

Publication

03/14/2023

Client Alert: Raising the Curtain on the Next Act: SECURE ACT 2.0

Introduction

On December 29, 2022, the President signed into law the SECURE 2.0 Act of 2022 ("SECURE 2.0"). As its name suggests, SECURE 2.0 expands on actions taken by the original SECURE Act of 2019 ("SECURE 1.0"). SECURE 2.0 increases access and contribution limits to retirement plans; further extends the time participants may keep funds in a retirement plan or IRA, eases some of the administrative burdens of retirement plans, and provides additional protections for participants. This briefing outlines key provisions of SECURE 2.0 that impact existing employer-sponsored retirement plans (both defined contribution and defined benefit). In addition, this briefing addresses certain provisions that are applicable only to "Small Employers" (generally, employers with no more than 100 employees) and "new plans."

Defined Contribution Plans

(401(k), profit sharing, 403(b) and other individual account plans)

Coverage of Part-Time Employees

SECURE 1.0 included a new enrollment requirement related to certain long-term, part-time employees in 401(k) plans. In general, under SECURE 1.0 rules, employees working at least 500 hours for three

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Patricia S. Cain

Linda L. Hoseman

consecutive years would become eligible to enroll in the 401(k) plan (at least for purposes of making elective deferrals).

Effective for plan years starting in 2025, the mandatory enrollment requirements for long-term part-time employees are expanded. SECURE 2.0 extends the mandatory enrollment requirement to 403(b) plans and reduces the years of service for mandatory enrollment. Employees (who are not otherwise excludable) who work the requisite hours for two consecutive years must be allowed to enroll in the 401(k) plan or 403(b) plan.

Under SECURE 2.0, an employer still may elect not to provide matching or nonelective contributions to these long term, part-time participants. However, if they choose to provide such contributions, a year of vesting service must be provided for each year in which the employee has at least 500 hours of service.

For purposes of applying these rules, certain service is not counted. For 401(k) plans, service prior to 2021 is not counted, which means that 2024 is the first year in which eligible part-time employees must be allowed to make elective deferrals to 401(k) plans. For 403(b) plans, service prior to 2023 is not counted, which means that 2025 is the first year in which eligible part-time employees must be allowed to make elective deferrals to a 403(b) plan.

Higher Catch-up Contribution Limits

Under current law, the amount a participant may elect to defer under a 401(k) plan and 403(b) plan is higher for participants who attain age 50 by the end of the plan year. In 2023, the maximum catch-up contribution is \$7,500. Effective in 2025, SECURE 2.0 increases these catch-up contributions for individuals who are between the ages of 60-63 as of the end of the tax year. Such an

individual may elect catch-up contributions equal to the greater of \$10,000 or 150% of the regular catch-up dollar amount in effect for the year. This additional catch-up contribution is not available once a participant attains age 64. Different limits apply for SIMPLE Plans (described under the Small Employer portion of this newsletter).

Under current law, catch-up contributions may be made as elective deferrals or Roth contributions (if available) at the participant's election. Effective in 2024, it appears that SECURE 2.0 intends to change this for certain participants. If the participant's pay exceeded \$145,000 for the prior year, SECURE 2.0 provides that catch-up contributions must be made as Roth contributions. There is a technical glitch with the drafting of this provision that would actually prevent any catch-up contributions from being made in 2024 (and beyond). It is anticipated that there will be additional guidance or legislation to fix the glitch and to further clarify how the universal availability requirements for catch-up contributions might be satisfied if a plan does not permit Roth contributions (which would mean that employees who make more than \$145,000 would be ineligible for catch-up contributions).

Matching/Nonelective Contributions

In 2018, the IRS issued Private Letter Ruling 2018-33012 permitting an employer to add a student loan matching program to its plan. Under this program certain student loan repayments were treated as elective deferrals for purposes of making matching contributions under the employer's 401(k) plan. Since that time many employers have expressed an interest in setting up a similar program for their employees, but did not want to go through the process of getting their own letter ruling. As part of SECURE 2.0, effective for plan years beginning in 2024, matching contributions may be made to a 401(k) plan or a 403(b) plan on account of a participant's

qualified student loan payment. A qualified student loan payment is a payment made by an employee in repayment of a qualified education loan incurred by the employee to pay qualified higher education expenses up to the elective deferral limit for the year, less any actual elective deferrals made by the employee to a retirement plan for the year. As well, the employee must certify annually to the employer that such payment has been made on the student loan.

Another provision of SECURE 2.0 impacts both matching contributions and nonelective contributions. Effective upon enactment, a plan can be amended to allow employees to elect to receive matching and/or nonelective contributions as Roth contributions, but only if the matching and/or nonelective contribution is fully vested when contributed.

Required Minimum Distributions and Involuntary Cashouts

SECURE 1.0 increased the age for determining required minimum distributions (RMDs) from age 70½ up to age 72 for those individuals who turned age 72 on and after July 1, 2021. SECURE 2.0 further delays the age for determining RMDs until age 73 starting in 2023 for individuals who turn age 72 on and after January 1, 2023. As well, SECURE 2.0 increases the age for RMDs to age 75 starting in 2033.

Effective generally in 2024, SECURE 2.0 also provides that Roth contributions held in a plan are not subject to required minimum distributions to the participant prior to such participant's death.

Effective immediately, the penalty imposed on an individual who fails to take an RMD is reduced to 25% of the RMD and may be further reduced to 10% of the RMD

if corrected in a timely manner (as defined in SECURE 2.0).

Effective for distributions beginning in 2024, SECURE 2.0 increases the maximum amount a plan may distribute without participant consent from \$5,000 to \$7,000. A plan does not have to increase the automatic distribution amount and there are still quite a few plans that have held the mandatory cash-out to \$1,000 to avoid having to set up an individual retirement account rollover process, as required for mandatory cash-outs that exceed \$1,000.

Plan Corrections

In a legislative twist, SECURE 2.0 provides updates to the plan correction process. Previously, plan correction matters were provided in guidance from the IRS or the DOL. In SECURE 2.0, Congress has provided correction guidance related to the recovery of retirement plan overpayments as well as to expand the availability of certain corrections under the IRS's Employee Plans Compliance Resolution System (EPCRS). These provisions are effective immediately.

In the case of inadvertent overpayments, SECURE 2.0 generally permits the fiduciary to determine whether or not to pursue recovery from a participant or beneficiary. If a fiduciary chooses to recoup, SECURE 2.0 provides certain controls around the recovery process and instructs the DOL to develop further guidance. SECURE 2.0 also contains a time limit for seeking the recoupment (absent fraud or misrepresentation by the participant). If the mistaken overpayment was rolled over to an IRA or another plan, SECURE 2.0 permits the rollover account to retain the excess amount, unlike in the past where the overpayments had to be removed from the account.

With respect to EPCRS, SECURE 2.0 generally expands the availability of the correction program for some loan errors, makes permanent automatic enrollment correction provisions that were set to expire and expands the availability of self-correction to “eligible inadvertent failures” which appears to be a broader category of errors than were previously self-correctable under EPCRS.

Other Changes

One provision of SECURE 2.0 that has received a good bit of attention is the requirement that new plans must adopt an auto-enrollment feature. More information on this requirement is provided in the “new plans” section below.

Beginning in 2024, SECURE 2.0 also permits employers to add a new feature to individual account plans called a “pension-linked emergency savings account” for eligible non-highly compensated employees. This short-term emergency savings account is to be funded by Roth contributions up to the lesser of \$2,500 or an amount picked by the employer. SECURE 2.0 sets forth a number of detailed requirements for these accounts including requirements for matching contributions, withdrawals, investments and notices.

Effective in 2023, Employers may now offer small financial incentives to employees, such as gift cards in small amounts, to encourage employees to participate in the employer’s 401(k) or 403(b) plan. These financial incentives may not be paid out of plan assets.

Pension Plans

(Traditional defined benefit plans and cash balance plans)

Distribution Rules

As was described above for defined contributions plans, effective for distributions beginning in 2024, SECURE 2.0 increased the maximum amount a plan could distribute without participant consent from \$5,000 to \$7,000. A plan does not have to increase the automatic distribution amount and there are still quite a few plans that have held the mandatory cash-out to \$1,000 to avoid having to set up an individual retirement account rollover process.

As well, SECURE 2.0 changes the required minimum distribution starting age. SECURE 1.0 changed the age for required minimum distributions (RMDs) from age 70 ½ up to age 72 for those individuals who turned age 72 on and after July 1, 2021. SECURE 2.0 further delays the age for determining RMDs until age 73 starting in 2023 for individuals who attain age 73 on or after January 1, 2023. SECURE 2.0 then also increases the age to age 75 starting in 2033. A plan does not have to increase the age it requires distributions to commence to reflect the age changes in the SECURE Acts, and many defined benefit plans have chosen not to do so.

Plan Corrections

As described in the defined contribution plan section above, SECURE 2.0 provides for changes to a plan's correction process when there is an overpayment, effective immediately. When there is an overpayment from a defined benefit plan that is due to a mistake, SECURE 2.0 provides the plan administrator the ability to choose not to recoup the overpayment. If the mistaken overpayment was rolled over to an IRA or another plan, unlike in the past where the amounts had to be removed from the rollover account, SECURE 2.0 permits the IRA or other plan to retain the excess amount.

If the plan administrator chooses to recoup the mistaken overpayment, SECURE 2.0 places limits and restrictions on how that recoupment may be accomplished.

As well, immediately effective, SECURE 2.0 expands correction alternatives under EPCRS. Under SECURE 2.0, and as described in detail above, there are more errors that may be self-corrected, without seeking approval from the IRS.

Other Defined Benefit/Hybrid Plan Changes

Effective for valuation dates after 2023, SECURE 2.0 provides a cap on the future mortality improvement rates that must be taken into account for purposes of the minimum funding rules. Under this new rule, a pension plan is not required to assume beyond the plan's valuation date future mortality improvements at any age which are greater than 0.78 percent. Currently there is no such cap.

Effective for plan years beginning after December 29, 2022, SECURE 2.0 addresses the interest rates to be used to determine compliance with the "backloading" rules by a hybrid (cash balance) plan that uses a variable interest crediting rate. The backloading rules limit the ability to increase accrued benefits as an employee's service and age increase. For this purpose, the interest crediting rate that is treated as in effect and as the projected interest crediting rate must be a reasonable projection of the applicable variable interest rate, subject to a maximum of 6 percent. This is expected to permit larger pay credits for older, longer service employees.

Effective as of the date of enactment, SECURE 2.0 changes the rules for determining the amount of a plan's Pension Benefit Guaranty Corporation (PBGC) premium obligation with respect to unvested benefits. SECURE 2.0 provides a flat fee of \$52.00 for each \$1000.00 of unfunded vested benefits. Before the change, the PBGC

premium rate varied with inflation. The change helps stabilize premium payments.

Small Employers

Employers with no more than 100 employees who earned at least \$5,000 in the preceding calendar year (“**Small Employers**”) are allowed to adopt a SIMPLE IRA Plan (also called a SIMPLE Plan). The SIMPLE Plan provides for contributions by the employer and the employees to Individual Retirement Accounts. SIMPLE Plans are easier to implement and administer than traditional retirement plans, but have lower contribution limits than traditional retirement plans. SECURE 2.0 extends additional benefits to Small Employers as described below.

Military spouse retirement plan eligibility

Effective for taxable years beginning after December 29, 2022, Small Employers may receive tax credits for each military spouse it employs who is not highly compensated and participates in the employer’s defined contribution plan. To receive the tax credit, the employer must make the military spouse (1) eligible to participate in the employer’s plan within 2 months of his or her hire date, (2) immediately eligible for any matching or other employer contributions in amounts not less than such amounts received by similarly situated nonmilitary spouses with 2 years of service and (3) fully vested in any employer contributions made on his or her behalf. The tax credit may be up to \$500 for each military spouse and can be claimed for the year in which the military spouse becomes a participant and the next two years.

Additional nonelective contributions to SIMPLE plans

Employers sponsoring SIMPLE plans may make an additional contribution to their plan of up to 10% of

compensation for each employee, subject to a cap of \$5,000, effective for taxable years beginning after December 31, 2023. The contribution must be made as a uniform percentage of compensation for each employee who was paid at least \$5,000 in the preceding year.

Increase in contribution limit for SIMPLE plans

The annual deferral limit and catch-up contribution limit in SIMPLE plans is increased by 10% for employers with no more than 25 employees, effective for taxable years beginning after December 31, 2023. Employers with 26 to 100 employees also may use these higher deferral limits in their SIMPLE plans, but only if the employer makes either a matching contribution on the first 4% of compensation deferred or an employer contribution of 3% of compensation.

Extending Roth treatment to SIMPLE contributions

Effective for taxable years beginning after December 31, 2022, employees may elect to treat the IRA to which contributions are made pursuant to a SIMPLE Plan as a Roth IRA.

New Plans

Credit for startup plan costs

Small employers with up to 50 employees may be eligible for a start-up tax credit for 3 years of up to 100% of the administrative costs for starting a new plan, effective in 2023. In addition, a new credit has been added for contributions to a new defined contribution plan based on the percentage of the amount contributed by the employer for certain employees up to a per-employee cap of \$1,000. The applicable percentage is 100 percent in the first and second years, 75 percent in the third year, 50 percent in the fourth year, 25 percent in the fifth year, with no credit for taxable years



thereafter. The latter credit is phased out for employers with between 51 and 100 employees.

Starter 401(k) or 403(b) plan

Beginning in 2024, an employer that does not sponsor a retirement plan may offer a starter deferral-only 401(k) plan or safe harbor 403(b) plan that would not be subject to the nondiscrimination and top-heavy requirements that would otherwise apply. The plan must generally require all employees to be automatically enrolled in the plan at a 3 to 15 percent of compensation deferral rate, unless an employee opts out or elects a different deferral rate. An annual deferral limit of \$6,000, with an additional \$1,000 for catch-up contributions, would apply to the plan. These deferral limits are subject to cost-of-living adjustment beginning after December 31, 2024.

Automatic enrollment

Effective for plan years beginning after December 31, 2024, each new 401(k) or 403(b) plan established after December 28, 2022 is required to automatically enroll employees to make elective deferrals to the plan, unless the employee opts out or elects to defer at a different rate. The initial automatic enrollment deferral rate must be at least 3 percent and not more than 10 percent of compensation. The plan must also automatically increase the deferral rate by 1 percent each year until the deferral rate reaches at least 10 percent and not more than 15 percent of compensation.

SIMPLE Plans, church plans, governmental plans, employers with 10 or fewer employees and employers that have been in business for less than 3 years are exempted from this automatic enrollment requirement.

If you have any questions regarding the SECURE ACT 2.0, please contact Patty Cain, Linda Hoseman, Andrew



Douglass, Jeff Bakker or your Neal Gerber Eisenberg attorney.