

## Publications

# SECURE 2.0 Creates New Opportunity to Use Surplus Pension Assets for Retiree Welfare Benefits

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Employers that maintain overfunded pension plans and are looking for ways to fund retiree health and/or group term life should take a fresh look at Section 420 of the Internal Revenue Code (“Section 420”), as amended by a provision tucked away near the end of the massive package of retirement plan changes in SECURE 2.0. Originally set to expire at the end of 2025, the SECURE 2.0 provision extends Section 420 through the end of 2032 and relaxes one of the key requirements to use surplus pension assets to pay retiree health and life insurance benefits for newly created *de minimis* transfers. We highlight this new option below.

## Background

Section 420 permits a transfer of assets in an overfunded pension plan to a separate health benefits “401(h) account” or an applicable life insurance account, that is part of that plan, to provide the retiree health and/or group term life insurance benefits reasonably estimated to be incurred over a “transfer period” selected by the plan sponsor. The “transfer period” (1) can be limited to the taxable year of the transfer for plans with surplus assets that exceed 125% of the plan’s Code Section 430 funding target and target normal cost (the “funded-status threshold”) or (2) include two or more consecutive years within the ten-year period beginning with the taxable year of transfer for plans with a funded-status threshold above 120%. These and numerous other requirements, described in the below “Principal Section 420 Requirements,” apply to such a transfer.

## What Has Changed

The key change made by SECURE 2.0 relates to the level of surplus pension assets that a plan must hold to make a *de minimis* transfer, which is up to 1.75% of plan assets.<sup>[1]</sup> Under this provision, the funded-status threshold for determining a plan’s surplus is reduced to 110%. This lower threshold may create opportunities for more employers looking for alternative sources to fund retiree health and/or group term life

insurance benefits.

The new Section 420 *de minimis* transfer option imposes two additional requirements that are not applicable to transfers under the existing rules. First, the plan's assets must have exceeded the 110% funded-status threshold in each of the two years immediately preceding the year of the *de minimis* transfer. Second, the "cost maintenance period" throughout which the retiree health and/or life insurance benefits must be maintained is extended by an additional two years in the case of a *de minimis* transfer (e.g., seven years rather than five years under existing rules for a single-year transfer).

## Next Steps

The above changes to Section 420 are already in effect. Thus, employers with overfunded pension plans who are interested in funding alternatives for their retiree health and/or group term life insurance benefits may wish to consider the new SECURE 2.0 *de minimis* transfer option. Groom has assisted many employers with 401(h) accounts and Section 420 transfers and would be pleased to discuss this opportunity with interested employers.

## Principal Section 420 Requirements

- Only one transfer is permitted during an employer's taxable year (although a transfer to a retiree health account and a transfer to a retiree life insurance account are treated as one transfer).
- Generally, amounts may be transferred only to the extent they exceed (i) 125% if the transfer period is only one year (120% for a multi-year transfer period), or (ii) 110% in case of a *de minimis* transfer, of the sum of the plan's funding target and the target normal cost. Importantly, in the case of a multi-year transfer period, the plan must maintain the funded-status threshold throughout the transfer period.
- The amount transferred must be used solely to pay for "qualified current retiree liabilities," which include retiree medical and group term life insurance benefits coverage for eligible retired employees. Eligible retired employees are those individuals who are entitled to both pension benefits from the defined benefit plan and retiree benefits from an employer-sponsored group retiree medical or term life insurance plan immediately before the transfer.
- The amount transferred must not exceed the amount that the employer reasonably expects to pay out of the health benefits or life insurance account (whether directly or through reimbursement) for retiree health or life insurance benefits, respectively, during the transfer period.
- The plan must fully vest the accrued pension benefits of all participants, as well as all participants who separated from service within the one-year period ending on the date of the transfer.
- Participants and certain other parties, including the Department of Labor, must be notified of the transfer at least 60 days in advance.
- The employer may not separately fund any health benefits account or VEBA for qualified current retiree liabilities for which a Section 420 transfer has been made.
- Any group health plan and/or group term life insurance plan for which benefits are funded through the health benefits account or life insurance account must meet a "minimum cost" or "minimum benefit" requirement for the entire transfer period plus 4 years (6 years for a *de minimis* transfer).
- To the extent transferred amounts have not been used to provide permissible benefits by the end of the transfer period, they must be transferred back into the general account of the pension plan. This transfer is not included in the employer's gross income, but is subject to the 20% excise tax on employer reversions.