401(k) Plan Providers Need To Be Secure After SECURE

By Ary Rosenbaum, Esq.

While I took a couple of courses on ERISA and retirement plans for my Boston University Tax L.LM degree, my real education began in September 1998 when I worked for Harvey Berman, who co-owned a third-party administration (TPA) firm in Syosset and an affiliated law firm that employed me. My teacher wasn't Harvey, but a paralegal named Marge Tracy whose work in retirement plans predated ERISA. Working with Marge wasn't easy and I was a little immature to soak all her knowledge in and deal with her. One wise thing that Marge said was that when the Tax Reform of 1986 happened, a lot of TPA firms involved in defined benefit plans went out of business because they couldn't deal with change. The point she was trying to make is that anytime there is a change in the retirement plan business, there are many plan providers who can't deal with the change and either sell out or go out of business. We saw many plan providers fold their cards in when fee disclosure regulations in 2012 including many insurance company TPAs who sold their 401(k) block of business to their competitors. SECURE and its sequel SECURE 2.0 created many changes in this business and plan providers that fail to adapt, will go by the wayside. This article is all about being secure after SECURE, with my two cents on many of these changes.

PEPs

They often say certain things are the best thing since sliced bread. Just don't know why cutting bread with a knife or machine is a big deal. Many plan providers thought Pooled Employer Plans (PEPs) would be the greatest thing since sliced bread. Like sliced bread, PEPs are a little overrated. PEPs are the old Open Multiple Employer Plans (MEPs) which were codified into law through the first SECURE Act because the Department of Labor (DOL) still didn't want to treat MEPs with adopting employers with zero commonality as a single plan for ERISA purposes.

When introduced in 2021, Pooled Employer Plans (PEPs) were a big deal. It filled a need and a niche, ever since the Department of Labor said "open" Multiple Employer Plans with unrelated employers were not single plans for purposes of ERISA and Form 5500. It's been over 3 years of PEPs and it's not the greatest thing since sliced bread, because very few providers have grown PEPs to a situation where its size has truly led to cost savings for those that adopt one. You see the press releases that. announce the creation of PEPs, but you don't see the press releases when they close up shop as some PEPs have already done so. One of the things we tried to bank on was that PEPs would only first need an audit if they had an adopting employer with 100 or more employees or if the PEP in the aggregate, had more than 1,000 participants with an account balance. The DOL, probably on an anti-PEP bent, announced in 2023, that PEPs would need an audit when they hit that magic 100 participants with an account balance, not 1,000. I hate surprises and this surprise may put some PEPs out to pasture. I think PEPs have space on that shelf of plans and can be attractive as a fiduciary solution for many smaller plans. Until they achieve a size of critical mass, it won't be the cost savings that many plan providers would like to promote. One wise thing that most plan providers have done is that they haven't priced PEPs to the point where they are truly lowering their fees to get PEP business that hasn't materialized. If plan providers got a nickel for every time that advisors would claim they would have an audience for PEPs, they'd be rich. I think PEPs will be an effective solution for many plan providers and adopting employers, as long as struggling PEPs close up shop and narrow the market because I think there are still too many PEPs out there.

After-Tax, Roth Employer Contributions

One of the provisions in SECURE 2.0 allows plan participants to elect to have any employer contributions funded to their 401(k) plan made as a Roth contribution. Like with Roth salary deferrals, participants making such an election will owe income tax on the contributions but will avoid tax on qualified distributions of both principal and income. Unlike mandatory Roth contributions for participants for catch-up contributions who are Highly Compensated Employees (I assume that will be effective in 2025), this is an optional provision for plan sponsors. As someone who hates volunteering people for work, this is a hard pass for me because of the added work that TPAs would have to do for

this. I would not recommend this provision to any plan sponsors, because it won't be popular because most participants can't afford to pay taxes on employer contributions upfront. I think it will be a lot of work for the one or two employees who can afford it and want to do it. The biggest problem with this provision is that any Roth employer contribution would have to be fully vested. Most plan sponsors won't want to reward those selecting Roth employer contributions with immediate vesting. In addition, there is a headache of recordkeeping. Since it's an employer contribution and the participant will have to pay tax on it, there is the issue of tax reporting. If a participant elects to receive matching or nonelective contributions (profit sharing) as Roth contributions, the Roth contributions are treated as an in-plan Roth rollover and must be reported on Form 1099-R (and not a Form W-2) for the year in which the contributions are allocated to the employee's account (even if the contributions are designated for a prior year). Roth contributions will not be subject to FICA taxes, and federal income tax withholding does not apply. So, the participant would need to adjust their tax withholding to avoid owing additional income tax at the end of the year. The TPA is the likely one that will have to issue a 1099R. TPAs are going to want to be paid for this added work. While I love the idea of Roth IRAs and Roth 401(k) deferrals, I think Roth employer contributions are too much work for you to offer, because I don't believe that they will be very popular. This provision reminds me of the Sidecar IRA provision that allowed participants to make IRA contributions within their 401(k) plans. That provision was as popular as Crystal Pepsi.

Emergency Savings Accounts

Secure 2.0 allowed a lot of optional provisions for plan sponsors. One nugget is something the Department of Labor (DOL) calls Pension Linked Emergency Savings Account (PLESA). PLESAs are tied to a defined contribution retirement plan, such as a 401(k) plan. A PLESA balance is capped at $2,500 (which may increase over time because of inflation), and participants would be able to withdraw from the account at their discretion without paying a 10% early withdrawal fee. Unlike hardship distributions, participants will not be required to prove a hardship, or even be experiencing one, to take money from a PLESA; withdrawals may be taken at "the discretion of the participant." As a plan provider, I won't recommend this. It's too much recordkeeping for too little money. The contributions are after-tax, like the old voluntary contributions. With contributions capped at $2,500, that seems you would need to do a whole lot of work for a small amount of money. $2,500 isn't much for an emergency. With plans loans and hardship distributions available under most plans, I just PLESAs aren't necessary with such a low maximum contribution of $2,5000 allowed.

The De Minimis Incentive Rule

I always joke that free stuff goes a long way. SECURE 2.0 authorized plan sponsors to provide "de minimis" financial incentives to employees who elect to participate in the plan. A financial incentive qualifies as a de minimis financial incentive only if its value does not exceed $250. De minimis financial incentives apply only to employees without an existing election to defer. I think providing gift cards or free food to get people deferring sounds like a great idea, but I worry about plan providers who will go crazy over them. A $25 gift card per employee to get them to defer can be a huge expense, and unless an employer wants to pay for it, I don't know if that truly is something to be totally vested in them. I'm sure someone will try a 401(k) gift card company or another incentive, but won't have the business to support it.

The student loan match

Starting this year, thanks to SECURE 2.0, plan sponsors can amend their 401(k) plans to make matching contributions with respect to "qualified student loan payments." This loan covers loans for tuition, fees, and room and board expenses incurred by students who are enrolled at least half-time in a degree program at an accredited post-secondary school. The total amount taken into account for an individual's matching contribution, including both loan repayments and elective deferrals, may not exceed the lesser of (1) the annual deferral limit in effect for the year (e.g., $23,000 for 2024) or (2) the participant's compensation. Participants will have to certify that a school loan repayment has been made. For the Actual Contribution percentage test, participants receiving matching contributions on student loan repayments may be tested separately from the rest of the participant pool. In addition, these matching contributions will be considered safe harbor matching contributions for both regular safe harbor plans and qualified automatic contribution arrangements. Student loans are a huge issue, my 25-year-old student loan was just paid off. I think again, I think many small to medium-sized plans are not going to want to offer this option. If there is a minimal amount of work involved in the recordkeeping side, this is something I can get behind, because it allows participants to accrue a benefit, despite a huge student loan bill. Plan sponsors may balk at matching contributions for those who don't defer, but this can be a great tool to recruit and retain employees.

THE ROSENBAUM LAW FIRM P.C.

The Rosenbaum Law Firm P.C.
734 Franklin Avenue, Suite 302
Garden City, New York 11530
(516) 594-1557

http://www.therosenbaumlawfirm.com
Follow us on Twitter @rosenbaumlaw