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Beyond the summary: What does the SECURE Act 2.0 really mean for participants, plans and advisors?

Six key issues advisors need to understand to maximize opportunities, not just meet requirements

It's not hard to find summaries of what's in the SECURE Act 2.0—everywhere you look people are putting out lists chock-full of legal jargon reciting effective dates, section numbers, tax rate percentages, etc. The problem facing advisors isn't getting the information. The problem facing advisors is piecing it all together and figuring out what it actually means, not only for client plans and participants, but also for advisors themselves.

The reality is that the SECURE Act 2.0 presents everyone—plans, participants and advisors—with new opportunities, not just new requirements.

As we'll explain, many of the new provisions can work hand in hand with one another, combining new options, powerful new tax incentives and new plan designs to make starting plans much easier and more attractive (especially in states that now mandate payroll deduction IRAs, like California, Oregon, Illinois and others).

In this paper, we're going to focus on six key issues advisors need to understand to help everyone take advantage of those opportunities. There are obviously quite a few more provisions in the new law, but these are some of the most significant immediate concerns facing plans and advisors.

The SECURE Act 2.0 is a "win-win-win," but simple? Not so much.

There's no question the last-minute passage of the SECURE Act 2.0 is great news for plan participants, plan sponsors and plan advisors. Among its more than 90 provisions are new incentives for employers to sponsor plans, new incentives for employees to become plan participants, and new opportunities for advisors to expand client services and to bring in new clients. The SECURE Act 2.0 is a "win-win-win" for participants, plans and advisors.

Of course, everything good comes at a price. For advisors, that price is being the guide who must shepherd clients through a new law full of complexity, confusing choices, some outright errors, and lots of different deadlines. For example, what options are best to raise with your long-time clients? How does the law affect new clients whose plans you just got up and running? What does it mean for identifying and approaching future clients?

But before we dive into the details, there are several general concerns advisors should appreciate:

1. **Uncertain timing of regulations and guidance:** There are a host of as-yet unanswered practical implementation questions and issues that need to be addressed. Some of these will require regulation or guidance from Treasury, IRS and Department of Labor (DOL) (which may or may not come in time). Advisors should anticipate that decisions may need to be made in the absence of clear guidance, and that some of those judgement calls later may be reversed when guidance finally comes. We are going to be working on SECURE Act 2.0 issues for several years.
2. **Key role of record-keepers:** The primary burden to solve the real-world implementation problems in time to meet the statutory deadlines falls on record-keepers. Advisors will be well-served to stay in close contact with their primary record-keeping partners to understand when and how different providers roll out different solutions. In fact, not all record-keepers may choose to offer all of the new options, or they may do so on different schedules. As a result, conversations about next steps may differ from plan to plan based on their record-keepers.
3. **Errors, omissions, and ambiguities:** As with any major tax bill negotiated on a deadline, the SECURE Act 2.0 has its share of problems, from typographical errors to major drafting mistakes that likely can't be addressed with guidance. It is not clear whether Congress will be able to pass a technical corrections bill, so it may take some time for even glaring mistakes to be corrected.

With that in mind, here are six issues advisors need to understand to help their clients over the next several months:

1. Auto-enrollment and auto-escalation are now mandatory…but not for everybody. And there's a catch.

Since passage of the Pension Protection Act in 2006 and the subsequent promulgation of the DOL's Qualified Default Investment Alternative ("QDIA") safe-harbor regulation, voluntary adoption of auto-enrollment and auto-escalation plan design features made a huge difference in participant outcomes. More than 10 years of data shows that participation rates in auto-enrollment plans typically exceed 90% (and stay there), and that participant elective contribution rates of 10% or more are soon reached in plans with auto-escalation. In fact, these voluntary programs proved so successful that Congress decided to make them mandatory for most new 401(k) and ERISA-covered 403(b) defined contribution plans.

The new mandate applies prospectively to most new plans:

Effective January 1, 2025 (for calendar year plans), 401(k) and ERISA-covered 403(b) plans must automatically enroll eligible employees at a default contribution rate of between 3% and 10%. The plan sponsor may choose where within that range to start. They must then automatically escalate that contribution rate by one percentage point each year up to a minimum of 10% and a maximum of 15%. The plan must use a QDIA under the DOL rule as the default investment.

The mandatory requirement does not apply to most existing plans—it only applies to new plans started on or after December 29, 2022. It also does not apply to plans sponsored by employers with 10 or fewer employees; to new businesses that have been in existence for less than three years; to governmental plans; or to church plans. In other words, the new requirement applies to plans started on or after December 29, 2022, but compliance is not required until January 1, 2025.

The catch is in the transition

The catch is that thousands of new plans recently formed under the old rules are NOT exempted from the new rules, and many will have to be amended before the end of 2024. If your client started a new plan on or after December 29, 2022—and many new 401(k)'s and 403(b)'s started on January 1, 2023—that plan will have to be reviewed and possibly rewritten to comply with the new auto-enrollment and auto-escalation requirements that take effect on January 1, 2025.

Another important transition issue is the application of the new rule to Pooled Employer Plans ("PEPs") and Multiple Employer Plans ("MEPs"). On the one hand, the new requirements do not directly apply to PEPs and MEPs. On the other hand, the new rules do apply to each new participating employer that started a new plan by joining a PEP or MEP on or after December 29, 2022. In practice, that means PEPs/MEPs will either have to maintain separate rules for participating employers based on when they joined the PEP/MEP, or adopt the new requirements universally. It seems likely most PEPs/MEPs will comply universally to simplify administration, but it is not technically required.

What are the advisor opportunities?

There is a lot of good news in this provision for advisors (along with a lot of new work).

One big advantage of auto-enrollment and auto-escalation is that new plans will grow quickly—past data shows that most workers will stick with the plan and with the increasing contribution rates. Thus, what's good for participants is good for advisors who work with start-ups and small plans.

Another advantage is that the government effectively has endorsed auto-enrollment and auto-escalation. Existing plans "grandfathered" in, the new businesses, and the small employers not required to comply are more likely to be receptive to adopting auto-enrollment and auto-escalation voluntarily. Employer concerns about being too "paternalistic" are likely to be mitigated when many other employers competing with the plan sponsor in the labor market are required to offer these benefits. Revisiting auto-enrollment and auto-escalation should be on most advisors' agendas to discuss with existing plan clients this year.

Finally, as we'll discuss in more detail below, some of the key objections from employers to offering a plan, or to adopting automatic plan design features—such as cost and administrative complexity—may be materially reduced by new, very significant employer tax credits, and by simplified plan design options like the starter 401(k). There are synergies between the different provisions of the SECURE Act 2.0 that can help advisors explain the benefits of offering a plan.

2. Plans may choose to make retirement plan matching contributions based on employee student loan payments

Concerned that younger workers with high student loan payments may be foregoing contributing to their workplace retirement plans in order to service their debt, Congress passed a new optional provision that is available to calendar year plans beginning January 1, 2024. The optional provision permits plans to treat Qualified Student Loan Payments ("QSLP") as elective deferrals for purposes of providing an employer matching contribution. Plans may also test the individuals receiving student loan matching contributions separately for purposes of the actual deferral percentage ("ADP") test. Solely for purposes of satisfying a 401(k) Safe Harbor, student loan payments may be treated as elective deferrals.

In essence, a student loan payment receives the same treatment as an elective contribution under the same thresholds—thus, the greatest benefit accrues to employees would not have made an elective contribution but who do make student loan payments, as they may now receive an employer match on a plan contribution they would not have made.

Implementation questions: What debt is eligible and how does it work?

The provision defines a QSLP to include a payment for any indebtedness incurred by an employee solely to pay qualified higher education expenses to an educational institution able to participate in the Federal student loan program. This broad definition includes most post-secondary educational programs, including trade schools and community colleges.

Implementation will likely be somewhat complicated. The law permits the plan to rely on an annual self-certification by the employee that the loan payment was made. This suggests that the matching contribution may only be annual and retroactive. Further guidance from regulators may clarify whether other matching schedules are permissible.

Opportunities for advisors:

This new option should be on the agenda for discussions with plan clients in the near term given the effective date of next year. Advisors likely need to discuss implementation plans with record-keepers to understand the next steps and time frames for each plan client. It is also likely that the option may have a broader appeal among different kinds of employers than some advisors anticipate. While employers in medical, legal and similar fields requiring specialized training likely will be very interested, the broad definition of QSLP that includes debt related to trade schools may interest employers competing for skilled workers in many other industries as well.

3. Taxes, taxes and taxes: Roth mandates, Roth options and major new tax incentives for employers and participants

Congress's love affair with Roth continues with a combination of new mandates and new Roth options that plan advisors need to understand. More significantly, the SECURE Act 2.0 significantly increases tax credits available to employers starting plans and to lower-income workers participating in them.

Roth provisions raise significant issues and some confusion

Why does Congress love Roth provisions? Because taxes are collected this tax year instead of being deferred into the future. (In fact, taxes that would be collected after the next 10 years simply are not counted at all—ignoring that fact that a lot of deferred tax on retirement savings will be owed 11 or more years in the future.) As a result, the Roth provisions in SECURE Act 2.0 helped pay for all the other items that "lose" revenue (like increased participant contributions from auto-enrollment and auto-escalation). The result is a mix of provisions that offer new options to use Roth for some plans, but also new requirements.

- **No more Roth RMDs:** Beginning January 1, 2024, the required minimum distribution rules for defined contribution plans no longer apply to Roth accounts.
- **General catch up contribution provisions:** The good news is that starting in 2025, the limit for catch up contributions for individuals ages 60-63 will increase to the greater of $10,000 or 150% of the regular catch-up amount in 2025 (indexed for inflation thereafter). In further good news, effective immediately, plan sponsors can offer employees the choice to have employer matching contributions and nonelective contributions made on a Roth basis.
- **Roth-only catch up contributions for high-earners:** The bad news is that for employees making more than $145,000, all catch up contributions must be Roth only beginning January 1, 2024. And if the plan does not permit Roth contributions for these highly compensated employees, then they may not make any catch up contributions at all. What does this mean for plans and advisors? It means conversations about providing for Roth catch-up contributions—and indeed, discussions of Roth features more generally—need to take place in the near future. This provision likely will motivate many plans to rethink their Roth decisions across the board, not just with respect to catch-up for those making more than $145,000.

Expanded employer tax credits for new plans—administrative costs and employer matching

The new tax credits incentivizing employers to offer new plans are quite significant, covering not only administrative costs, but also a significant portion of matching contributions. Especially in states now requiring employers to make payroll deduction IRAs available in the workplace, these tax incentives can be very powerful in making that case that a "real" employer-provided plan might be a better alternative.

- **Up to $15,000 over three years for administration:** Employers that sponsor a new plan (including SEPs and SIMPLEs but not defined benefit plans) with less than 50 employees may receive 100% of qualified plan start-up costs, up to $5,000, for three years. For employers with more than 50 but less than 100 employees, the existing 50% credit remains unchanged.
- **Up to $1,000 per employee for employer contributions:** Employers that sponsor a new plan (including SEPs and SIMPLEs but not defined benefit plans) with less than 50 employees may receive up to a $1,000 tax credit for employer contributions made to each employee making less than $100,000 per year. Employers can receive a credit of 100% of eligible contributions for the first and second years of the plan—the credit is reduced to 75% in the third year, 50% in the fourth year, 25% in the fifth year, and zero for any taxable year thereafter. The credit is phased out for employers with 51 to 100 employees by 2% for each employee in excess of 50 employees.

4. Starter 401(k) and 403(b) plans—simplified cost and complexity for new plans

To further facilitate the creation of employer-provided plans, thereby increasing access to retirement savings for workers currently without a plan, the SECURE Act 2.0 Act provides for "starter" 401(k) or 403(b) plans. These starter plans limit salary deferrals to the IRA limits of a maximum of $6,500, plus catch-up contributions of $1,000 for participants over age 50. Workers must be automatically enrolled at a rate of 3% to 15%. If certain notice requirements are met, the starter plan is deemed to have met discrimination testing.

Issues for advisors

Advisors focusing on start up and small plans will have more choices than ever to recommend for plan design, from new starter plans, to MEPs and PEPs, to traditional retirement plans. In conjunction with the tax benefits outlined above, starter 401(k)s and 403(b)s may be very attractive to some plan sponsors.

5. Optional pension-linked emergency savings accounts

Intended to address the fact the too many working Americans lack access to even a small amount of emergency savings, this optional new provision is intended to combine the benefits of saving for retirement with easier access to savings in an emergency. The intended benefit is to keep participants from taking loans or hardship withdrawals that can trigger additional tax penalties. However, the new option is quite complex, and it is not clear whether employers will want to embrace an approach that makes it easier for employees to access retirement savings.

How does it work?

Effective January 1, 2024, employers may choose to offer a savings account funded with employee payroll deductions and treated as a Roth account. They may also choose to automatically enroll workers into the account at a maximum 3% contribution.

The account may be invested in cash, interest-bearing deposit accounts, and principal preservation assets. Only non-highly compensated employees may participate in the account. The worker may accrue a maximum of $2,500 in the account, and after that, any contributions go into the 401(k) plan to which the account is linked. Contributions to the emergency account are treated as elective deferrals to the 401(k) plan. Employer contributions go only to the 401(k) account, including employer matching contributions based on the employee's emergency savings account contribution.

Workers can withdraw amounts from the emergency account on a monthly basis without an early distribution penalty, and the first four such distributions in a year must be without charge. There is no definition of what constitutes an emergency, suggesting that distributions can be made for any purpose.

Opportunities for the advisor

The pension-linked emergency savings account is very complex, comprising fully 10% of the entire text of the SECURE Act 2.0, despite being only one of more than 90 provisions in the law. While it does offer a way to derive some retirement savings from the emergency account contributions via employer matching, the monthly withdrawal requirement seems to permit use of the account as a revolving fund.

Further, there are other provisions in the new law that address similar concerns. For example, the 10% early distribution tax is also waived for those who are terminally ill, who are victims of domestic violence, or who have immediate financial needs of up to $1,000 once per year. The normal hardship withdrawal provisions also may now rely on self-certification by participants, reducing the employer's burden in administering those requirements. Given that, does an employer want or need a plan-linked account that permits monthly access to retirement savings? Advisors are likely to receive questions regarding the availability of this provision, and be asked to help employers evaluate the pros and cons of adoption.

6. Expanded eligibility requirements for part-time, long-term employees

The original SECURE Act (1.0) implemented a new requirement that long-term, part-time workers must be eligible to participant in 401(k) plans. It defined such employees as those who worked 500 or more hours in each of three consecutive years.

SECURE Act 2.0 makes two significant expansions to this program. First, it now applies to ERISA-covered 403(b)s and well as 401(k)'s. Second, the time period is now shortened to two years, beginning January 1, 2025.

Issues for advisors

Advisors should raise this provision for plan sponsors, particularly 403(b) plan sponsors who have not previously been monitoring this issue, this year because compliance will require significant coordination between payroll providers and plan record-keepers. The work necessary to connect these systems to ensure that all 500+ hours workers are identified from the past two years of payroll records should begin well in advance of the new requirement. While much of the compliance work will be the responsibility of the plan sponsor, the plan's record-keeper, its payroll provider and its Third Party Administrator ("TPA"), the advisor likely should remind the plan that advance preparation among these entities is required.

Conclusion:

While the SECURE Act 2.0 offers significant new opportunities for plans, participants and advisors, it will require significant effort by advisors, beginning right away, to assist plan clients in understanding the opportunities as well as the requirements. Further, advisors need to appreciate the interaction between different parts of the new law to identify opportunities to advise existing clients and to identify new ones. While these are not all of the important provisions of the SECURE Act 2.0, these are key issues advisors should be aware of over the next several months.

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The Hon. Bradford P. Campbell, partner at Faegre Drinker Biddle & Reath LLP, is a nationally-recognized figure in employer-sponsored retirement plans. He counsels his clients in ERISA Title I issues, including fiduciary conduct and prohibited transactions. Mr. Campbell served as Assistant Secretary of Labor for Employee Benefits and head of the Employee Benefits Security Administration from 2006-2009. As ERISA's former "top cop" and primary Federal regulator, he provides his clients with insight and knowledge across a broad range of ERISA issues, and also serves as an expert witness in ERISA litigation. Mr. Campbell has been listed as one of the 100 Most Influential Persons in Defined Contribution by 401kWire and has been listed as one of the top 15 ERISA attorneys in the country by a poll of the National Association of Plan Advisors. He has testified before Congress on employee benefits issues 11 times.

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