

CLIENT ALERT

# SECURE 2.0 Brings Significant 401(k) Plan Changes

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## AUTHORS

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On December 29, 2022, President Biden signed into law the SECURE 2.0 Act of 2022 (“SECURE 2.0” or the “Act”) as part of a larger congressional appropriations bill. SECURE 2.0 makes significant changes to existing law for retirement plans by building upon provisions in the Setting Every Community Up for Retirement Enhancement Act of 2019 (the “SECURE Act”) and introducing new requirements and considerations for plan sponsors that are intended to expand coverage, increase savings, preserve income, and simplify plan rules and administrative procedures.

SECURE 2.0 comprises more than 350 pages of legislative text, making it difficult to discuss all provisions of the extensive law in one summary. This client alert summarizes the key highlights applicable to employer-sponsored 401(k) plans. Because SECURE 2.0 contains a mix of optional plan changes and required plan changes, all 401(k) plans<sup>1</sup> will be impacted by the Act in some way. Although many of the changes in SECURE 2.0 are not effective until 2024 or 2025, some changes will affect plans in 2023. As a result, plan sponsors should begin examining operational compliance considerations and reach out to third-party plan administrators and legal counsel for guidance. Plan sponsors will have until the last day of the plan year beginning on or after January 1, 2025 (i.e., December 31, 2025 for a calendar year plan) to adopt SECURE 2.0 plan amendments.

<sup>1</sup> The Act also includes provisions relating to defined benefit plans, 403(b) and 457(b) plans, employee stock ownership plans, pooled employer plans, SIMPLE IRAs and SIMPLE 401(k)s, simplified employee pension (SEP) arrangements, and individual retirement accounts (IRAs). This client alert does not address the changes under SECURE 2.0 for these plans, although certain of the provisions described may apply to such plans.

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## SECURE 2.0 Brings Significant 401(k) Plan Changes

### Plan Sponsorship, Participation and Contribution Changes

- **Optional Treatment of Employer Contributions as Roth Contributions:** Effective immediately, plan sponsors may offer participants the option to receive employer matching and non-elective contributions on a Roth basis, provided that the employer contributions are vested when made. Prior to SECURE 2.0, employer contributions were required to be made on a pre-tax basis and participants who desired Roth treatment for those contributions were required to make an in-plan Roth rollover. SECURE 2.0 effectively consolidates this process by treating the employer contributions as Roth, making them subject to taxation, at the time the contributions are made. Although plan sponsors are permitted to adopt this change for any contributions made after December 29, 2022, creating an administrative process to accept employee elections and ensure appropriate tax treatment will likely take additional planning.
- **Optional De Minimis Financial Incentives to Encourage Participation:** For plan years beginning after December 29, 2022, plan sponsors may provide de *minimis* financial incentives to encourage 401(k) plan enrollment, so long as such incentives are not paid for with plan assets. Prior to the change, these types of incentives were prohibited. SECURE 2.0 does not define what de *minimis* incentives include, although “low-dollar gift cards” are mentioned as an example.
- **Required Roth Treatment for Catch-Up Contributions Made by High-Paid Participants:** Beginning in the 2024 tax year, all catch-up contributions made by participants who were paid at least \$145,000 in the prior year (as adjusted for inflation) must be made as Roth contributions. Under current law, catch-up eligible participants (those who are at least 50 by the end of the calendar year) may elect catch-up contributions on a pre-tax or Roth basis, if available under the plan. This change will require the addition of a Roth feature for any plan that does not have one (to the extent catch-up contributions are allowed).
- **Optional Emergency Savings Account Linked to 401(k) Plans:** Beginning in the 2024 plan year, plan sponsors may permit non-highly compensated employees to establish plan-linked emergency savings accounts of up to \$2,500 (indexed for inflation). Savings contributions must be made on a Roth basis, and plan sponsors may automatically enroll employees into these accounts (although participants may opt out). If employer matching contributions are made under the plan sponsor’s 401(k) plan, amounts contributed to the emergency savings account must be matched at the same rate as applicable to regular participant deferrals, but the emergency savings matching contributions must be made to the plan account rather than the savings account. The account must permit withdrawals, at the discretion of the participant, at least once per month.
- **Optional Treatment of Student Loan Payments as Elective Deferrals for Purposes of Matching Contributions:** Beginning in the 2024 plan year, plan sponsors may treat qualifying student loan payments as elective deferrals for purposes of providing employer matching contributions. Under current law, matching

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## SECURE 2.0 Brings Significant 401(k) Plan Changes

contributions can only be made with respect to employee contributions made to the plan. Plan sponsors may rely on employee certifications of student loan payments.

- **Employers Permitted to Replace SIMPLE Plan with Safe Harbor 401(k) Plan:** Beginning in the 2024 plan year, employers may replace a SIMPLE plan (a type of retirement plan available to small employers) with a safe harbor 401(k) plan during a plan year. Currently, SIMPLE plans must be maintained for an entire calendar year and cannot be replaced mid-year.
- **Increased Catch-up Contribution Limit Available to Participants Age 60 – 63:** Beginning in the 2025 tax year, plans may allow participants who are ages 60, 61, 62, and 63 to make catch-up contributions equal to the greater of \$10,000 or 150% of the then-effective regular catch-up contribution limit. The \$10,000 limit is indexed for inflation. These catch-up contributions must be made on a Roth basis if the participant's compensation exceeds the new threshold described above.
- **Required Automatic Enrollment for New Plans:** Beginning in the 2025 plan year, plan sponsors of newly established 401(k) plans must automatically enroll eligible plan participants (subject to opt-out provisions) at a compensation deferral rate of not less than 3% and not more than 10%. Each successive year, the compensation deferral rate increases by 1% until reaching at least 10% (but not more than 15%). Plans in place on the Act's effective date are not subject to these automatic enrollment rules.
- **Required Coverage for Part-Time Employees:** Beginning in the 2025 plan year, plan sponsors must allow participation by part-time employees who complete at least 500 hours of service in two consecutive years. The SECURE Act contained a part-time employee participation provision effective for the 2024 plan year, but only with respect to employees who complete three years of such service. SECURE 2.0 shortens the period.

### Distribution and Withdrawal Changes

- **Required Minimum Distribution (“RMD”) Changes:**
  - *Increase in Required Beginning Age:* Beginning on January 1, 2023, the age upon which RMDs must commence increased from 72 to 73. Beginning on January 1, 2033, the age increases again from 73 to 75.
  - *Reduction in Missed RMD Excise Tax:* For tax years beginning after December 29, 2022, the excise tax penalty for failing to take an RMD decreases from 50% of the amount that should have been distributed to 25% of such amount. The penalty may be further reduced to 10% if, within two years following the missed RMD and prior to receipt of a notice of assessment from the Internal Revenue Service (“IRS”), the individual receives all past due RMDs, files the necessary tax returns, and pays the applicable taxes.

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## SECURE 2.0 Brings Significant 401(k) Plan Changes

- o *Elimination of Pre-Death RMD for Roth Amounts:* Beginning with the 2024 tax year, RMDs are not required during a participant's lifetime from Roth-designated plan accounts. This change does not apply to distributions required by April 1, 2024 for those reaching the RMD age in 2023.
- **Increased Availability of Penalty-Free Distributions:** At varying effective dates, SECURE 2.0 makes available new distributions or withdrawals that will not be subject to the 10% tax on early payment. These withdrawals are generally available in-service to the extent permitted by the plan. In some cases, the withdrawals will be eligible for recontribution if permitted by the plan.
  - o *Withdrawals for Federally Declared Disasters:* Effective immediately, the Act provides permanent disaster withdrawal rules, similar to rules adopted on a one-off basis following prior disasters. SECURE 2.0 allows participants to make penalty-free withdrawals of up to \$22,000 within 180 days following a federally declared disaster, including disasters occurring on or after January 26, 2021. The withdrawals may be recontributed to the plan within the following three years.
  - o *Withdrawals for Terminal Illness:* Effective immediately, participants with terminal illnesses (generally, a condition reasonably expected to result in death within 84 months) may make penalty-free withdrawals. The withdrawals may be recontributed to the plan within the following three years. The Act is not clear whether such withdrawals are available for contributions that may be restricted from distribution, such as elective deferrals, while in-service.
  - o *Withdrawals for Personal or Family Emergencies:* Beginning in 2024, plan participants who face personal or family emergencies may make a penalty-free withdrawal of not more than \$1,000. The withdrawal may be recontributed to the plan within the following three years, and additional emergency withdrawals are permitted within the three-year recontribution window only if prior withdrawals have been recontributed to the plan. In all cases, participants are limited to one emergency withdrawal per year.
  - o *Withdrawals for Domestic Abuse Survivors:* Beginning in 2024, domestic abuse survivors may make penalty-free withdrawals equal to the lesser of \$10,000 (indexed for inflation) or 50% of their plan benefits. The withdrawals may be recontributed to the plan within the following three years.
  - o *Withdrawals for Long-Term Care Insurance:* Beginning on December 29, 2025, participants may make penalty-free withdrawals of up to \$2,500 per year to pay premiums for qualifying long-term care insurance contracts.
- **Increased Cash-Out Limit and Changes to Mandatory Distributions:** Beginning in 2024, the dollar limit applied to mandatory cash-outs for former employees will increase from \$5,000 to \$7,000. Relatedly, effective December 29, 2023, third-party plan service providers may provide portability services to plan sponsors, such that

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## SECURE 2.0 Brings Significant 401(k) Plan Changes

an IRA account resulting from a mandatory distribution may be automatically rolled into the participant's plan account with a new employer (absent affirmative opt-out). The Act includes new prohibited transaction exemption relief under the Employee Retirement Income Security Act ("ERISA") and the Internal Revenue Code (the "Code") for such portability services.

- **Limitations on Repayment of Qualified Birth or Adoption Expenses:** The SECURE ACT allowed penalty-free withdrawals for qualified birth or adoption expenses and provided for indefinite repayment rights. SECURE 2.0 limits the plan recontribution period to three years. This change is effective immediately, and, with respect to withdrawals already made, the Act provides a voluntary recontribution deadline of December 31, 2025.
- **Availability of Hardship Self-Certification:** For plan years beginning after December 29, 2022, plan sponsors may accept self-certification by plan participants regarding the existence of hardships and amount needed to satisfy such hardships. This change further aligns with existing regulations, which allow self-certification of participants' lack of cash or other liquid assets.

### Plan Compliance and Other Changes

- **Changes to Retirement Plan Overpayment Recovery:** Effective immediately, plan fiduciaries will generally not be required to recoup mistaken overpayments. Prior IRS and Department of Labor ("DOL") guidance generally required plans to be "made whole" when a payment was made that exceeded the amount due under the plan. SECURE 2.0 provides that fiduciaries will not fail to comply with ERISA, and plans will not lose qualification status, when a fiduciary chooses not to recoup mistaken overpayments. If a fiduciary chooses to seek repayment, SECURE 2.0 imposes certain limits on the amount that can be recovered and prohibits charging interest.
- **Expansion of EPCRS:** Effective immediately, the Act expands the availability of self-correction under the Employee Plans Compliance Resolution System ("EPCRS"), where the failure in question is inadvertent. By December 29, 2024, the IRS must publish revised guidance for EPCRS consistent with this expansion. In addition, the Act extends EPCRS relief available to auto-enrollment or auto-increase failures, which was scheduled to expire on December 31, 2023. SECURE 2.0 makes this relief permanent.
- **Reduced Notice Obligations for Unenrolled Participants:** Beginning in the 2023 plan year, plan sponsors are no longer required to provide certain plan notices to eligible employees who elect not to enroll in the plan. However, plan sponsors must deliver notices to non-participating employees annually regarding their eligibility to participate.
- **Changes to Top-Heavy Testing:** Beginning in the 2024 plan year, plan sponsors may perform separate top-heavy testing for excludable employees (employees under age 21 with less than one year of service), which

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## SECURE 2.0 Brings Significant 401(k) Plan Changes

aligns top-heavy testing with other nondiscrimination testing for 401(k) plans with respect to excludable employees.

- **Extended Time to Amend a Plan to Increase Benefit Accruals:** Beginning in the 2024 plan year, the deadline for plan amendments that increase participant benefits will be extended. Instead of requiring that such amendments be adopted by the last day of the plan year, as is currently the case, plan sponsors will have until the due date for the plan sponsor's tax return (including extensions) to make such amendments. This aligns with a SECURE Act provision that allows employers to adopt new retirement plans on a retroactive basis.
- **Requirement to Provide Paper Statement in Certain Cases:** Beginning in the 2026 plan year, plan sponsors must provide a paper benefit statement to participants once annually, unless the participant elects otherwise. The DOL is required to issue guidance on such disclosure obligations by December 31, 2024.

### Future Rulemaking

- **Creation of Lost-and-Found Database:** By December 29, 2024, the DOL must create a lost-and-found database in which ERISA plan participants can obtain contact information for plan administrators of retirement plans in which they have participated in the past. Plans will be required to provide certain participant information to the database.
- **Consolidation of Plan Notices:** By December 29, 2024, the DOL and the IRS must publish rules that permit plan sponsors to provide required plan notices on a consolidated basis.
- **Performance Benchmarking for Asset Allocation Funds:** By December 29, 2024, the DOL must publish rules to facilitate benchmarking of target date funds in ERISA individual plan account plan participant disclosures. These regulations will allow an investment that uses a mix of asset classes to be benchmarked against a blend of broad-based securities market indices.

### Lifetime Income and Annuity Changes

In connection with the changes made to RMDs, and building upon the concept of lifetime income, SECURE 2.0 makes various changes to certain retirement income vehicles, such as annuities. For example, the changes remove the RMD barriers for certain lifetime income features under annuities, and increases the amounts that can be allocated to qualified longevity annuity contracts (QLACs). These changes, effective at different intervals, are expected to increase the availability and attractiveness of such products marketed to 401(k) plans.

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## SECURE 2.0 Brings Significant 401(k) Plan Changes

### Conclusion

Building on the SECURE Act, SECURE 2.0 presents the most significant changes to retirement plans in many years. The Act includes numerous changes, both mandatory and voluntary, that will affect 401(k) plan sponsors and plan participants moving forward. Employers and plan sponsors should be aware of these forthcoming plan changes, and continue to monitor future guidance and rulemaking in these areas.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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