IRS Clarification Urgently Needed for SECURE 2.0 Automatic Enrollment and Escalation Implementation

On December 21, 2023, the Internal Revenue Service released guidance (IRS Notice 2024-2) in the form of questions and answers concerning specific provisions of the SECURE 2.0 Act of 2022, including a focus on Section 101, which generally requires 401(k) plans with cash or deferred arrangements (CODA) established after the date of enactment to have automatic enrollment and escalation effective for plan years beginning after December 31, 2024.

Unfortunately, the guidance has confused and concerned the retirement community because it seems to indicate that a distinction exists between pre-enactment pooled employer plans (PEPs) and post-enactment PEPs. Specifically, that if a plan with a pre-enactment CODA merges into a pre-enactment PEP, it will retain pre-enactment status for purposes of the exclusion from this requirement, but if the same plan merges into a post-enactment PEP, it will lose its pre-enactment status, i.e., an employer in this example, will forfeit its auto-enrollment and escalation grandfather status.

However, the most reasonable interpretation of the statutory language from both a technical and public policy perspective is that the PEP's date of establishment is not a relevant factor when determining whether a plan retains grandfathered status when it joins a PEP; the critical determinant of grandfathered status should rest on whether the employer had an existing plan that was established before the date of SECURE 2.0 enactment.

If the guidance were implemented as is, it would effectively establish two different "classes" of PEPs, which would harm employees and employers by

- discouraging the formation of new PEPs, which will inevitably lead to higher participant fees and limit innovation in the PEP market as employers may be drawn to pre-enactment PEPs rather than risking the loss of grandfathering,
- impacting the employee experience in that they may only be exposed to pre-enactment PEP platforms, services and investments choices, any of which could be inferior to offerings that post-enactment PEPs could offer,
- inappropriately limiting a plan fiduciary's options when selecting a PEP,
- placing a roadblock in front of sponsors with collectively bargained plans who want to join a PEP.

Congress intended to expand access to cost-effective and professionally managed retirement savings plans by developing a vibrant PEP marketplace offering cost-effective retirement services and solutions to plan sponsors and employees. The IRS guidance could hinder congressional goals of increasing retirement security and innovation in the retirement marketplace.

Many in the retirement community, including plan sponsors, professional services firms, ERISA experts, and trade associations, have taken a similar view on the guidance and have demonstrated their concerns during the IRS comment period. Most of the comments submitted to the IRS were about this issue, and they uniformly asked the IRS to clarify their guidance and allow grandfathered plans to keep that status when joining **any** PEP, not just pre-enactment PEPs.

As a result, the IRS should release additional clarifying guidance that would ensure a plan with a pre-enactment CODA can preserve its pre-enactment status when joining a PEP, regardless of when the PEP was established. Additionally, Congress should include this clarification in the legislative package of SECURE 2.0 technical corrections to further demonstrate that Congress intended the employers joining PEPs to be treated as the plan sponsor concerning the portion of the plan attributable to the employees of such employer, in accordance with IRC § 413(e)(3)(D).

Below are Representative Excerpts from SECURE 2.0 Grab Bag Comment Letters in Support of the Aforementioned Position and for Additional IRS/Treasury Clarification

WTW: "… an immediate need exists to issue supplemental clarifying guidance indicating that a plan with a pre-enactment CODA can preserve its status when joining any PEP, regardless of whether the PEP is a pre-enactment PEP or post-enactment PEP. Not doing so will effectively result in a limited special class of PEPs that can offer something no other PEPs can offer (i.e., retention of pre-enactment status), leading to the following adverse consequences for employers and employees …
… A plan fiduciary's options could be inappropriately limited when selecting among PEPs … Similarly, a sponsor of a collectively bargained plan without automatic enrollment … may be unable to join a post-enactment PEP because it is bound by the terms of the bargaining agreement, even if the plan fiduciary determines that a pooled plan provider with a post-enactment PEP would be the best option for plan participants…. and
… It could decrease competition, which could then lead to higher participant fees or less innovation."

American Benefits Council (ABC): "One major concern related to the notice … relates to Q&A A-3, which we interpret to mean … that if a single-employer plan that includes a pre-enactment qualified CODA is merged into a pooled employer plan (PEP) … that was established on or after December 29, 2022, the single-employer plan loses its status as having a pre-enactment qualified CODA. … [W]e believe that this result (1) is technically incorrect, and (2) will have very adverse policy effects."

The ERISA Industry Committee (ERIC): "IRS should clarify that if a pre-enactment single employer plan is merged into a post-enactment plan maintained by more than one employer, the CODA should be treated as pre-enactment with respect to that single employer."

Groom Law Group: "A plan sponsor is eligible for grandfathering status if it had a plan – of any kind – in place at the time of SECURE 2.0's enactment. Legislative history and intent do not support a conclusion that a plan sponsor loses grandfathered status under Code section 414A merely by joining a PEP that was established after the enactment of SECURE 2.0."

Faegre Drinker: "…we would respectfully implore the IRS to issue clarifying guidance making clear that, despite what Q&A #2 could be read to imply, an employer with a pre-enactment qualified CODA will remain exempt from the SECURE 2.0 automatic enrollment requirements if it merges into a multiple employer plan after December 29, 2022 without regard to whether multiple employer plan itself had a qualified CODA … in place prior to December 29, 2022. … This would be the best interpretation from both a policy perspective, as well as from a legal and regulatory perspective."

Investment Company Institute (ICI): "We urge the Service to expressly confirm that the application of the grandfather rule to a MEP with respect to each participating employer plan depends on the date the employer first adopted the plan, regardless of when the MEP itself was first established. Not only is this the better reading of the statute, but it also is preferable for policy reasons. It is clear that Congress' intention with the SECURE 2.0 Act is to expand the availability and use of PEPs. Treating PEPs that were established after December 29, 2022 differently than those established before that date would put newer PEPs at a significant disadvantage in the marketplace, discouraging the adoption of newer PEPs."

The Standard: "When a single employer joins a PEP, … for most purposes, [it] continues to operate under requirements distinct from the other employers who adopt the PEP. For example, many of the rules governing the operation and qualification of retirement plans continue to apply employer-by-employer… For these reasons, and others, when a single employer plan with a pre-enactment CODA joins a pre- or post-enactment PEP, it should be viewed as continuing its pre-enactment CODA …"

Organizations that made similar comments: American Retirement Association; SPARK; KeyBank.