 7, 2016, with the initial applicability date set for April 10, 2017.[6]

On February 3, 2017, President Trump signed a Memorandum regarding the fiduciary rule, directing the DoL to prepare an "updated economic and legal analysis concerning the likely impact of the Fiduciary Duty Rule," including the likelihood of harm to investors.[7] If this review leads the DoL to conclude that the rule is inconsistent with the policy goals highlighted in the Memorandum, it "shall" modify or rescind the rule. In light of the Presidential Memorandum, DoL, on April 7, published in the Federal Register a final rule to delay the Applicability date until June 9. There is no indication of the timing for the completion of the review by DoL as mandated by the President's Memorandum. However, on April 28, R. Alexander Acosta was confirmed as Secretary of the Department of Labor and will begin filling out the political staff below him, including the Assistant Secretary for the Employee Benefits Security Administration, and this should assist in moving forward with the Department's review of the Fiduciary Rule.

On May 23, 2017, The Wall Street Journal published an Op-Ed, authored by Labor Secretary Acosta, through which he indicated that there would be no further delay in the scheduled June 9 applicability date for the Fiduciary Rule, thus beginning the transition period for the Rule applicable as of that date. Also, he indicated that full compliance with the Fiduciary Rule and all applicable exemptions will be required as of January 1, 2018, but that DoL would seek additional comments on a possible delay of that final applicability date as well as with regard to other aspects of the Rule and exemptions.

In addition to the Op-Ed, DoL also released Field Assistance Bulletin 2017-02 indicating, among other things, that the agency would not pursue claims against firms during the transition period (between June 9 and January 1, 2018) so long as they are working diligently and in good faith to comply with the rule. It is unclear whether the nonenforcement policy extends to private litigation claims during this transition period. The DoL also released a series of Frequently Asked Questions (FAQs) designed to provide some clarity to questions surrounding issues likely to arise during the transition period. While DoL did indicate in one of the FAQs that Advisor compensation changes need not be completed by June 9, it did reiterate that firms must be "candid" with clients on variable compensation, platform limitations and, presumably, conflicts that might influence advice.

A link to the Op-Ed can be accessed via the link to the EBSA website below. Also included herein are links to the Field Assistance Bulletin as well as the Conflict of Interest FAQs:

https://www.dol.gov/agencies/ebsa

https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2017-02

https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-transition-period.pdf

Treasury Department/IRS

The Trump Administration's Treasury Department, as of this writing, had yet to release the second quarter update to the 2016-2017 Priority Guidance Plan. Part of the problem is the lack of new political staff below the Secretary level, who would be in decision-making positions regarding tax policy and objectives going forward (e.g., as of this writing, the Assistant Secretary for Tax Policy had yet to be confirmed by the Senate). Yet, carrying over from the Obama Administration are 37 items identified as those retirement issues upon which they intend to work in the coming year. While some of these items are likely to change with the new Administration, they nonetheless remain as valid projects at this point in time. Again, while identified as items they plan to address, the guidance plan doesn't place any firm deadlines for initiation or completion of any particular project. The link at the end of this listing provides access to the Priority Guidance Plan:

- Regulations on exceptions to additional tax under Section 72(t) on early distributions from retirement plans and IRAs.
- Final regulations under 417(e) to simplify the treatment of optional forms of benefit that are paid partly in the form of an annuity and partly in a more accelerated form.
- Additional guidance on issues relating to lifetime income from retirement plans and IRAs.
- Guidance on rules applicable to IRAs under 408 and 408A.
- Regulations updating the rules applicable to ESOPs.
- Amend Revenue Procedure 2013-1 relating to Employee Plans Compliance Resolution System (EPCRS) to provide guidance with regard to certain corrections.
- On July 27, 2015, the IRS Published Notice 2015-49, detailing its intention to amend the required minimum distribution regulations under section 401(a)(9) of the Internal Revenue Code to provide that qualified defined benefit plans, generally, will not be permitted to replace any joint and survivor, single life, or other annuity currently being paid (in paid status) with a lump sum payment or other accelerated form of distribution. The Treasury Department and IRS intend for the rule, when promulgated, to apply as of July 9, 2015. As of this publication, proposed rules had not yet been issued.

To access Treasury's listing of items upon which they intend to work this coming year, access this link:

https://www.irs.gov/pub/irs-utl/2016-2017_pgp_1st_quarter_update.pdf

Miscellaneous

Benefit Limits for 2017

For quick reference, the 2017 retirement plan limits are listed below:

- Elective deferral (contribution limit) for 401(k), 403(b), 457 plans—**$18,000**
- Catch-up contribution limit for 401(k), 403(b), 457 plans—**$6,000**
- Annual contribution to an IRA—**$5,500**
- Catch-up contribution limit for IRAs—**$1,000**
- SIMPLE employee deferrals—**$12,500**
- SIMPLE catch-up deferral—**$3,000**
- Annual Defined Contribution limit—**$54,000**
- Annual Compensation limit—**$270,000**
- Limit on annual benefit under a defined benefit plan—**$215,000**

[1] Reform of the Affordable Care Act ("ACA") is also a key priority for both the Trump Administration and Congress. While there are a number of tax provisions within the ACA that are likely to be repealed should reform of ACA move forward, those don't impact retirement savings and so are not included within this Update.

[2] Reconciliation is a means for moving certain limited types of legislation through the Senate without the ability of the minority party to stop such legislation via filibuster. Should Congress adhere to the reconciliation instructions that are included in a Budget Resolution that must pass first, then only a simple majority is necessary for passage. However, the process is extremely limited in its application and comes with substantial restrictions on its effectiveness, the most important being that, as revenue legislation, it cannot cause an increase in the deficit in the years outside of the first 10-year budget window. Reconciliation can be used for tax legislation, but if such legislation cannot be structured in a way to avoid revenue losses in the out years (in the decades beyond the first 10-year budget window), the minority party can raise a point of order that it violates the budget rules, and such a point of order would require 60 votes to be overcome, essentially nullifying the protections that reconciliation otherwise brings to the legislative process.

[3] At this point in time, the Senate has yet to release a substantive tax reform proposal, although discussions are well underway in an attempt to put forth a substantive proposal as part of the discussions.

[4] The Savers Credit is a nonrefundable tax credit made available to low- and moderate-income taxpayers that would allow them to offset a portion of their contribution to a retirement plan.

[5] The fallback to fundamental tax reform will be to attempt to pass legislation to simply cut marginal and other tax rates for individuals and businesses. It is likely that such a tax cut bill would be structured to sunset in 10 years. Retirement savings changes as described above may not be included in such a tax cut bill, although they could raise a significant amount of revenue and thus cannot be discounted from consideration as they could help to offset the revenue loss associated with the lowered marginal rates. It remains to be seen whether such a tax cut bill would seek, or need, offsets.

[6] However, compliance with certain of the exemptions that accompany the Fiduciary Rule is not required until January 1, 2018.

[7] https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule

[8] The applicability date for amendments to PTE 84-24 was also delayed until January 1, 2018 (but the Exemption's Impartial Conduct Standards were made applicable as of June 9). Any exemptions, or amendments to existing exemptions not specifically mentioned either in this footnote or above, that were included in the DoL's Fiduciary Rule, were made applicable as of June 9, 2017.