GROOM LAW GROUP

Publications

IRS Issues Guidance on Mandatory Automatic Enrollment

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On January 10, 2025, the Treasury Department and the IRS issued Proposed Regulations addressing one of SECURE 2.0's signature requirements: that all newly established 401(k) plans and 403(b) plans with cash or deferred arrangements include automatic enrollment features. The Proposed Regulations largely incorporate previous interim guidance issued by the IRS at the end of 2023, with some important clarifications. The Proposed Regulations also address various participant notice requirements for plans subject to the automatic enrollment requirements.

A. Background

A key objective of SECURE 2.0 was to encourage more Americans to participate in workplace retirement savings plans, and many of the Act's ninety-plus reforms are aimed at this goal. Reflecting the significant role that automatic enrollment plays in driving employee participation,[1] the very first provision (Section 101) of SECURE 2.0 requires all new 401(k) and 403(b) plans to use automatic enrollment. Under the legislation as enacted, the automatic enrollment requirements do not apply to plans established prior to the enactment of SECURE 2.0 (December 29, 2022), nor to church plans, governmental plans, or plans maintained by certain small or new businesses. However, the legislation left open how some of these carve-outs would apply to unique situations, such as plan mergers and spin-offs.

In December 2023, the IRS issued Notice 2024-2, which included guidance on a number of SECURE 2.0 provisions, including Section 101's automatic enrollment requirements. Notice 2024-2 clarified that a plan with a cash or deferred arrangement was considered to be established prior to SECURE 2.0's enactment as long as it was adopted prior to that date (even if the effective date was later). The Notice also provided interim guidance on the impact of plan mergers and spin-offs.

B. Proposed Regulations

- *Required Terms.* The Proposed Regulations provide generally that a cash or deferred arrangement ("CODA") will not be treated as qualified, and a 403(b) plan with a CODA will not be treated as satisfying the 403(b) rules, unless the automatic enrollment requirements ("AE requirements")

described in the Proposed Regulation are satisfied. Plans subject to the AE requirements must offer an eligible automatic contribution arrangement ("EACA"), as described in Code Section 414(w), in which participants are enrolled at a uniform deferral percentage of between 3 and 10 percent, with annual 1 percent increases up to a maximum of between 10 and 15 percent. The Proposed Regulations further provide that participants must be allowed to withdraw their deferrals within 90 days of the first automatic contribution to the plan.

- *Covered Employees.* In response to comments, the Proposed Regulations clarify that all employees eligible to make salary deferrals (including "long-term part-time employees") to a plan that is subject to the AE requirements must be covered by the EACA. This includes employees hired prior to the date that the AE requirements first apply, if the employees have not made affirmative deferral elections prior to such date. However, if a participant has an affirmative deferral election in place on the date that a plan first becomes subject to the AE requirements (including an affirmative election not to defer any compensation), the participant's existing election can remain in place.
- *Rehired Employees.* The Proposed Regulations allow plans to provide that if an employee is not eligible to have default contributions made on their behalf for an entire plan year, they may be treated as a new employee for purposes of determining their default deferral percentage upon rehire. For example, if employee P is automatically enrolled in 2025 with a 3 percent deferral rate, which is automatically increased to 4 percent in 2026, and P terminates employment in late 2026 before being rehired in early 2028, P may be automatically enrolled at 3 percent upon rehire. This treatment of rehired employees is similar to how rehires are treated under qualified automatic contribution arrangements ("QACAs").
- *New and Small Businesses.* SECURE 2.0 provides that the AE requirements do not apply to employers which have been in existence for less than 3 years. The legislation left open how quickly after the end of the 3-year period an employer would be required to comply with the AE requirements. The Proposed Regulations clarify that the AE requirements would apply at the start of the first plan year in which, as of the first day of such plan year, the employer has been in existence for at least 3 years.

SECURE 2.0 also excludes businesses with 10 or fewer employees from the AE requirements, but did not specify how employees should be counted for this purpose. The Proposed Regulations instruct employers to use the same methodology that applies when counting employees for purposes of COBRA's continuation coverage requirements. For example, each full-time employee counts as 1 employee, while part-time employees are counted on a fractional basis.

- *Multiple Employer Plans.* For multiple employer plans ("MEPs"), which include pooled employer plans ("PEPs"), the Proposed Regulations clarify that whether the AE requirements apply (including the exceptions for new and small businesses) is determined on an employer-by-employer basis. Importantly, this means that a plan established prior to December 29, 2022 ("pre-enactment plan"), or a plan sponsored by a new or small employer, will not automatically become subject to the AE requirements merely by joining a MEP or PEP, regardless of when the MEP or PEP was established.
- *Plan Mergers and Spin-Offs*. The Proposed Regulations largely incorporate prior Q&A guidance from IRS Notice 2024-2. Specifically, the Proposed Regulations explain that the merger of two pre-enactment plans into a single plan does not cause the post-merger plan to be treated as "newly established" and subject to the AE requirements. By contrast, the merger of a plan that is subject to the AE requirements with a pre-enactment plan would generally result in the post-merger plan being subject to the AE requirements. However, if the merger of a pre-enactment plan and a plan subject to the AE requirements occurs within the transition period described in Code Section 410(b)(6)(C), and the sponsor designates the pre-enactment plan as the post-merger ongoing plan, then the entire ongoing plan will be treated as a pre-enactment plan. With respect to spin-offs, a plan resulting from the spin-off of a portion of a pre-enactment plan generally will be treated as a pre-enactment plan.
- *Plan Amendments.* The Proposed Regulations confirm that most plan amendments would not affect a plan's status as a pre-enactment plan. As discussed above, a plan amendment relating to a plan merger, or to adopt a multiple employer plan would have to be reviewed to determine whether it would cause the EACA requirements to apply.
- *Participant Notices.* Another provision of SECURE 2.0 (Section 320) allows plans to provide certain unenrolled participants with an annual "reminder" notice in lieu of the full suite of annual plan notices provided to active participants. The Proposed Regulations confirm that for plans subject to the AE requirements, EACA notices need not be provided to unenrolled participants who receive the reminder notice. The Proposed Regulations also confirm that the required EACA notices may be combined with other required participant notices, including automatic enrollment and default investment notices, notices required for Pension-Linked Emergency Savings Accounts, QACA notices, and annual safe harbor notices.

C. Next Steps

While this guidance will not be effective until the first plan year beginning 6 months after the IRS issues final regulations, the automatic enrollment requirements of SECURE 2.0 are effective for plan years beginning on and after January 1, 2025. For plan years before the final regulations become effective, plans will be treated as compliant as long as they follow a reasonable, good faith interpretation of the law.