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Publications

New Guidance on Pension-Linked Emergency Savings Accounts

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Over the past several years, there has been a growing interest in enhancing employee benefit programs to help employees save for emergencies. Employers and service providers have developed a number of different types of emergency savings programs with some being "in plan" (*i.e.*, established within a qualified retirement plan) and others being offered as standalone saving options. In an effort to facilitate the in-plan approach, Congress included a provision in the SECURE 2.0 Act of 2022 ("SECURE 2.0") intended to provide a framework for integrating emergency savings accounts into defined contribution plans.

For plan years beginning after December 31, 2023, Section 127 of SECURE 2.0 allows employers to establish pension-linked emergency savings accounts ("PLESAs"). Participants (other than highly compensated employees) may contribute to a PLESA on an after tax (*i.e.,* Roth) basis subject to a $2,500 statutory maximum, though a sponsor may set a lower amount. A participant may take tax-free withdrawals from a PLESA for any reason. Employers cannot contribute to PLESAs, but they must take employees contributions to PLESAs into account when making matching contributions to the plan. While participation in PLESAs is voluntary for participants, SECURE 2.0 permits, but does not require, employers to automatically enroll participants.

The Biden Administration has expressed interest in encouraging emergency savings programs, and recently released guidance intended to clarify a number of open legal questions related to PLESAs. First, the Internal Revenue Service ("IRS") issued Notice 2024-22 (the "Notice") to clarify the anti-abuse rules applicable to PLESAs under the Internal Revenue Code of 1986, as amended (the "Code"). Shortly thereafter, the Department of Labor ("DOL") issued a series of Frequently Asked Questions (the "FAQs") to explain some of the requirements applicable to PLESAs under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). The guidance is summarized below.

I. IRS Notice

If a plan that establishes a PLESA has matching contributions on deferrals, the employer also must match the employees' PLESA contributions at the same rate as it does for regular 401(k) contributions (considering only PLESA contributions that do not cause the total participant contributions to exceed the statutory maximum). These employer matching contributions are held as part of the plan account, not within the PLESA, so they are not available for periodic withdrawal when an emergency arises (but are available once vested for distributions in the same manner as a match on 401(k) deferrals) and will grow tax-free inside the tax-qualified plan. To address the concern that an employee could put money into the PLESA just to get the employer match, take a distribution, and then reinvest the same amount again in order to get another employer match on the same funds (*i.e.*, churning), SECURE 2.0 permits employers to establish "reasonable procedures" to limit the frequency or amount of a match.

The Notice provides guidance on these anti-abuse rules. It first highlights several Code provisions that sponsors can use to limit manipulation of matching contributions. Specifically, the Notice points to –

- The requirement (under Code section 402A(e)) that matching contributions be treated as first attributable to elective deferrals outside the PLESA, meaning a participant would have to maximize elective deferrals outside the PLESA in order to receive the match in the PLESA; and
- The ability (under Code section 402A(e)(6)(A)) to impose a lower limit on PLESA contributions, which could decrease the amount of annual matching contributions made with respect to PLESA contributions.

The Notice then states that a "reasonable anti-abuse procedure" would balance the interest of participants in using the PLESA for its intended purpose with the interest of the plan sponsors in preventing manipulation of the plan's matching contribution rules. The Notice provides examples of anti-abuse procedures that are not considered reasonable and, therefore, may not be used to limit the frequency or amount of matching contributions made to the PLESA. Specifically, a plan may not –

- Provide that matching contributions will be forfeited due to a participant's withdrawal from the PLESA;
- Suspend a participant's ability to contribute to the PLESA due to a withdrawal from the PLESA; or
- Suspend matching contributions made on account of elective deferrals to the underlying defined contribution plan.

The Notice also addresses the application of two revenue rulings (Revenue Rulings 74-55 and 74-56), which deal with "churning" of after-tax contributions to manipulate the amount of matching contributions to profit-sharing plans. It clarifies that Treasury and IRS do not view these 50-year-old rulings as applicable to PLESAs, regardless of whether PLESA contributions are matched, and IRS requests comments on the application of the rulings more generally.

The Notice requests comments relating to PLESAs with a particular interest in comments providing examples of reasonable anti-abuse procedures. Comments are due April 5, 2024, and should include a reference to Notice 2024-22.

II. DOL FAQs

Shortly after IRS issued the Notice, DOL issued the FAQs to provide guidance on various rules under ERISA applicable to PLESAs. The FAQs provide the following useful clarifications:

- **Account Size.** The FAQs provide flexibility in designing the $2,500 PLESA account size limitation. They state that the limitation can be applied either with respect to the amount of employee contributions or to the total account size. However, DOL also took the position that sponsors cannot establish an annual, aggregate limit on PLESA contributions, despite language in the statute permitting sponsors to subject contributions to a limit lower than $2,500.
- **Contribution Timing.** DOL clarified that the PLESA contribution timing rules are the same as the rules applicable to other participant contributions. Specifically, the employee contributions must be made on the earliest date that they can reasonably be segregated from the employer's general assets, but in no case later than the 15th business day of the month immediately following the month in which the contribution is either withheld or received by the employer.
- **Withdrawals.** The FAQs state that a participant does not need to provide any evidence of an emergency to make a withdrawal from a PLESA. DOL also decided not to exercise its statutory authority to impose additional administrative requirements on distributions.
- **Accounting/Recordkeeping**. ERISA requires that plans separately account for PLESAs. The FAQs reiterate this requirement, but permit sponsors to hold PLESA assets in a segregated omnibus account.

- **Fees.** A PLESA may not be subject to any fees for the first four withdrawals and may only be subject to reasonable fees thereafter. DOL clarifies in the FAQs that the reasonableness of fees (and of the fee allocation) can be determined consistent with prior DOL guidance and the general fiduciary standards under ERISA.

Although some of the FAQs are useful, the guidance left unresolved a number of key questions about PLESAs. For example –

- **Involuntary Distributions**. The majority of 401(k) plans involuntarily distribute small accounts for terminated vested participants, and there have been question about how the involuntary distribution rules work for plans with PLESAs. SECURE 2.0 did not address the issue, and the FAQs appear further muddy the waters by interpreting the statutory language to prohibit "any policy requiring closure and distribution of a PLESA based on a minimum balance requirement."

- **Governmental Plans**. The amendments to the Code permitting PLESAs appear to contemplate the use of PLESAs by governmental plans. However, the statute also requires that PLESAs be "established pursuant to section 801 of [ERISA]," which some have interpreted as limiting PLESAs to ERISA-covered plans. Some had hoped that DOL (or Treasury) would clarify that a PLESA merely needs to be established in a manner consistent with ERISA and does not need to be subject to ERISA. However, the FAQs do not address the issue.

- **Stable Value Funds**. PLESAs are required to be invested in cash, interest-bearing deposit accounts, or an investment designed to "maintain over the term of the investment the dollar value that is equal to the amount invested in the product and preserve principal and provide a reasonable rate of return, whether or not such return is guaranteed, consistent with the need for liquidity[.]" Stable value products typically seek to preserve participants' invested principal, credit reasonable rates of interest and provide benefit responsive levels of liquidity, including by allowing participants to withdraw their account balances as permitted under the terms of the plan. To that extent, stable value products would generally appear to be a fit with PLESA investment needs.

  However, the FAQs contain a potentially significant issue for plan fiduciaries. By observing that investment products with "liquidity constraints, such as surrender charges at the participant or plan level" are generally incompatible with the statutory objectives of capital preservation and liquidity consistent with immediate access to savings to respond to unexpected financial needs, DOL implies that the selection of PLESA investment products that provide for such liquidity constraints could be an imprudent choice.

  DOL cites surrender charges as an example, but the same concept could similarly apply to products with a market value adjustment ("MVA") feature. Many stable value products that provide for a surrender charge or an MVA upon a plan-level immediate withdrawal event also contain an alternative discontinuance pay-out feature over a period of years under which the plan may avoid an MVA or surrender charge while continuing to provide benefit responsive liquidity. In light of the DOL's guidance, stable value products containing such an alternative pay-out feature would appear to be the better fit for PLESAs. We note that DOL has authority under the statute to permit "reasonable restrictions" but, apparently, has declined to exercise the authority (at least for now).

The FAQs state that DOL is still evaluating issues related to Form 5500 reporting and model participant notices.