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SECURE 2.0: Retirement Plan Rules Get a Makeover!

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SECURE 2.0, which was signed into law on December 29, 2022 as part of the larger Consolidated Appropriations Act, is the most wide-sweeping retirement plan legislation enacted in more than a decade. It contains a myriad of changes, ranging from new emergency saving accounts to significant changes to the catch-up contribution rules.

The first SECURE Act was enacted in 2019 (Setting Every Community Up for Retirement Act of 2019, also known as SECURE 1.0), and SECURE Act 2.0 builds on the changes made by that legislation and adds many more. Some of the changes are mandatory but many are discretionary, and the effective dates range from immediately to a decade from now. The analysis and implementation of these changes will undoubtedly be on the agenda of plan sponsors and their advisors for the next several years.

Amendments for these changes must generally be adopted by the end of the first plan year beginning on or after January 1, 2025 (January 1, 2027, for governmental and collectively bargained plans). In the meantime, plans must be administered in compliance with the mandatory provisions as they become effective.

This article provides a high-level overview of the key provisions that relate to defined contribution plans. The discussion is generally organized by the year in which the provision is first effective, but please note that the specific effective date may relate to the plan year of the relevant plan.

EFFECTIVE IMMEDIATELY

Required Minimum Distributions – Increase in Age

The age to start taking required minimum distributions (“RMDs”) is raised to age 73 this year and to age 75 in 2033. Previously, SECURE 1.0 raised the age for taking RMDs from 70 ½ to 72. If a participant turned 72 in 2022 or earlier, he or she will have to continue taking the RMDs under the prior rule. A participant who will turn 72 in 2023 is not required to take an RMD in 2023.

Required Minimum Distributions –Reduced Excise Tax

An excise tax is assessed against the participant if the RMD is not distributed timely. Previously, this tax was a whopping 50% of the missed distribution, which was one of the highest penalties under the

Internal Revenue Code. This penalty has been reduced to 25%, and possibly to 10% if the error is timely corrected.

Employer Roth Contributions

Effective for contributions made after December 29, 2022, plans may permit participants to designate matching contributions and non-elective contributions that are fully vested when contributed as Roth (that is, after tax) contributions.

Penalty-Free Distribution in Connection with Terminal Illness

Plans may now allow an individual to take a withdrawal on account of being diagnosed with a terminal illness. If the individual takes the withdrawal prior to attaining age 59 1/2, they will not incur the 10% early withdrawal penalty. To qualify for the penalty-free withdrawal, a doctor must certify that the employee has a terminal illness that is expected to result in death within 84 months. The participant may repay the amount of the withdrawal to the plan within three years.

Distributions for Federally Declared National Disasters

Plans may now allow distributions for federally declared disasters of up to $22,000 per disaster. The participant may choose to have the federal income tax related to the distribution spread over three years and may repay the amount to the plan over the following three years. The limit on plan loans may be temporally increased in connection with the disaster to the lesser of $100,000 or 100% of the participant’s vested account balance.

Change in Repayment of Birth or Adoption Distributions

SECURE 1.0 allowed plans to add an option for participants to take a distribution to pay qualified expenses relating to the birth or adoption of a child. Under the prior law, participants could repay those distributions to the plan at any time.

SECURE 2.0 requires that birth or adoption distributions must be repaid to the plan within three years. For birth or adoption distributions taken prior to December 29, 2022, if the participant wishes to repay the distribution, the repayment must be made before January 1, 2026.

Participants May Self-Certify that the Hardship Withdrawal Requirements are Met

Plans may now rely on an employee’s self-certification that the requirements for a hardship distribution are met. A participant is deemed to have hardship if they certify that 1) they have an immediate and heavy financial need, 2) the amount of the hardship withdrawal requested is not in excess of what is needed to meet the need, and 3) the employee cannot otherwise reasonably meet the financial need with other resources.

Employer Can Provide De Minimis Incentives for Participants to Enroll

Employers may now offer financial incentives to encourage employees to contribute to 401(k) and 403(b) plans. The incentives must be “de minimis,” such as a gift card for a relatively small amount, and must be paid by the employer, not by plan assets.

Relaxed Rules on Recovery of Overpayments

Plan fiduciaries now have more flexibility in deciding whether to seek repayment of an inadvertent overpayment. If the plan does decide to attempt to collect the overpayment from the participant (or their beneficiary), certain restrictions will apply.

IRS Correction Procedures amended to Expand Self-Correction

Plan sponsors may self-correct inadvertent errors, with certain exceptions, regardless of whether the error is significant or insignificant. The correction must be completed within a reasonable period after the error is identified and some action must be taken before the IRS identifies the error. The Treasury Department has been directed to update the IRS correction procedures accordingly by December 29, 2024.

2024

Catch-Up Contributions "Rothicized" for Certain Participants

Participants whose annual income in the prior plan year was more than $145,000 (as indexed in the future) may only make catch-up contributions as Roth (after-tax) contributions. This applies to catch-up contributions to a 401(k), 403(b) and governmental 457(b) plan.

Cash-Out Threshold Increased from $5,000 to $7,000

The automatic cash-out limit is increased from $5,000 to $7,000 for distributions made after December 31, 2023.

Roth Accounts no Longer Subject to Pre-death Required Minimum Distribution ("RMD") Rules

Amounts held in Roth accounts will not be required to be distributed pursuant to the pre-death required minimum distribution rules after December 31, 2023.

New In-Plan Emergency Savings Accounts

Plans may establish a new emergency savings program for non-highly compensated participants. Contributions must be made on an after-tax basis, and the account cannot exceed $2,500 (indexed for future years). The savings account can only be invested in cash, an interest-bearing account or in an investment product otherwise designed to protect principal. Withdrawals from the account must be allowed at least once a month, at the participant's discretion. If the plan provides for employer matching contributions on salary deferrals, the contributions to the emergency savings account must be matched as well (subject to annual contribution limits).

Match on Student Loan Payments

Plans may provide for matching contributions based on payments made by participants on qualified student loans. A qualified student loan must generally be incurred to pay higher education expenses.

Penalty-Free Distribution in the Event of Domestic Abuse

Certain plans may allow a participant who is a victim of domestic abuse to take a distribution with no early withdrawal 10% penalty. The distribution cannot exceed the lesser of $10,000 (indexed for inflation) or 50% of the participant's vested account and must be made within one year of the domestic abuse by a spouse or a domestic partner. The participant may repay the distribution within three years.

Personal Emergency Distributions

Plans may allow participants to take a distribution of up to $1,000 (with certain limitations) once a year for a personal emergency. The reason for the withdrawal must be an unforeseeable emergency or an immediate financial need, either personal or family-related, and the plan can rely on the participant's written self-certification of the cause. The participant must be given the opportunity to repay the distribution within three years. If a participant does not fully repay the distribution or make contributions to the plan equal to the amount of the distribution, the participant will not be allowed to take a new personal emergency distribution for the following three years.

2025

Participation by Long-Term Part-Time Employees

Part-time employees who are at least age 21 and complete at least 500 hours of service in two consecutive 12-month periods must be allowed to make elective deferrals into the plan the following year. This is a change from the requirement of SECURE 1.0, which allowed plans to require service for three years. This provision applies to 401(k) and 403(b) plans that are subject to ERISA.

Catch-Up Contribution Limits Increased for Ages 60-63

The annual limit on catch-up contributions for individuals who attain age 60, but not age 64, (i.e., ages 60, 61, 62, or 63) will be the greater of $10,000 or 150% of the regular catch-up limit that would otherwise apply (indexed for inflation).

"Retirement Savings Lost & Found"

The Department of Labor is directed to create a searchable online database to aid plan participants in identifying and locating retirement benefits. Plan administrators will be required to provide information to the DOL for this purpose.

CHANGES EFFECTIVE BEYOND 2025

Paper Statements Required

Defined contribution plans will be required to provide one paper benefit statement annually, unless an exception applies, effective for plan years beginning after December 31, 2025.

Distribution from Plan to Long-Term Care Policy – Penalty Free

Plans may allow participants to take distributions to purchase long-term care insurance contracts. The amount of the distribution will be limited to the lesser of 1) the amount paid or payable by the participant for the year for the long-term care insurance, 2) 10% of the participant's vested plan account balance, or 3) $2,500 (indexed for inflation). This provision is effective for distributions beginning on or after December 29, 2025.

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