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Research

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A deeper look at SECURE 2.0

The new law is designed to help employees save more toward retirement and make certain aspects of plan administration easier.

The SECURE 2.0 Act of 2022, a collection of retirement-related provisions signed into law last year as part of the Consolidated Appropriations Act of 2023, is designed to simplify retirement saving. Not only does it increase employees' ability to save for retirement, but it also provides ways to help employees save for an emergency. SECURE 2.0 also contains several provisions to make plan administration easier for plan sponsors.

The law includes both required and optional features. Many of them are effective for the calendar plan year beginning January 1, 2024, but some took immediate effect.

This commentary explores several key provisions of the new law and offers insight into the requirements, timing, and considerations of various provisions.

Required provisions

Required minimum distributions (RMDs)

The Internal Revenue Code (IRC) requires plan participants to begin taking distributions from a qualified plan upon the later of their required beginning date or retirement. SECURE 2.0 increases that required beginning date from age 72 to age 73, effective January 1, 2023. (The age will increase again in 2033 to age 75.) This gives participants who want to delay distributions from their retirement plan the ability to do so. Participants with Roth accounts in employer-sponsored retirement accounts will also benefit, as Roth accounts are no longer subject to pre-death RMDs, effective January 1, 2024.

Despite an administrator's best efforts, timely RMD payments can be missed, which could result in a significant tax penalty for the participant. Under SECURE 2.0, this penalty tax is reduced from 50% to 25%, with a possible further reduction to 10% if certain requirements are met. Vanguard is already in the process of updating our administration to reflect the changes to the RMD rules.

For plans utilizing our RMD service, we will be reaching out to participants turning age 72 in 2023 to let them know that RMDs may not be required.

Catch-up contributions

Catch-up contributions are a great way for participants who started late on their retirement savings journey to make additional contributions to their plan or simply for employees to save more once they reach a certain age. Under current rules, participants may make additional pre-tax deferrals (catch-up contributions) starting the year they turn age 50. (The catch-up limit for 2023 is $7,500.) Effective January 1, 2025, the catch-up limit for participants ages 60, 61, 62, and 63 increases to the greater of $10,000 or 50% more than the then-current catch-up limit.

SECURE 2.0 is also changing the way certain participants must make catch-up contributions. Effective January 1, 2024, participants who earned more than $145,000 in the previous year may only make catch-up contributions as Roth contributions. Participants who earned less than $145,000 may continue to make pre-tax catch-up contributions. (Only compensation from the employer sponsoring the plan counts toward the $145,000 limit.)

Beginning January 1, 2024, to continue offering catch-up contributions retirement plans must allow Roth contributions. In 2022, 77% of Vanguard plans offered Roth contributions while 98% offered catch-up contributions.[1] Sponsors of plans not currently offering Roth should start working with Vanguard and their payroll provider to add Roth contributions.

Automatic enrollment

Vanguard has long recognized the power of automatic plan design features. SECURE 2.0 requires 401(k) and 403(b) plans established after December 29, 2022, to offer automatic enrollment design features beginning in the 2025 plan year.

New plans must offer automatic enrollment with saving rates of at least 3% and automatic annual increases of up to at least 10% (but not more than 15%), with limited exceptions.

Existing plans are grandfathered and will not be required to add automatic enrollment or increase.

Long-term part-time employees

One of the biggest barriers to retirement savings sufficiency is that some employees lack access to a retirement plan. The Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE 1.0) attempts to address the issue by requiring part-time employees who worked at least 500 hours in three consecutive years to become eligible to make elective deferrals, effective January 1, 2024. SECURE 2.0 reduces the period from three years to two years, beginning January 1, 2025.

Retirement lost and found

Another challenge the new law tackles is keeping track of retirement benefits from various employers. SECURE 2.0 directs the Department of Labor (DOL) to create a searchable online retirement savings lost-and-found database that will enable workers to locate retirement benefits to which they may be entitled. (No transfer of assets is required.) Plan sponsors will be required to provide certain participant information to the DOL to help populate the database for plan years beginning on or after January 1, 2024.

Annual paper benefit statement

Beginning in 2026, defined contribution plans must provide at least one paper benefit statement each year unless the participant specifically elects electronic delivery.

[1,2] Source: *How America Saves* 2022. Vanguard, 2022.

Vanguard believes automatic plan design features can enhance retirement savings. In 2022, 56% of Vanguard plans offered automatic enrollment, and 69% of automatic enrollment plans offered annual automatic increases.[2]

For more information on automatic plan design, see Hesitant About Autoenrollment? Try Myth Busting.

Optional provisions

Automatic portability of retirement benefits

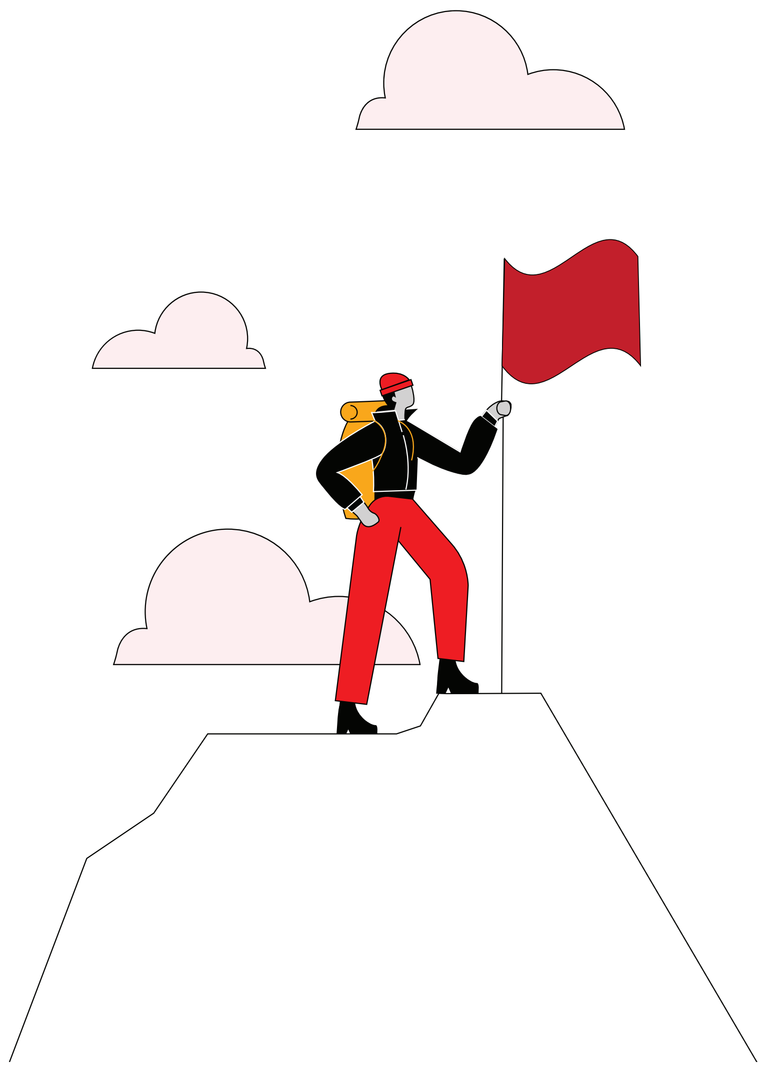
Under SECURE 2.0, temporary DOL guidance allowing a retirement plan service provider to offer automatic portability services is made permanent. Using this feature, a participant's small-balance account that was cashed out from a retirement plan and transferred to an IRA can be automatically transferred to the participant's new employer's retirement plan, provided certain notice requirements are met and the participant does not affirmatively elect otherwise. Currently, small account balances of less than $5,000 may be cashed out. SECURE 2.0 increases that limit to $7,000 for distributions on or after January 1, 2024.

Vanguard and several other large recordkeepers have formed the Portability Services Network. Working with Retirement Clearinghouse, LLC, this consortium will allow plan sponsors to facilitate automatic transfer of participants' small account balances to an IRA and, ultimately, the retirement plan at the participant's new employer.

Qualified student loan repayments

Congress recognizes that overwhelming student loan debt can be a major reason certain employees are unable to contribute to their retirement savings. To help those employees, SECURE 2.0 allows plan sponsors to make matching contributions on qualified student loan repayments without requiring employees to make elective deferrals. Plan sponsors don't need to worry about failing annual nondiscrimination testing despite potentially lower employee deferral rates because SECURE 2.0 allows for separate average deferral percentage (ADP) testing for student loan matching contributions. These provisions are effective for plan years beginning on or after January 1, 2024.

Before determining if student loan matching is right for their plan, plan sponsors should consider several factors, including their current workforce, participation rates, and saving rates. Vanguard, in conjunction with the student debt management platform Candidly, can help plan sponsors who decide to offer this feature to their participants. To learn more, read [What to Know Before Adopting an In-Plan Student Loan Benefit].



Employer contributions designated as Roth contributions

For plan years beginning on or after January 1, 2023, plan sponsors may allow employees to elect to treat any vested employer matching contributions or employer nonelective contributions as Roth contributions. Roth in-plan conversion can provide plan participants with an opportunity to convert employer contributions to Roth while the industry awaits the guidance necessary to make this optional feature available to plans and participants.

In-service withdrawals and distributions

Several new, optional in-service withdrawal provisions allow plans to permit participants to access retirement funds without being subject to the 10% early withdrawal penalty tax and to repay those withdrawals within three years from the date of distribution. These include a withdrawal for domestic abuse victims (in the amount of the lesser of $10,000 or 50% of the participant's vested account balance) and a distribution to participants with a terminal illness (up to the full vested account balance).

A plan may also permit distributions of up to $22,000 for those affected by a federally declared disaster. A disaster distribution would not be subject to the 10% early withdrawal penalty and may be repaid within three years of distribution. Taxes on the distribution are spread over three years unless the participant chooses otherwise. Plans also may offer special loan provisions to participants affected by a federally declared disaster, including offering loans with an increased limit of up to $100,000 (or full vested balance) and suspending existing loan repayments for up to a year.

SECURE 2.0 modifies the current hardship rules to allow plans to permit participants to self-certify that a distribution meets the requirements for a hardship withdrawal and removes inconsistencies between the 401(k) and 403(b) hardship rules.

Emergency savings

Some employees have insufficient savings to support their emergency needs. The law provides two optional features that would give such employees access to retirement funds for emergencies.

First, a plan may allow participants to take a distribution of up to $1,000 for personal or family emergency expenses. This distribution would be exempt from the standard 10% early withdrawal penalty and can be repaid within a three-year period. Only one distribution per year is allowed and participants cannot take additional distributions during the three-year repayment period until they repay their initial distribution.

Second, effective for plan years beginning on or after January 1, 2024, a plan sponsor may offer an emergency savings account within a retirement plan for nonhighly compensated employees. These participants may elect to make contributions to the emergency savings account or may be automatically enrolled at a rate of no more than 3% of compensation.

Vanguard is committed to helping employees succeed in managing their financial future, including their retirement and emergency savings. Learn more about our approach to financial wellness.

Emergency savings (continued)

Amounts are contributed on a Roth basis and may be eligible for an employer match at the same rate as other deferrals. The maximum amount that may be contributed to the account is $2,500. Withdrawals must be permitted at least once a month and the first four withdrawals per year may not be subject to a withdrawal fee.

Notices and disclosures

Over the years, the DOL and IRS have worked to ensure that participants have sufficient information to make informed decisions about participating in a retirement plan. However, those efforts have resulted in a significant number of notices and disclosures to plan participants. No later than three years after enactment, the DOL, IRS, and the Pension Benefit Guaranty Corporation must review current notice requirements for purposes of consolidating, simplifying, and standardizing those notices.

One of the current features of the participant fee disclosure that may be confusing to participants is the use of a broad-based securities market index as the benchmark for target-date funds. This benchmark may not accurately represent the composition of a target-date fund. SECURE 2.0 directs the DOL to issue regulations by the end of December 2024 to allow the use of a composite benchmark (that is, a blend of two or more benchmarks) for target-date funds.

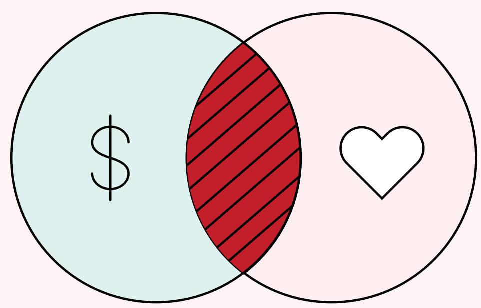
Finally, to reduce the number of notices, eligible nonparticipating employees are no longer required to receive ongoing notices provided they receive initial and annual notices of eligibility.

Correction of administrative errors

Recognizing the complexities of plan administration, SECURE 2.0 includes provisions to streamline the correction of certain unintended plan errors. The current safe harbor correction guidance for automatic enrollment/automatic increase errors under the IRS Employee Plans Compliance Resolution System (EPCRS) that was set to expire in December 2023 is now permanent. Additionally, the IRS is directed to expand the EPCRS program to allow for self-correction of more types of administration errors, including loan failures. Plan sponsors may also now forego recovery of overpayments to plan participants under certain circumstances. Unlike in the past, these unrecovered overpayments will remain eligible for rollover.

Collective investment trusts in 403(b) plans

Although SECURE 2.0 provided the necessary amendments to the tax code to allow the use of collective investment trusts (CITs) in 403(b) plans, the necessary changes to securities law were not made. Because of the lack of securities law relief, we do not expect any CIT providers to offer CITs to 403(b) plans.



Vanguard supports expanding access to low-cost CITs for retirement savings in 403(b) plans and is continuing to work with industry groups to advocate for the needed securities law changes.

Good news for small employers

Credit for small employer plan start-up costs

Currently, small businesses (up to 100 employees) can receive a tax credit when they start a new plan of the lesser of 50% of administrative start-up costs or $5,000. SECURE 2.0 increases the credit to 100% for employers with up to 50 employees. An additional credit based on the percentage of the amount contributed by the employer (subject to certain limitations) is also available to small businesses with fewer than 100 employees. (The additional credit phases out for employers with between 51 and 100 employees). These changes are effective beginning in the 2023 tax year.

Starter 401(k) plans

SECURE 2.0 recognizes the importance of providing access to a retirement savings vehicle and allows employers that don't offer a retirement plan today to offer a "starter 401(k) plan." The starter 401(k) plan can allow employee deferrals only (so, no employer contributions) and would require all employees to automatically be enrolled at a rate of at least 3%, with the ability to opt out. Annual deferral limits would be the same as for IRA contributions ($6,500 in 2023), plus an additional $1,000 in catch-up contributions beginning at age 50. These plans would not be subject to certain nondiscrimination testing requirements. Starter 401(k) plans take effect January 1, 2024.

Looking ahead

SECURE 2.0 provides benefits to both plans sponsors and participants, but there's a lot of work ahead to implement its provisions. Vanguard is here to help. We are continuing to review the law and are awaiting additional guidance on a number of provisions. Look for more information from Vanguard in the coming weeks and months as we move from analysis to implementation.

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All investing is subject to risk, including the possible loss of the money you invest.

Investments in target-date funds are subject to the risks of their underlying funds. The year in the fund name refers to the approximate year (the target date) when an investor in the fund would retire and leave the workforce. The fund will gradually shift its emphasis from more aggressive investments to more conservative ones based on its target date. An investment in target-date funds is not guaranteed at any time, including on or after the target date.

Collective trusts are not mutual funds. These investments are available only to tax-qualified plans and their eligible participants. Investment objectives, risks, charges, expenses, and other important information should be considered carefully before investing.

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