SECURE 2.0: Changes Affecting Defined Benefit Pension Plans

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Enacted last December as part of omnibus appropriations legislation, the “Securing a Strong Retirement Act of 2022” (SECURE 2.0) includes a number of provisions that have an impact on retirement plan administration, effective in 2023 and later. In a previous article, we discussed key changes affecting retirement plans for 2023. This article focuses on some of the more significant and immediate changes specific to the administration of defined pension plans.

Required minimum distributions

As is the case for 401(k) plans and other defined contribution plans, SECURE 2.0 changes the rules applicable to required minimum distributions (RMDs) under defined benefit pension plans. While previous legislation raised the age that triggers RMDs to age 72 (from the previous threshold age of 70 ½), SECURE 2.0 raises the applicable age again to age 73, effective for individuals who reach age 72 after 2022. The excise tax applicable to an individual who fails to take an RMD when required has also been reduced (from 50% to 25% of the required amount that was not distributed) and may be even further reduced (to 10% of such amount) if the affected individual makes a timely correction of the failure.

Defined benefit pension plan sponsors should take note, however, that this additional change in the RMD age still does not affect the actuarial increase that applies to pension benefits that commence after age 70 ½.

New rules on lump sum windows and pension risk transfers

SECURE 2.0 includes significant modification of the rules relating to two strategies that many defined benefit pension plan sponsors employ to reduce the costs associated with plan sponsorship. First, SECURE 2.0 imposes new notice requirements applicable to lump sum windows, which are limited periods during which plan participants may elect to take their benefit in a single lump sum, regardless of whether such form of payment is otherwise available under the plan. Effective as of the date of issuance of related final regulations by the Department of Labor (DOL), the new notice provisions require certain disclosures to plan participants, the DOL, and the Pension Benefit Guaranty Corporation (PBGC), both before and after the lump sum window. All such notices must satisfy certain content requirements.

Second, SECURE 2.0 also includes what may prove to be a major modification of existing rules applicable to plan fiduciaries who seek to implement the “de-risking” of plan sponsorship by transferring the obligation to make benefit payments to a commercial annuity provider. The legislation instructs the DOL to update its guidance on the process for plan fiduciaries to follow in selecting a provider for purposes of the transfer of benefit payments. It remains to be seen the extent to which such an update may materially change the existing guidance found in DOL Interpretive Bulletin 95-1, which details a “safest available annuity” standard for plan fiduciaries.

New overpayment correction rules

Defined benefit pension plan fiduciaries are generally required under existing law to take action to try to recover benefit overpayments made by a defined benefit pension plan. Effective immediately upon passage, SECURE 2.0 adds a provision to ERISA to add new rules applicable to the recovery of such benefit overpayments. The rules generally permit plan fiduciaries in the exercise of their fiduciary discretion not to recover all or part of an overpayment from a plan participant or beneficiary (with certain exceptions) and impose limitations on the ability of a plan fiduciary to recover such overpayment from a plan participant or beneficiary.

Annual funding notices

SECURE 2.0 changes certain disclosures that are included in the annual funding notice that every defined benefit pension plan is required to provide to plan participants, applicable for notices for the 2024 plan year and later. Among other things, the annual funding notice will be required to include a statement as to the sufficiency of plan assets to pay benefits that are not insured by the PBGC.

Cash out of small benefits

Effective for distributions after December 31, 2023, SECURE 2.0 raises the dollar threshold for the cash out of small benefit accruals without the participant’s consent from $5,000 to $7,000.

The general deadline for plan amendments required to implement SECURE 2.0 changes is the last day of the plan year beginning on or after January 1, 2025, i.e., December 31, 2025, for a calendar year plan. Governmental and collectively bargained plans may be amended as late as the last day of the plan year beginning on or after January 1, 2027.

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