What Retirement Plan Sponsors Need to Know About SECURE 2.0

Legislation to boost savings and access is likely this year.

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KEY INSIGHTS

- Federal legislation that would substantially impact retirement plan sponsors, service providers, and plan participants appears likely by year-end.
- Although the contours of a final bill still need to be refined, certain provisions are likely to be included in enacted legislation, dubbed "SECURE 2.0."
- It is not too early for plan sponsors to begin preparations. There are steps that plan sponsors may want to consider now and when legislation becomes reality.

This year is likely to see the culmination of efforts to advance comprehensive federal legislation designed to boost retirement savings and broaden access to defined contribution (DC) plans—a project that has brought together members from both sides of the congressional aisles at a time when partisan rancor on other issues is high.

While Congress is unpredictable and any number of unanticipated events potentially could derail passage, we see several signs that enactment of comprehensive retirement legislation is likely before year-end. Well-developed proposals already have been crafted, and several congressional champions of U.S. retirement policy, including Sen. Rob Portman (R-OH) and Rep. Kevin Brady (R-TX), are about to leave Congress. We believe these lawmakers will want to make a successful bill part of their legacies.

Although the pending legislation is popularly known as SECURE 2.0 (a reference to the original SECURE Act, a package of retirement measures passed by Congress in 2019), the final bill is likely to combine provisions from three different pieces of legislation:

- the House-passed Securing a Strong Retirement Act of 2022 (SSRA);
- The Enhancing American Retirement Now Act (EARN), which has been approved by the Senate Finance Committee; and
- the Retirement Improvement and Savings Enhancement to Supplement Healthy Investments for the Nest Egg Act (RISE & SHINE), a bill approved by the Senate Health, Education, Labor, and Pensions Committee.

The details of final legislation will be negotiated by key House and Senate stakeholders. However, we have identified a number of provisions that we believe are likely to be included. We

discuss these provisions below and also highlight some important distinctions among the three bills. While we have no crystal ball, we assume the final legislation will include provisions that appear in at least two or in all three of the proposals, as well as the measures seen by lawmakers as being most politically important.

Automatic Enrollment and Automatic Increase

All three proposals provide for an increased use of automatic enrollment and automatic contribution increases in DC plans. However, each bill approaches the issue differently. The SSRA requires that most new plans provide for both automatic enrollment and automatic increases. In contrast, RISE & SHINE requires reenrollment every three years for all automatic enrollment plans.

EARN does not mandate automatic enrollment or reenrollment but provides for a new safe harbor plan design called a secure deferral arrangement (SDA) that incorporates automatic enrollment and automatic increase features. Under an SDA, plan participants would start by contributing between 6% and 10% of salary in the first year, with deferrals increasing by one percentage point a year until the annual contribution equals 10% of salary. This safe harbor would require a stretch match equivalent to just under 5% of salary by the time the participant reached the 10% deferral level.

Catch-Up Contribution Limits

We believe the final version of SECURE 2.0 is likely to increase catch-up contribution limits to DC plans for certain individuals over age 50 to $10,000 from the 2022 level of $6,500 (indexed for inflation). However, the three bills vary as to whether individuals between the ages of 60 and 63 would be able to take advantage of this increase, or whether it would be limited to those between ages 62 and 64.

Because of the need to raise revenue to offset tax expenditures that are likely to be included in the legislation, SECURE 2.0 likely will require all catch-up contributions to be treated as Roth contributions (i.e., taxed at the time of contribution; however, contributions and earnings are tax-free if included in a "qualified distribution").[1] A companion revenue-raiser provision would allow employers to make matching contributions as Roth contributions should they so choose.

Depending on which catch-up proposal ends up in the final bill, there is a possibility that mandatory Roth treatment will be limited to plan participants who have more than $100,000 in adjusted gross income (AGI) for the prior year. Roth treatment of catch-up contributions is likely to be one of the more difficult SECURE 2.0 provisions for plans and service providers to administer, especially if the requirement is conditioned on prior-year AGI.

403(b) Plans and Collective Investment Trusts

Today, federal securities laws and tax laws both contain provisions that make it impossible for 403(b) plans to offer collective investment trusts (CITs), which typically are priced lower than comparable mutual funds. All three of the pending congressional proposals contain tax law changes that would allow 403(b) plans overseen by fiduciaries to invest in CITs, and our understanding is that congressional staffers are confident that the necessary changes to securities laws also will be made.

By allowing more individuals access to institutionally priced investments, we believe SECURE 2.0 would help improve

[1] A qualified distribution is tax-free if taken at least 5 years after the year of a participant's first Roth contribution *and* they have reached age 59½, become totally disabled, or died. If the distribution from a Roth account is not qualified, the earnings on Roth contributions will be taxable. These rules apply to Roth distributions only from employer-sponsored retirement plans. Additional plan distribution rules may apply.

the ability of 403(b) plan participants to meet their financial needs in retirement.

Saver's Tax Credit

While it is not critical to plan administration, one hot-button political issue potentially could jeopardize passage of legislation this year. The final bill is likely to expand eligibility for the saver's credit—tax credits provided to individuals who have contributed to a DC plan or an individual retirement account (IRA)—and increase the credit percentage for many taxpayers. This isn't controversial. What is controversial is a proposal in the EARN Act to make the credit refundable so long as the money is paid into an IRA or a plan willing to accept such contributions. In order for SECURE 2.0 to advance, this divide will need to be closed.

Student Loan Repayment Matches

SECURE 2.0 is likely to allow 401(k), 403(b), and governmental 457(b) plans to provide for employer matching contributions when participants certify that they have repaid a student loan. Matching contributions for student loan repayments would be subject to the same rules (and contribution caps) as matching contributions for elective deferrals, although the timing for making matching contributions could vary. Unlike a prior private letter ruling issued by the Internal Revenue Service (IRS) on a similar theme, SECURE 2.0 would protect plans from nondiscrimination testing challenges when they provide a plan benefit attributable to student loan repayments.

- The EARN Act would allow an individual to withdraw up to $1,000 each year to defray emergency expenses based on the individual's simple certification of need. Amounts withdrawn for emergencies could be repaid to the plan from which they were taken or to an IRA within three years.
- The RISE & SHINE Act would create a pension-linked emergency savings account, a more complex structure that would allow individuals to contribute up to $2,500 annually on an after-tax basis to an emergency savings account within the plan. The bill also would allow both automatic enrollment and employer after-tax contributions. Individuals would be able to withdraw from the emergency savings account upon certification of need. After the first year, contributions to an individual's emergency savings account would be limited to the amount necessary to return the account to a balance of $2,500. Amounts not used before the participant terminated employment would be distributed or converted to Roth contributions.

We believe both of these emergency savings proposals are highly likely to be included in the final legislation.

Financial Incentives for Participation

Today, providing financial incentives to participate in a 401(k) or 403(b) plan is forbidden. We believe the final version of the SECURE 2.0 legislation is likely to address behavioral impediments by allowing employers to provide small financial incentives to individuals for plan participation. However, the legislation is likely to leave the specifics of what constitutes a "small" incentive to federal regulators.

Broadening Plan Access

The original SECURE Act for the first time required that part-time employees with over 500 hours of service for three consecutive years be allowed to make salary deferrals to their employers' 401(k) plans. Plans were required to allow long-term, part-time individuals to participate by January 1, 2024. SECURE 2.0 is likely to shorten that service requirement to two years, accelerating the earliest eligibility date for long-term, part-time individuals to January 1, 2023. We also expect the final legislation to subject 403(b) plans to the same rule.

SECURE 2.0 also is likely to address a glitch in the original SECURE Act

that allowed more generous vesting provisions for part-time employees by counting service years prior to the effective date of the original act for vesting.This provision also is highly likely to be effective on January 1, 2023.

Improving MEPs and PEPs

The original SECURE Act introduced pooled employer plans (PEPs) to the plan-design universe, and SECURE 2.0 is likely to provide modest fixes to that legislation by clarifying that trustees can delegate to others the responsibility to collect contributions from participating employers. The legislation is also likely to clarify that 403(b) plans are eligible to participate in both multiple employer plans (MEPs) and PEPs.

Provisions for Small Employers

We expect the final version of SECURE 2.0 to provide additional incentives for small employers to maintain effective retirement plans by increasing the start-up credit for employers with 50 or fewer employees and by clarifying that joining a MEP or PEP for the first time makes an employer eligible for the credit. Various proposals could add additional small-employer incentives, such as an enhanced credit for providing an employer match, adopting an SDA, or including auto-portability programs.

SECURE 2.0 is also likely to address a common problem faced by military spouses who frequently transfer from location to location, by providing an additional credit to small-employer plans willing to accelerate eligibility and vesting for non-highly compensated military spouses.

Retirement Asset Retention

We expect the final legislation to include measures designed to encourage retirement savers to keep assets in their plans and accounts longer but also some provisions that could increase leakage of those assets. Two of the three SECURE 2.0 bills—SSRA and EARN—would raise the mandatory age for beginning to take required minimum distributions (RMDs) to 75 from the current 72. However, the proposals vary on the details of this change:

- SSRA proposes that the increase occur in stages, starting at age 73 and rising to age 75 for those who reach that age in 2033.
- EARN would bump the mandatory age directly to age 75 for those reaching that age in 2032.

EARN also creates another avenue for retaining assets, by exempting Roth accounts in plans from RMD requirements before the death of the participant.

EARN specifically authorizes plans to use auto-portability features and, as noted above, provides a tax credit to small employers that adopt an auto-portability program. Under these programs, a former employee's plan balance that otherwise would be subject to small-balance distribution is automatically transferred to their new employer's plan, unless the employee affirmatively elects to have the balance remain with the prior employer.

On the other hand, some SECURE 2.0 provisions—such as rules expanding the availability of in-service distributions—could increase plan leakage. One change would make the hardship withdrawal rules for 403(b) plans comparable to the current rules for 401(k) plans by allowing hardships to be taken from earnings on salary deferrals as well as from employer contributions and earnings on those contributions.

SECURE 2.0 is also likely to allow penalty-free distributions of up to $10,000 to victims of domestic abuse upon a plan's receipt of certification from the affected individual. (These distributions, as well as distributions for qualified births and adoptions, would be repayable to the plan or to an IRA within three years.)

Finally, SECURE 2.0 is likely to bring private sector firefighters into parity with their public sector colleagues by

allowing penalty-free distributions from DC plans and IRAs at age 50. EARN would add additional penalty-free distributions for corrections officers age 50+ with 25 years of service participating in governmental plans, for terminally ill participants, and for qualifying "high-quality" long-term care insurance premiums up to $2,500 annually.

Support for Annuitization

The final SECURE 2.0 legislation is likely to include various small improvements that will make annuitization easier. For example, we expect it to remove impediments to certain popular features in commercial annuities, such as modest uniform increases in payments, return of premium death benefits, and receipt of dividends on participating annuities. We also expect SECURE 2.0 to increase the amount of a plan account that could be used to purchase a qualified longevity annuity contract (QLAC) by removing the current provision limiting premiums to no more than 25% of the balance. If the EARN proposals are adopted, SECURE 2.0 would increase the dollar amount of the fixed premium limit to $200,000.

Finally, if EARN is adopted, provisions that discourage partial annuitization also would be ameliorated. Today, if an individual chooses to partially annuitize their retirement plan or account, RMDs continue to be assessed against the non-annuitized portion. SECURE 2.0 would allow both the annuity and the plan from which it was sourced to be combined for purposes of satisfying the RMD requirements.

Streamlining Plan Administration

We expect SECURE 2.0 to include provisions that would help streamline retirement plan administration and lessen the impact of good faith missteps. Increasing small-balance cash-out limits (to either $6,000 or $7,000, depending on which version makes it into the final bill) would raise the amount that plans could treat as eligible for automatic rollover to an IRA provider unless the participant takes a distribution.

Another SECURE 2.0 provision that we believe would help streamline retirement plan administration is a proposal to eliminate the requirement to provide certain notices to eligible nonparticipating employees, so long as they are alerted annually of their right to participate. Federal regulators also would be instructed to study whether current notices and disclosures could be improved, eliminated, or combined.

In addition, plans would be allowed to use a custom benchmark for target date funds in participant fee disclosures, the overpayment remediation process would be reformed to remove the requirement that overpaid amounts be collected from recipients, self-certification of hardship withdrawals would be authorized, and the first-day-of-the-month rule for deferral elections in 457(b) plans would be eliminated.

Other proposals include the creation of a starter 401(k) or simplified 403(b) plan that would allow an employer to have a plan with a uniform contribution percentage (between 3% and 15%) for almost all employees where contributions are limited to the IRA contribution limit. Plans would also be allowed additional time (until the employer's income tax return is due) to amend a plan retroactively so long as that amendment increased benefits.

SECURE 2.0 is also likely to lower the cost of missteps in retirement plans and accounts. The IRS's Employee Plans Compliance Resolution System (EPCRS) would be expanded to allow self-correction of virtually all inadvertent errors, including streamlined corrections for errors in automatic enrollment and automatic increases. EPCRS also would be extended to IRAs. RMD penalties, meanwhile, would be reduced.

On the other hand, it appears that certain SECURE 2.0 proposals could add some complexity and cost to retirement plan administration. SSRA includes one of the most controversial provisions under discussion, which

would require that plans provide participants with one annual paper benefit statement. SSRA also would require substantial additional disclosures in addition to the paper statement. We believe the final legislation is likely to require both annual paper benefit statements and the additional disclosures.

All three versions of the SECURE 2.0 legislation contain some provisions designed to help connect participants to earned balances in cases where they have lost track of them, primarily by establishing a registry of individuals who have balances at plans maintained by prior employers. SSRA would require ongoing reporting on those with deferred vested amounts so that the registry could help individuals locate their benefits. EARN would require that small balances (amounts of $1,000 or less) cashed out of plans be transferred to the regulator overseeing the registry. The RISE & SHINE Act contemplates a registry overseen by the Department of Labor. EARN includes a registry overseen by the IRS.

Effective Dates

Unlike with the original SECURE Act, Congress appears mindful of the challenges that rapid implementation of SECURE 2.0 provisions could pose for plan administration. However, we expect that some changes will have immediate or near immediate effective dates. Figure 1 shows the effective dates in EARN (the most recently introduced bill) for the most impactful provisions for plan sponsors.

Key Takeaways for Plan Sponsors

Assuming that the effective dates for key SECURE 2.0 provisions are essentially the same as those shown in Figure 1, we believe it isn't too early to begin preparing for the new legislation. There are a number of steps that we think plan sponsors may want to consider, both now and as SECURE 2.0 becomes a reality.

- Employers with previously excluded long-term, part-time employees may want to prepare to welcome those workers into the plan for salary deferrals by January 1, 2023.
- 403(b) plan sponsors may want to consider whether CITs could be appropriate for their plan and evaluate potential changes to the hardship distribution rules.
- Plans that offer hardship distributions may want to investigate a prompt switch from substantiation of hardships to self-certification.
- Plans may want to halt the distribution of unnecessary notices to eligible unenrolled participants and, instead, substitute an annual notice of eligibility to participate.
- Plans may want to review how they currently administer catch-up contributions and get ready to treat catch-up contributions as Roth deferrals by January 1, 2024.
- Developing a communications plan now could help plans quickly alert participants (especially those at or near retirement) to any upcoming changes to the mandatory age for beginning to take RMDs.
- Plans may want to evaluate whether optional features that may be included in the legislation (such as an SDA safe harbor, student loan matches, small financial incentives for participation, new in-service distributions, and new in-plan emergency savings) are right for them.
- Even if not required or otherwise necessary for a tax credit, plans also may want to consider whether auto-portability or auto-reenrollment is appropriate for them.
- Plans should be prepared to revisit their preparations when and if a final version of SECURE 2.0 passes to determine whether items on their lists should be moved or eliminated or if new items should be added.

A SECURE 2.0 Timetable

(Fig. 1) Effective Dates in the EARN Act

Upon Enactment or in 2023	2024	2025 or Later
403(b) plan eligibility for CIT investment	Student loan repayment match	Higher beginning age for RMDs
Long-term, part-time eligibility acceleration	Mandatory Roth treatment for catch-up contributions	Mandatory automatic reenrollment for automatic enrollment plans
Expanded 403(b) hardships	Automatic enrollment enhancements	Higher catch-up contributions at certain ages
Self-certified hardships	$1,000 emergency withdrawals	
QLAC premium increases and annuity enhancements	Increased limit for small-balance account distributions	
Pension-linked emergency savings	Annual paper benefit statements	
Small financial incentives for plan participation		
Many small-employer credit enhancements		
Elimination of the first-day-of-the-month rule for 457(b) plans		

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