Multiemployer Benefit Plans Alert

SECURE 2.0 ACT : IMPLICATIONS FOR DEFINED CONTRIBUTION PLANS | FEBRUARY 2023

On December 29, 2022, the "Securing a Strong Retirement" Act (the "SECURE 2.0 Act" or "Act") was signed into law by President Biden as part of the Consolidated Appropriations Act, 2023. The Act was intended to address some of the difficulties Americans face when saving and investing for retirement and is 120 pages long with 90 sections. This memorandum outlines a number of important changes made by the Act, and the impact those changes will have on <u>multiemployer defined contribution plans</u>. We hope that this summary of the Act is helpful to you, and we will be prepared to discuss any questions you might have.

A. ***Section 101 - Automatic enrollment required for "new" 401(k) plans – REQUIRED FOR NEW 401(k) PLANS.***

- The Act mandates that "new" 401(k) plans (meaning a defined contribution plan that *first establishes* a cash or deferred (401(k)) arrangement after the Act's enactment date, which was December 29, 2022) must provide for automatic enrollment of eligible employees at a 401(k) contribution rate between 3% and 10% per year, with an automatic contribution increase of 1% per year up to a maximum of at least 10%, but no greater than 15%. Eligible employees can opt-out of these automatic contributions if they so elect.

- Defined contribution plans that had a 401(k) feature in place as of December 28, 2022 <u>do NOT need to comply with these new automatic enrollment requirements</u>.

<u>EFFECTIVE DATE</u>: With respect to any defined contribution plan that first implements a 401(k) arrangement on or after December 29, 2022, the automatic enrollment requirement is effective for plan years beginning on or after January 1, 2025.

<u>OTHER CONSIDERATIONS</u>: For Funds that do <u>not</u> offer a 401(k) arrangement now, this will add further complexities in the event a Fund would like to add this arrangement, as assistance from the Fund's contributing employers will be absolutely critical to ensure compliance with the automatic enrollment rules. Specifically, the Fund's contributing employers will need to report new employees to the Fund Office, provide 401(k) election forms to employees, return them to the Fund Office, etc. Our expectation is that the collective bargaining agreement governing the Fund would outline the responsibilities of the contributing employers to provide clarity on this topic.

B. ***Section 107 – Further changes to required minimum distributions – REQUIRED.***

- Under the SECURE Act of 2019, §401(a)(9) of the Internal Revenue Code (Code) was modified to increase the age at which "required minimum distributions" or "RMDs" must begin. The prior age was 70.5, and the SECURE Act of 2019 increased that to age 72 for those born on and after July 1, 1949.

- The Act makes further changes to the RMD rules. Specifically, for a person who both reaches age 72 after December 31, 2022 <u>and</u> age 73 before January 1, 2033, the RMD age is increased to 73. In addition, for an individual who attains age 74 after December 31, 2032, the RMD age is further increased to 75.

<u>EFFECTIVE DATE</u>: The change in RMD age applies to all retirement plans (both defined benefit and defined contribution), and is effective for distributions under Code §401(a)(9) which take place on or after January 1, 2023, with respect to individuals who attain age 72 after that date.

<u>OTHER CONSIDERATIONS</u>:

✓ For those who previously attained age 70.5, OR age 72 (based on earlier changes made by the SECURE Act of 2019), prior to January 1, 2023, their required beginning date has locked in (age 70.5 or 72, as applicable) and any future RMDs must be made as scheduled.

✓ Multiemployer defined contribution plans will need to update their systems to account for four distinct "tracks." Specifically, those who have already reached their required beginning dates under the age 70.5 rule and the age 72 rule, as well as those individuals who have not yet reached their required beginning dates and who fall under either the new age 73 rule or the age 75 rule. This change will also impact certain distributions that are eligible for direct rollover treatment, as RMDs are <u>not</u> eligible to be rolled over.

✓ Please note that these changes *do not* modify the rule that RMD payments must initially begin by April 1st of the calendar year following the calendar year in which the participant reaches their applicable RMD age.

C. ***Section 109 - Catch-up contribution limit increased for ages 60 to 63 – REQUIRED IF CATCH-UPS ALLOWED.***

- For Funds which have a 401(k) arrangement, those arrangements normally allow "catch-up" contributions for older participants. For 2023, the normal 401(k) deferral limit is $22,500, but for those who have attained at least age 50, or who will attain at least age 50 by the end of 2023, further "catch-up" contributions of up to $7,500 may be made.

- The Act increases age-based catch-up contribution limits for individuals ages 60- 63. The otherwise applicable catch-up limit for participants in this age group will increase to the *greater of* $10,000 or 150% of the regular catch-up amount in 2024.

- Increases to the age-based catch-up contribution limit amounts will be indexed to inflation beginning in 2026.

EFFECTIVE DATE: Effective for taxable years beginning on or after January 1, 2025.

OTHER CONSIDERATIONS: Please note that under Section 603 of the Act (discussed below in T.), catch-up contributions made on and after January 1, 2024, could potentially be bifurcated. For those participants who earn $145,000 or less in annual compensation (indexed) from their contributing employer(s) in the prior year, these catch-up contributions may still be made on a pre-tax basis, just as "normal" 401(k) contributions are made now. However, for those participants who earn above that threshold (greater than $145,000), such catch-up contributions are only allowed on a post-tax (i.e., Roth) basis.

D. ***Section 115 – Hardship withdrawals for certain emergency expenses – OPTIONAL.***

- Code §72(t) generally imposes a 10% excise tax on any early distributions from qualified retirement plans. The Act creates a new exception under Code §72(t) for certain distributions used to satisfy an unforeseeable or immediate financial need that is related to a "personal or family emergency expense." The new exception permits only one such distribution per calendar year, of up to $1,000, and the participant has the option to repay this distribution within 3 years. Note that if the distribution is not repaid during the 3-year repayment period, no further emergency distribution will be allowed during that time.

EFFECTIVE DATE: Effective for "personal or family emergency expense" distributions made on or after January 1, 2024.

OTHER CONSIDERATIONS: While the Act does not address this, we are assuming that the IRS will expand its hardship withdrawal regulations to expressly authorize this new rule. This assumption flows from the fact that participants would be allowed to "self-certify" that they have an unforeseen or immediate financial need for a personal or family emergency expense, and another provision in the Act (Section 312, discussed later) allows participants to "self-certify" to any hardship withdrawal. This new rule may have some appeal for Funds that allow hardship withdrawals, as it would allow withdrawals to cover unexpected bills or expenses. The one drawback, in our view, is that the $1,000 maximum amount for such a distribution seems low.

E. ***Section 125 - Updated eligibility rules for part-time employees who participate in defined contribution plans with 401(k) arrangements – REQUIRED.***

- The SECURE Act of 2019 generally prohibited a defined contribution plan with a 401(k) feature from utilizing a service-based exclusion applicable to employees who have completed at least three (3) consecutive 12-month periods of service, with at least 500 hours of service in each of those 12-month periods (and who are at least age 21).

- The Act reduces the three consecutive 12-month period of service rule for those with at least 500 hours of service down to two (2) consecutive years. The Act also provides that pre-2021 service is disregarded for eligibility and vesting purposes.

- As before, the Act contains an exception for collectively bargained employees, and collectively bargained employees are not subject to these modified eligibility rules for part-time (500+ hour) employees.

<u>EFFECTIVE DATE</u>: Effective in plan years beginning on or after January 1, 2025. The clarification regarding the exclusion of pre-2021 service for vesting purposes is effective as if it were part of the 2019 SECURE Act, meaning it is effective for plan years beginning on or after December 31, 2020.

<u>OTHER CONSIDERATIONS</u>:

✓ Although this provision of the Act has an exception for collectively bargained employees, this provision *might* be implicated in situations where an Annuity or Supplemental Retirement Fund has a 401(k) feature which: (1) covers certain non-collectively bargained groups (e.g., employees who work in the Fund Office, or employees who work for the sponsoring Local Union(s)), and (2) allows employees of such group(s) to make 401(k) deferrals of their compensation.

✓ Based on the change made by the Act, plan sponsors should determine whether their plan documents and/or participation agreements need to be modified to cover those non-collectively bargained employees who complete two (2) consecutive 12-month periods with at least 500 hours of service in each of those 12-month periods.

F. ***Section 127 - Emergency savings accounts – OPTIONAL.***

- The Act allows, but does not require, a defined contribution plan to be amended to offer "emergency savings accounts" or "ESAs" to participants who are not "highly compensated employees" or "HCEs" as defined by the IRS. Under current IRS rules, a participant is deemed to be "highly compensated" if he or she earns in excess of $150,000 in 2023.

- The provision permits a plan sponsor to automatically enroll participants into an ESA at a 3% contribution rate, or the plan sponsor may merely offer participants the opportunity to make contributions into such an ESA. It is critical to note that:

  (1) any contributions made into an ESA *must be made by the participant through a 401(k) arrangement* (i.e., <u>normal employer contributions to an ESA are not permitted</u>),

  (2) such contributions must be made on a post-tax (Roth) basis,

  (3) the overall ESA limit for any participant is $2,500 (indexed) or any smaller amount set by the plan sponsor, and

  (4) contributions made to an ESA will "count" toward the normal 401(k) limit ($22,500 for 2023, as discussed earlier).

- Assuming an ESA is adopted, participants must be allowed to take at least one withdrawal per month, and the first four withdrawals must not be subjected to fees solely on the basis of such a withdrawal.

EFFECTIVE DATE: Effective for plan years on or after January 1, 2024.

OTHER CONSIDERATIONS: We see a number of potential headaches with establishing an ESA for Funds which already have a 401(k) arrangement. First, the Act requires ESA contributions to be segregated and invested in a manner that is *different* than normal employer and/or 401(k) contributions. Specifically, the Act says that such an ESA must be invested in cash, in an interest-bearing deposit account, or in an investment account which is designed to maintain the value of the contributions made to it over time. Further, with respect to the creation of an ESA, an initial notice must be provided to any participant who makes his or her first ESA contribution, and an annual notice must be provided thereafter. Despite these concerns, an ESA does appear to be a viable way to provide participants with an alternate source of funds to cover a financial emergency, such that they avoid taking other withdrawals from their employer and/or 401(k) accounts.

G. ***Section 301 - Recovery of retirement plan overpayments – REQUIRED.***

- The Act amends ERISA §206 and Code §414 to provide fiduciaries of tax-qualified retirement plans with discretion to decide whether to seek recoupment of overpayments mistakenly made to participants or beneficiaries.

- Under this provision of the Act, tax-qualified retirement plans will not lose their qualified status simply for the failure to recover an inadvertent benefit overpayment. Prior to the Act, such plans risked the loss of their qualified status if they did not take reasonable steps to recover (or attempt to recover) an overpayment. In the event that a qualified plan chooses not to seek recoupment of an overpayment, then that overpayment is treated as an "eligible rollover distribution" (to the extent that amount would have been an eligible rollover distribution but for the fact that it was an overpayment).

- We note that if a tax-qualified plan is seeking repayment from a participant or beneficiary, then that individual will have new protections under the Act. For example, a plan cannot impose any interest or collection fees above and beyond the actual dollar amount of the overpayment, and recovery may not be sought from any beneficiary of the participant, including a surviving spouse. Additionally, recoupment generally cannot be sought if the first overpayment occurred more than three (3) years before the applicable participant or beneficiary is first notified in writing of the error.

EFFECTIVE DATE: Effective at the Act's date of enactment, December 29, 2022, with retroactive relief available to plan sponsors in certain circumstances for good faith interpretations of previously existing guidance.

OTHER CONSIDERATIONS:

✓ A participant or beneficiary who is "culpable" for an overpayment is not entitled to the protections imposed on recoupment of overpayments noted above. The statute defines culpability as when a participant or beneficiary made misrepresentations or omissions that led to the overpayment, or when a participant or beneficiary knew that the benefit payment or payments they received were materially in excess of the correct amount.

- ✓ Notwithstanding the rule above, a participant or beneficiary is deemed “not culpable” if the individual informed a plan representative of the individual’s belief that a benefit payment or payments may have been in excess of the correct amount, and that plan representative subsequently tells the individual that the payment or payments were correct.

H. ***Section 302 - Reduction in excise tax on certain accumulations in qualified retirement plans – REQUIRED.***

- Under prior law, if an RMD payment was not made in a timely manner, the applicable participant or beneficiary was subject to a 50% excise tax under Code §4974(a). Under the Act, this excise tax has been reduced to 25%. In addition, the 25% excise tax is further reduced to 10% if the applicable participant or beneficiary: (1) receives all of his or her past-due RMD for the respective tax year, (2) files a tax return paying the applicable tax before receiving notice of assessment of the RMD excise tax from the IRS, and (3) takes the actions required by (1) and (2) within two years after the year of the missed RMD.

EFFECTIVE DATE: Effective for taxable years beginning after December 29, 2022.

I. ***Section 303 - Retirement savings lost and found database – AWAITING FURTHER GUIDANCE.***

- The Act requires the establishment of a national online “Retirement Savings Lost and Found” database, where individuals who may have lost track of their defined contribution plan(s) and related benefits can search and obtain contact information for their plan administrator.

EFFECTIVE DATE: The Act mandates that the DOL and the IRS establish the database no later than two years after the Act’s enactment date of December 29, 2022.
OTHER CONSIDERATIONS: Funds will eventually need to provide information to the government so that this database can be populated. It is our expectation that Funds will have a good sense of “inactive” or “lost” participants and beneficiaries, and the Fund’s Form 8955-SSAs (Annual Registration Statement Identifying Separated Participants With Deferred Vested Benefits) filings will likely be helpful in this regard.

J. ***Section 304 - Updated dollar limit for mandatory distributions – REQUIRED.***

- The Act amends ERISA and the Code to increase the dollar limit that is allowed to be taken as a mandatory distribution without participant and/or spousal consent (under Code §417(e)), from $5,000 to $7,000.

EFFECTIVE DATE: Effective for distributions made on or after January 1, 2024.

OTHER CONSIDERATIONS: As a general rule, most Funds require participants to apply for their benefits in all circumstances, so the dollar limit noted above ($5,000 and $7,000 from January 1, 2024 forward) comes into play solely when a married participant is looking to apply for his or her benefit without the need for spousal consent.

K. ***Section 305 - Expansion of Employee Plans Compliance Resolution System – AWAITING FURTHER GUIDANCE.***

- The Act significantly expands the scope of the Employee Plans Compliance Resolution System (EPCRS), which is a correction program initially implemented by the IRS. Under the Act, tax-qualified plans can self-correct an "eligible inadvertent failure" in order to comply with Code §401(a).

- Under this provision of the Act, an "eligible inadvertent failure" can be self-corrected using EPCRS *at any time*, unless: (1) the IRS has identified the failure before the plan began to make efforts to self-correct, or (2) the self-correction is not completed in a reasonable period of time after the failure was discovered.

- Eligible inadvertent failures can be self-corrected under EPCRS regardless of whether they are significant or insignificant, but self-correction cannot be used for any failure which is "egregious, relates to the diversion or misuse of plan assets, or is directly or indirectly related to an abusive tax avoidance transaction."

<u>EFFECTIVE DATE</u>: Effective as of the Act's enactment date of December 29, 2022.

<u>OTHER CONSIDERATIONS</u>: Further IRS guidance is to be issued on the implementation of this provision, and we expect that this will result in substantial revisions to Revenue Procedure 2021-30 (the current EPCRS guidance document). According to the Act, this guidance will include specific correction methods for some errors, as well as general principles to guide self-correction efforts under EPCRS for errors for which a specific method is not provided. The Act mandates that this guidance be released no later than two years after the enactment date of December 29, 2022.

L. ***Section 312 – Hardship withdrawal self-certification - OPTIONAL.***

- The Act provides that plan administrators may, if they wish, rely on a participant's self-certification that he or she has experienced an event that qualifies as a deemed hardship under the Code and applicable regulations, <u>without requiring that the participant submit evidence about the hardship itself</u>. The participant must also certify that he or she has no alternative means reasonably available to satisfy the need.

- The Act makes clear, however, that plan administrators should not rely on a participant's self-certification in situations where they have actual knowledge that the self-certification is incorrect.

<u>EFFECTIVE DATE</u>: Effective for plan years beginning on or after January 1, 2023.

<u>OTHER CONSIDERATIONS</u>: This approach is similar to that taken by the IRS and DOL in 2020 for Coronavirus-Related Distributions. If a multiemployer plan would like to apply this new approach to hardship distributions in 2023, the plan must be amended with the approval of the trustees. Additionally, a plan that chooses to adopt self-certification for hardship distributions should draft and distribute a new hardship withdrawal application for participants that provides for this type of self-certification.

M. ***Section 316 - Amendments to increase benefit accruals under plan for previous plan year allowed until the plan sponsor's tax return due date – OPTIONAL.***

- The Act amends current law to expand the window in which a plan sponsor is allowed to make discretionary plan amendments. Under the Act, a plan sponsor may now make an amendment to the plan that increases benefits up until their tax filing deadline for the fiscal year in which the amendment is effective. While very few multiemployer plans with a 401(k) feature offer "matching contributions" (i.e., employer contributions that are based on the level of 401(k) contributions made by the participant), we wish to note that increases in any matching contributions are specifically excluded from this new rule.

- Previously, plan sponsors were required to adopt plan amendments that increase benefits by the last day of the plan year in which the amendment is effective.

EFFECTIVE DATE: Effective for plan years beginning on or after January 1, 2024.

N. ***Section 318 - Performance benchmarks for asset allocation funds – AWAITING FURTHER GUIDANCE.***

- For Funds that allow participant-directed investments (ERISA §404(c) plans), disclosure regulations issued by the DOL require that each investment option's historical performance must be compared to an appropriate broad-based securities market index. However, as the use of investment options that offer a blend of investments has increased (e.g., target-date investment options), the ability to make consistent comparisons has become more difficult. This provision requires the DOL to revise its regulations such that these blended investment options can be benchmarked against a blend of broad-based securities market indices. This change will allow plans to provide participants with more appropriate comparators when evaluating and selecting investments in defined contribution plans.

EFFECTIVE DATE: The Act states that the DOL must enact regulations within two years from the enactment date (December 29, 2022) to implement this provision.

OTHER CONSIDERATIONS: Plans that offer target date funds and similar investments containing a blend of asset classes should work with their investment consultant to determine if they should change the benchmark(s) used for these investments in participant-facing communications.

O. ***Section 326 - Exception to penalty on early distributions for individuals with a terminal illness – OPTIONAL.***

- The Act creates a new exception to the Code §72(t) 10% tax penalty typically assessed on early distributions from tax-qualified retirement plans for distributions to individuals suffering from a terminal illness. In order to qualify for this exception, an individual must have their physician certify that they have an illness that is reasonably expected to result in death within 84 months or less.

EFFECTIVE DATE: Effective for distributions occurring on or after January 1, 2023.

OTHER CONSIDERATIONS: While this provision creates an exception to the 10% tax on early distributions for terminally ill individuals, it makes no corresponding change to the rules governing distributions from tax qualified plans. So, to take advantage of this new exception, an individual would still need to have a normal distribution event (e.g., break in service, attainment of normal retirement age, etc.).

P. ***Section 327 - Surviving spouse may elect to be treated as the deceased participant for RMD purposes - REQUIRED.***

- The Act amends Code §401(a)(9)(B)(iv) to allow for a surviving spouse to elect to be treated as the deceased participant for the purposes of the RMD rules. This means that the RMD date for the surviving spouse cannot be earlier than the RMD date would have been for the deceased participant if the surviving spouse chooses to make this election. This will be useful in situations where the surviving spouse was older than his or her participant spouse.

EFFECTIVE DATE: Effective for calendar years beginning on or after January 1, 2024.

OTHER CONSIDERATIONS: Multiemployer plans should consider preparing appropriate election forms before the beginning of 2024 that will allow for the spouse of a deceased participant to make this election if he or she so chooses.

Q. ***Section 338 - Requirement to provide paper statements in certain cases – AWAITING FURTHER GUIDANCE.***

- The Act amends ERISA to mandate that a defined contribution plan must provide a paper statement reporting accrued benefits to participants at least once per year, unless the participant affirmatively elects to receive electronic delivery. For participant-directed plans, the other three quarterly statements may be provided electronically.

EFFECTIVE DATE: Effective for plan years beginning on or after January 1, 2026.

OTHER CONSIDERATIONS: The Act dictates that new regulations with changes to the DOL electronic delivery rules are to be written by December 31, 2024. These new regulations will mandate certain participant protections to ensure that participants are aware of their rights to receive plan disclosures on paper.

R. ***Section 341 - Consolidation of defined contribution plan notices - AWAITING FURTHER GUIDANCE.***

- The Act directs the IRS and the DOL to adopt new regulations within 2 years of the date of enactment allowing for the consolidation of certain mandatory notices for defined contribution plans.

EFFECTIVE DATE: Effective on the Act's date of enactment of December 29, 2022.

OTHER CONSIDERATIONS: While this provision does not mandate that defined contribution plans consolidate their required notices, it would likely be more efficient for plans and less confusing for participants if plans do adopt this change once the applicable regulations and guidance are published.

S. ***Section 501 - Provisions relating to plan amendments - REQUIRED.***

- Plan amendments made, or required, pursuant to the Act are generally to be adopted on or before the last day of the first plan year beginning on or after January 1, 2025 (i.e., December 31, 2025 for calendar year plans), so long as the plan operates according to such amendments as of the effective date of the requirement or amendment in question. However, for collectively bargained plans (plans maintained pursuant to one or more collective bargaining agreements that were ratified before December 29, 2022), plan amendments must be adopted on or before the last day of the first plan year beginning on or after January 1, 2027 (i.e., December 31, 2027, for calendar year plans).

- The deadline for plan amendments under the SECURE Act of 2019, the CARES Act, and the Taxpayer Certainty and Disaster Relief Act of 2020 have also been pushed back to the end of a plan's 2025 (or 2027) plan year, in line with guidance from recent IRS notices.

EFFECTIVE DATE: Effective as of the Act's enactment date of December 29, 2022.

T. ***Section 603[1] - Elective deferrals generally limited to regular contribution limit – REQUIRED IF CATCH-UPS ALLOWED.***

- The Act now requires that "catch up" contributions for participants in Funds with a 401(k) arrangement and whose wage earnings from one or more contributing employers exceed $145,000 (as indexed) in the preceding calendar year must make their catch-up contributions on a Roth (i.e., post-tax) basis. As noted earlier, for those participants under the $145,000 threshold (as indexed), catch up contributions may continue to be made on a pre-tax basis.

EFFECTIVE DATE: Effective for taxable years beginning on or after January 1, 2024.

OTHER CONSIDERATIONS: This provision will cause considerable administrative issues for multiemployer defined contribution plans with a 401(k) arrangement. First, the plan will very likely need to be amended so that post-tax / Roth contributions can be accepted in the first place, as we see very few multiemployer plans offering Roth accounts right now. Second, the Plan, working with its service providers, will need to determine if it is possible to track participant compensation to determine if the $145,000 threshold (as indexed) in the prior year was met. Third, this rule creates a scenario where some catch-up contributions may be made on a pre-tax basis, while others are made on a Roth basis. This may cause complications for a plan's internal computer systems, and will require very careful consideration and reporting when any distributions occur (as to proper reporting on Form 1099-R).

[1] We are aware that there was a significant drafting error in this section of the Act which effectively eliminates the ability to make pre-tax catch-up contributions *entirely* starting in 2024. It is expected that a technical correction will be enacted to remedy this error at some future time.

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