Voya Alert!

January 15, 2025

IRS Issues Proposed Regulations Regarding Mandatory Automatic Enrollment in Qualified Retirement Plans

On January 10, 2025, the Internal Revenue Service (IRS) issued proposed regulations (Proposed Regulations) addressing the mandatory automatic enrollment provisions of Section 101 of the SECURE 2.0 Act of 2022 (SECURE 2.0). The Proposed Regulations under Code section 414A supersede the initial guidance provided in Notice 2024-2 and respond to comments the IRS received on the notice by providing clarification and examples regarding how some aspects of the new requirements would be implemented.

The full text of the Proposed Regulations can be found on the Federal Register at:
https://www.federalregister.gov/public-inspection/2025-00501/automatic-enrollment-requirements-under-section-414a

BACKGROUND – NOTICE 2024-2:

Section 101 of SECURE 2.0 requires that newly formed 401(k) and 403(b) plans must automatically enroll eligible participants who do not otherwise opt out of the plan at a default rate not lower than 3% or greater than 10% of compensation. Such plans must also provide for an automatic escalation feature that increases employee contributions by 1% per year up to at least 10%, but not to exceed 15% of compensation. The plan must permit a participant to make permissible withdrawals no later than 90 days after the date of the first contribution.

This provision does not apply to: (1) 401(k) and 403(b) plans that were adopted prior to December 29, 2022; (2) governmental or church plans; (3) SIMPLE 401(k) plans; (4) new businesses in existence for less than three years; and (5) small employers that normally employ 10 or fewer employees. Notice 2024-2 confirmed that 401(k) and 403(b) plans are considered to be established on the date they are first adopted, not the date the plan is first effective. Notice 2024-2 also provided various scenarios of plan merger and spin-off transactions and the application of the provision related to pre-enactment plans after such transactions.

PROPOSED REGULATIONS:

Automatic Enrollment Requirements

Initial Period. Plans must implement an Eligible Automatic Contribution Arrangement (EACA) with a default rate of at least 3% applying during the employee's "initial period" which begins when the employee is first eligible to elect to have contributions made to the plan and ends on the last day of the following plan year. This is impactful to employees who enter the plan and are automatically enrolled at the plan's minimum default rate late in the plan year, as it allows them a full year at that rate before they are automatically escalated by 1%. Redeterminations of the initial period are permitted under certain circumstances.

Permissible Withdrawals. The Proposed Regulations include the statutory requirement that plans subject to mandatory automatic enrollment permit permissible withdrawals under the existing EACA rules, which provides that a participant may withdraw their automatic contributions, plus earnings, for a period up to 90 days after the participant is initially subject to automatic enrollment.

Investments. The Proposed Regulations include the statutory requirement that the mandatory EACA must be invested in the plan's Qualified Default Investment Alternative (QDIA) unless the participant makes an alternate affirmative investment election.

PLESAs. The Proposed Regulations clarify that a Pension-Linked Emergency Savings Account (PLESA) is part of the 401(k) feature, so an employee's affirmative election to contribute to a PLESA is an affirmative election to contribute to the 401(k) feature. Thus, a participant who makes an affirmative election to the PLESA is not required to be

subject to the automatic enrollment mandate. However, if a participant is automatically enrolled in the PLESA, the automatic contributions to the PLESA would not be able to be used to satisfy the automatic enrollment mandate because the PLESA's designated investment option likely will not satisfy the QDIA investment requirement of the EACA.

Notices. The Proposed Regulations explained that all participants eligible to defer are "covered employees" of the EACA, so participants with affirmative elections must still receive the annual EACA notice even if they are otherwise exempt from the automatic enrollment feature. Additionally, the IRS clarified that no EACA notice is needed for unenrolled participants if the plan provides an annual reminder notice and complies with any other applicable requirements with regard to such participants. Finally, EACA and PLESA notices may be combined with the QDIA and SH notices, so long as the combined notice:

- Includes all required content of all the combined notices;
- Clearly identifies the issues being addressed in the notice;
- Is furnished at a time that meets the requirements (and with a frequency that meets the requirements) of all combined notices;
- Is written in a manner calculated to be understood by the average participant; and
- Does not obscure or fail to highlight the primary information for each of the combined notices.

Coverage

Employees Subject to Mandatory Automatic Enrollment. Although plans that voluntarily implement an EACA have options on who will be subject to the automatic enrollment provision, the Proposed Regulations only permit an employer subject to mandatory automatic enrollment to exclude participants with an affirmative election to defer or not to defer from the automatic enrollment. No classes of employees otherwise eligible to make a deferral election may be excluded from the automatic enrollment, which means that long-term part-time employees must be subject to the automatic enrollment feature.

Coverage Correction. Plans that implemented EACA by the first day of the 2025 plan year in a good faith attempt to comply with the mandate but limited the coverage of the automatic enrollment, i.e., the plan did not cover participants who were already in the plan but did not make an affirmative election, must implement the correct automatic enrollment provision for such employees by the first plan year for which final regulations are effective, computed as though the participant was correctly subject to the automatic enrollment feature when the feature was required to be implemented. Alternatively, the plan terms could provide for a redetermination of the initial period for affected employees, so that they could be automatically enrolled at the initial default contribution rate.

Grandfathered Plans Exempt from the Mandate

The Proposed Regulations provide additional guidance in interpreting the plans and entities who are exempt from the automatic enrollment mandate, which include 401(k) and 403(b) plans established prior to the enactment of SECURE 2.0, SIMPLE 401(k) plans, governmental plans (including public schools), church plans, new businesses that have been in existence for less than three years, and small businesses that normally employ 10 or fewer employees.

Pre-enactment Plans. The Proposed Regulations confirm that a 401(k) plan or 403(b) plan is established when it is adopted, *not* when it is effective. This means that as long as a plan with a 401(k) feature was *adopted* prior to December 29, 2022, it is considered a pre-enactment plan, even if the plan was originally effective 1/1/2023. Additionally, plan amendments to pre-enactment plans generally have no impact to the plan's grandfathered status with regard to the automatic enrollment mandate.

New Business Exception. The IRS clarified that a new business must comply with the automatic enrollment mandate no later than the first plan year that begins on or after the third anniversary of the employer's existence, including the existence of any predecessor employer. The IRS requested comments on whether guidance as to what constitutes a predecessor employer for this purpose is needed.

Small Business Exception. The Proposed Regulations provide that the automatic enrollment requirements do not apply to a 401(k) or 403(b) plan before the first plan year that begins at least 12 months after the close of the first taxable year with respect to which the employer maintaining the plan normally employed more than 10 employees. For purposes of

this exception, the COBRA rules apply in determining the number of employees in a given tax year, where only common law employees are counted, and part-time employees are counted as a fraction. Thus, under these rules, a company will be determined to "normally employ" 11 people if there are at least 11 people during 50% of the company's fiscal year.

MEPs, PEPs, Multiemployer and Plans Maintained by Related Employers. Entities that adopt a MEP or PEP on or after December 29, 2022, will be subject to the automatic enrollment mandate unless another exception to the mandate applies. For this purpose, entities that adopt a MEP or PEP will apply the new business and small business exceptions individually, but this rule does not apply to multiemployer plans or plans maintained by related employers. Thus, a pre-enactment multiemployer plan would continue to be treated as a pre-enactment plan with respect to an employer that adopts the plan on or after December 29, 2022, or with respect to an employer that merges a plan into the multiemployer plan, regardless of the date the merged-in plan was established.

Mergers and Spinoffs. As a result of the number of comments received after Notice 2024-2 was issued, the Proposed Regulations provide additional guidance regarding the determination of whether a plan that is merged into or that spins off of another is subject to the automatic enrollment mandate:

- **Merger of Two Pre-enactment Plans.** The plan with be treated as a pre-enactment plan, regardless of whether the plans involved were single employer plans or MEPs/PEPs.
- **Merger of Pre-enactment Plan with Post-enactment Plan.** Generally, the merger of a pre-enactment plan with a post-enactment plan results in the merged plan being treated as a post-enactment plan subject to the automatic enrollment mandate, with the following exceptions:
    - ***Corporate transactions.*** If the merger of a single employer post-enactment plan and a single employer pre-enactment plan occurs in connection with certain corporate acquisitions and dispositions, and the pre-enactment plan is designated as the surviving plan, then the surviving plan will be treated as a pre-enactment plan if the merger occurs within the transition period described in Code Section 410(B)(6)(C)(ii) that begins on the date of the transaction and ends on the last day of the following plan year. This is true even if the pre-enactment surviving plan is a MEP/PEP.
    - ***Merger of Pre-enactment Single Employer Plan Into MEP/PEP.*** In a change from Notice 2024-2, the Proposed Regulations provide that the MEP/PEP will be treated as a pre-enactment plan with respect to that employer regardless of when the MEP/PEP was established.
    - ***Merger of two MEPs/PEPs.*** If a pre-enactment MEP or PEP merges with a post-enactment MEP or PEP, the merger would not affect whether the merged plan is treated as a pre-enactment plan with respect to any employer that maintained either MEP or PEP prior to the merger.
    - ***Merger of Pre-enactment Plan with Plan That Does Not Include 401(k) Feature.*** If a pre-enactment plan merges into a plan that does not have a 401(k) feature, or a salary reduction agreement in the case of a 403(b) plan, the surviving plan will be treated as a pre-enactment plan.
- **Merger of Post-enactment Single Employer Plan Into MEP/PEP.** If an employer that maintains a post-enactment single employer plan merges that plan into a MEP/PEP, then the MEP/PEP will not be treated as a pre-enactment plan with respect to that employer unless the exception described above for corporate transactions involving a MEP/PEP applies.
- **Spin-offs.** The Proposed Regulations provide that, if a portion of a pre-enactment single employer plan or MEP/PEP is spun off, the new spun-off plan is also treated as a pre-enactment plan. If the plan was treated as a post-enactment plan with respect to the employer that spins off of the MEP/PEP, the new spun-off plan is also treated as a post-enactment plan.

<u>Effective Date</u>

The new automatic enrollment requirements apply to plan years beginning after December 31, 2024; however, the IRS proposes to make these regulations applicable to plan years beginning more than six months after publication of the final rules. Thus, for plan years between the required implementation date and the effective date of the regulations, a plan would be treated as having complied with the automatic enrollment mandate if the plan complies with a reasonable, good faith interpretation of the statute.

This publication is meant only as a high-level summary of some of the key points contained in the proposed regulations. Plan sponsors should review the final regulations with the plan's attorney to determine impact of these changes on the sponsor's retirement plan. Voya will continue to monitor and communicate future developments.

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