

SECURE 2.0 Means Change Is Coming For Retirement Plans

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On March 29, the U.S. House of Representatives passed the Securing a Strong Retirement Act of 2022, or SECURE 2.0, on a bipartisan basis, 414-5.[1]

SECURE 2.0 builds on the Setting Every Community Up for Retirement Enhancement Act, which was signed into law in December 2019 to improve retirement savings opportunities for workers.[2]

Many of SECURE 2.0's provisions are designed to increase defined contribution retirement plan enrollment over time. According to March 2020 data issued by the U.S. Department of Labor, 64% of employees in the private sector have access to a defined contribution plan, but only 47% choose to participate by deferring compensation.[3]

There is concern that many Americans are putting their retirement in jeopardy by not appropriately saving for retirement early in their careers, and so, SECURE 2.0 seeks to increase access and participation.

Of note, SECURE 2.0 includes provisions providing for the automatic enrollment of employees in certain plans, making it easier for participants with student loans to accumulate retirement savings, and increasing the age at which participants are required to begin receiving mandatory distributions.

By way of background, SECURE 2.0 includes most provisions from a prior version of the bill approved by the House Committee on Ways and Means and the Retirement Improvement and Savings Enhancement Act,[4] similar legislation cleared by the House Committee on Education and Labor last November.

On March 30, SECURE 2.0 was sent to the U.S. Senate. The Senate Committee on Health, Education, Labor and Pensions and the Senate Committee on Finance are now working on SECURE 2.0 proposals. While we expect changes in the Senate version of the act, it is widely anticipated that the Congress will approve a final SECURE 2.0 package this year.

Below is a summary of certain key provisions in the House-passed version of SECURE 2.0 that could



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serve to change the landscape regarding retirement savings in years to come.

Required Automatic Enrollment and Escalation for New Retirement Plans

Beginning in 2024, new 401(k) plans and 403(b) plans will be required to include automatic enrollment and contribution escalation features, and opt-out would be permitted. Plans established before the enactment of SECURE 2.0, along with small employers with fewer than 10 employees, new employers in business less than three years and sponsors of governmental and church plans, would be exempt from these rules.

Plans subject to these requirements would have to auto-enroll new participants at a deferral rate between 3% and 10%, with an auto-escalation provision of 1% annually up to a specified cap. A 15% cap would apply to safe harbor automatic contribution arrangements. A 10% cap — 15% after 2024 — would apply to non-safe harbor arrangements.

Auto-enrolled amounts for which no investment elections are made would be invested in qualified default investment alternatives, consistent with Department of Labor regulations regarding investments. These potential mandatory legal changes are specifically designed to increase plan enrollment for those private employers who sponsor a defined contribution plan.

Relatedly, because auto-enrollment increases participant deferral rates, the changes will increase the aggregate costs of any employer matching contribution formula. Accordingly, plan sponsors may consider reviewing their matching formulas to determine the financial impact of an increase in employee deferrals.

While the goal of the bill's changes is to increase retirement savings, for some employees the impact will be to further shift the cost to the employees themselves, as a result of reduced matching contribution rates.

Changes to Required Minimum Distributions

SECURE 2.0 would increase a participant's required minimum distribution, or RMD, start date from the current age of 72 — increased from 70 1/2 by the original SECURE Act — to age 73 in 2023, age 74 in 2030 and age 75 in 2033. Further, beginning in 2023, the excise tax for failure to take an RMD would decrease from 50% to 25%.

Some critics view this provision as favoring wealthier retirees, who can avoid withdrawing from retirement until later. However, in a recent opinion piece in the Hill, Cindy Hounsell, the president of Women's Institute for a Secure Retirement, argued that this is a helpful change to the many Americans who will need to continue working into their 70s.[5]

In other words, this provision could help those participants who did not start saving early. Additionally, with increases in life expectancy, increases in cost of living and questions on the adequacy of Social Security, many participants who are not wealthy will benefit from the flexibility of delaying withdrawals on their retirement savings.

Further, plan sponsors already struggle to locate all participants approaching the date they are required to start receiving RMDs. Delaying the date by which RMDs must commence will provide additional administrative flexibility to avoid plan qualification errors.

Changes to Catch-Up Contributions

Beginning in 2023, the catch-up contribution amount for 401(k) and 403(b) plans would increase to \$10,000 — currently \$6,500 — for eligible participants who will be at least age 62 but less than age 65 by the end of the applicable tax year.

Further, beginning in 2023, participants age 50 or older could only make catch-up contributions on an after-tax Roth basis. This too is a provision that is designed to help those Americans who did not start saving early for retirement or consistent with many Americans financial trajectory will provide further opportunities to save for retirement when they are more financially stable and at a time when they still have years of employment ahead.

Treatment of Student Loan Payments as Elective Deferrals for Purposes of Matching Contributions

For plan years beginning after Dec. 31, 2022, SECURE 2.0 would allow employers to amend their 401(k) and 403(b) plans to make matching contributions to employees based on an employee's qualified student loan payments.

Qualified student loan payments are defined in SECURE 2.0 as amounts in repayment of qualified education loans as defined in Section 221(d)(1) of the Internal Revenue Code. This student loan matching concept is not new; the IRS has approved student loan repayment matching contributions in a 2018 private letter ruling.^[6]

Given the amount of outstanding student loan debt in the U.S., this permissive provision of SECURE 2.0 may be well received by employees, and serves to address the concern that employees are not saving for retirement early enough in their respective careers.

Following the private letter ruling, many plan sponsors looked at opportunities to address student loans through their 401(k) and 403(b) plans. Many, however, found the lack of definitive statutory support a barrier to move forward. SECURE 2.0 should lead to an uptick in these programs.

Small Immediate Financial Incentives for Contributing to a Plan

Historically, under the contingent benefit rule, benefits other than matching contributions generally may not be contingent on the employee's election to defer. SECURE 2.0 would add an exception to this restriction and allow employers to offer de minimis financial incentives — e.g., gift cards — to encourage employees to participate in a 401(k) or 403(b) plan.

SECURE 2.0 does not include a monetary threshold for de minimis financial incentives. Again, SECURE 2.0 is designed to help employers incentivize workers to contribute to the applicable defined contribution plan.

We would suggest that matching contributions already serve as an incentive to participate in a defined contribution plan and these matching contributions will increase for certain plan sponsors as a result of expanded auto-enrollment. It is unclear whether plan sponsors will offer current incentives to increase participation and thereby also increase the costs of matching contributions.

Plan sponsors should look at these provisions together — based on what's required and what's

permissive — to study the financial impact on their defined contribution programs.

Expanded Coverage of Long-Term, Part-Time Workers

SECURE 2.0 includes a provision designed to increase retirement plan coverage for long-term, part-time employees. The act would require 401(k) and 403(b) plans that are not offered pursuant to a collective bargaining arrangement to expand eligibility to part-time workers once a worker has completed at least 500 hours of service in two consecutive years (reduced from three years) and has attained age 21.

Pre-2021, service would not be taken into consideration. Plan sponsors may, however, choose to impose lesser service requirements. This change would help to increase access to defined contribution plans, which is important as more people piece together employment in a gig-based economy.

Of all the provisions in SECURE 2.0, plan sponsors may struggle with this provision the most. It will require more diligent tracking of hours of service and potentially apply to certain employees with a limited nexus to the plan sponsor.

Recovery of Retirement Plan Overpayments

SECURE 2.0 would give retirement plan fiduciaries more latitude to decide whether to recoup certain inadvertent overpayments made from retirement plans. The purpose behind this change is to reduce the clawback of overpayments from retirement plans to retirees and to prevent the fixed income of retirees from being diminished.

Plan fiduciaries would be prohibited from recouping overpayments from a participant or fiduciary if the first overpayment occurred more than three years before the participant or beneficiary first received written notice of such overpayment, provided the participant or beneficiary is not culpable for the overpayment.

Without this change in law, a plan fiduciary is legally required to seek return of an overpayment, which undoubtedly put the plan fiduciary in an awkward position. This change would make it easier for the fiduciary to administer the plan. It will also avoid demand letters to retirees for repayments that cause unnecessary stress for the retirees and were only sent by the plan fiduciaries because of a fiduciary obligation.

Safe Harbor for Corrections of Elective Deferral Failures

SECURE 2.0 expands the Self-Correction Program under the IRS' Employee Plans Compliance Resolution System and adds a permanent safe harbor for elective deferral failures. SECURE 2.0 would give plans 9 1/2 months after the last day of the plan year in which elective deferral failures occurred to correct, without any penalty, reasonable errors in administering automatic enrollment and escalation features.

Like the change described above regarding recovery of retirement plan overpayments, this change is designed to make it easier for plan sponsors and plan administrators to operate a retirement plan, such that common errors can be corrected without huge risk to the plan, plan sponsor and/or plan fiduciary. Lessening the burdens of sponsoring and administering a plan may result in more employers being willing to sponsor defined contribution plans thereby increasing access.

Conclusion

As mentioned above, SECURE 2.0 sets the stage for numerous mandatory and optional changes to defined contribution retirement plans. Plan sponsors and administrators should follow SECURE 2.0 as it moves through the Senate to prepare for how to amend defined contribution retirement plans in light of the likely changes to the law.

As discussed, while the goal of SECURE 2.0 is to increase retirement savings, it will also increase the cost of retirement programs for many plan sponsors. Plan sponsors can begin to model the impact of the changes on their retirement programs so that they can design and implement a compliant program that takes advantage of the additional flexibility but without increasing costs beyond what is budgeted for their retirement program.

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[1] <https://www.congress.gov/117/bills/hr2954/BILLS-117hr2954eh.pdf>

[2] <https://www.govinfo.gov/content/pkg/PLAW-116publ94/pdf/PLAW-116publ94.pdf#page=605>

[3] See U.S. Department of Labor, National Compensation Survey: Employee Benefits in the United States, March 2020 (Sept. 2020), available at <https://www.bls.gov/ncs/ebs/benefits/2020/employee-benefits-in-the-united-states-march-2020.pdf>.

[4] <https://www.congress.gov/117/bills/hr5891/BILLS-117hr5891ih.pdf>

[5] Cindy Housell, SECURE 2.0 will advance women's retirement security, The Hill (Apr. 2022). <https://thehill.com/blogs/congress-blog/3273570-secure-2-0-will-advance-womens-retirement-security/>

[6] <https://www.irs.gov/pub/irs-wd/201833012.pdf>