Employee Benefits Corner

Qualified Plans Provide for More than Retirement Benefits—Introducing "Pension-Linked Emergency Savings Accounts"

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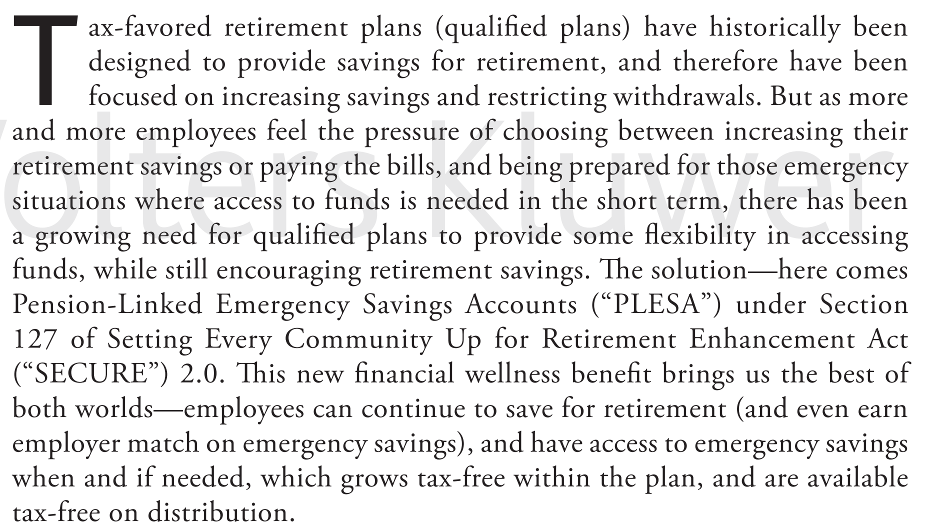

Tax-favored retirement plans (qualified plans) have historically been designed to provide savings for retirement, and therefore have been focused on increasing savings and restricting withdrawals. But as more and more employees feel the pressure of choosing between increasing their retirement savings or paying the bills, and being prepared for those emergency situations where access to funds is needed in the short term, there has been a growing need for qualified plans to provide some flexibility in accessing funds, while still encouraging retirement savings. The solution—here comes Pension-Linked Emergency Savings Accounts ("PLESA") under Section 127 of Setting Every Community Up for Retirement Enhancement Act ("SECURE") 2.0. This new financial wellness benefit brings us the best of both worlds—employees can continue to save for retirement (and even earn employer match on emergency savings), and have access to emergency savings when and if needed, which grows tax-free within the plan, and are available tax-free on distribution.

Let us see how this all works (in question-and-answer format). For sure, the devil is in the details, but hopefully, pending Internal Revenue Service ("IRS") guidance will help make these accounts work and give employees the added security they were looking for when it comes to making retirement savings decisions.

Is the Provision Optional?

Yes, plan sponsors are not required to add a PLESA.

When Is It Effective?

The rules are effective soon—plan years beginning after December 31, 2023. But even with the fast-approaching effective date, as with any new plan design feature, additional IRS guidance is needed (along with extensive system programming) before these programs may become available.

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What Type of Plans Can Have a PLESA?

Plan sponsors of an individual account plan/defined contribution plan are eligible to establish a PLESA (which should include 403(b) and 457(b) plans). We anticipate this will also extend to governmental plans.

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Will a Plan Amendment Be Required?

Yes, for plan sponsors that adopt this provision, a plan amendment will be needed to set forth the feature. Thankfully, plan amendments are not required until the end of the 2025 plan year (so we have some time there), and the Act references guidance on sample plan amendments, which is always welcomed.

Who Is Eligible to Have a PLESA?

Each employee that meets the plan's general age and service (or other eligibility) requirements, and who is not a highly compensated employee ("HCE," as defined under Code Sec. 414(q)) is eligible to establish an account. If after the account is established, the employee becomes an HCE, no further contributions can be made to the account (but can still make withdrawals).

How Is the Account Funded?

Only participants can make contributions to the account, and the contributions must be Roth contributions. This means that contributions to the account are taxed when contributed to the account (like Roth 401(k) deferrals), and are 100% vested when contributed to the account. There is an overall cap on contributions to the account of $2,500 (indexed) (or a lesser amount as determined by the plan sponsor), with special correction procedures (*e.g.*, transfer the excess to Roth 401(k) account in the plan or if no other Roth account, not accept them). Also, no amounts can be transferred from another plan's PLESA.

The plan sponsor can have the program require affirmative consent by participants or can use automatic enrollment (with a cap at 3% of compensation, which can only be changed once annually). The Act provides for state law exemption relief (with additional Department of Labor ("DOL") rules coming).

No employer contributions are allowed to be made to the account. However, if the plan provides for a matching contribution on 401(k) deferrals under the plan, the employer is required to make a matching contribution to the plan (at the same rate of match as applies to 401(k) deferrals, not to exceed the maximum PLESA account balance). Pending IRS guidance, reasonable procedures to limit the frequency or amount of match may be used to prevent abuse (so-called "churning," where a participant puts money in to get the match and take the money out and then back in again for another match on the same dollars).

What Kind of Restrictions Are Placed on These Accounts?

There are a number of restrictions on these PLESAs, including:

- *Separate Accounting*. The plan must separately account for and maintain records for each PLESA account.
- *No Account Minimums*. The plan cannot impose a minimum contribution or minimum account balance requirement.
- *Withdrawals*. Full or partial withdrawals at least once per calendar month, to be paid as soon as practicable to the participant. The plan's normal restrictions on in-service distributions do not apply.
- *Investment*. The account can be held (1) in cash, (2) interest-bearing deposit account, or (3) as an investment product offered by a state or federally regulated financial institution that is designed to preserve principal. Notably, Employee Retirement Income Security Act's ("ERISA's") 404(c) protection is available for these accounts (even if automatically enrolled).
- *Fees*. For the first four withdrawals during a plan year, no fees or charges can be imposed solely due to the withdrawal (after four reasonable withdrawals, fees can be imposed, which must be disclosed to participants).

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How Are Excess 402(g) Contributions Handled?

The PLESA is generally treated for Internal Revenue Code purposes as a designated Roth account. In the event the plan distributes any excess deferrals, the distributions must be made from the PLESA first (if contributions to the PLESA were made in the tax year).

Are There Participant Notice Requirements?

Yes, there are various disclosure requirements for the accounts, with additional DOL guidance pending. For example, the plan administrator must provide participants notice 30–90 days before the first PLESA contribution (or a change in the default contribution rate) and annually thereafter providing various disclosures related to the account. The notice may be consolidated with other plan-related notices.

How Are Withdrawals Taxed?

Withdrawals are treated as qualified distributions, so there is no income tax as a result of the withdrawal, no 10% early withdrawal tax, and no federal income tax withholding required. Note these payments are not eligible for rollover (unless the participant terminated employment, as noted below).

What Happens to the Account When the Employee Terminates Employment?

When an employee terminates employment, the plan must permit the participant to elect to transfer some or all of his/her PLESA to a Roth account in the plan and make the remainder of the PLESA available to the participant as a distribution in a reasonable amount of time. These amounts are treated as eligible rollover distributions, so can be rolled to an individual retirement account ("IRA") or another qualified plan.

Is the PLESA a Protected Benefit?

No, the PLESA can be eliminated at any time. Upon elimination, the plan must permit the participants to elect to transfer some or all of their PLESA to a Roth account in the plan and make the remainder of the ESA available to the participant in a reasonable amount of time (which are eligible for rollover treatment).

Of course, as with any new plan design feature, there are a number of complexities and open issues to be addressed—including the availability of using an eligible automatic contribution arrangement ("EACA") under Code Sec. 414(w), the interplay with the qualified automatic contribution arrangement ("QACA") rules, what simplification is available with regard to the account limit *via* plan design (*e.g.*, difficult-to-track withdrawals for contribution limits), can the accounts be automatically cashed out or rolled to an IRA (the reference to 401(a)(31)(B) does not appear helpful), how to handle and report various corrections (impact on Employee Plans Compliance Resolution System ("EPCRS")—Rev. Proc. Rev. Proc 2021-30) and distributions (Form 1099-R reporting, special distribution codes in box 7), what to do if the plan does not otherwise offer a Roth program, sample notice, sample plan amendment, *etc.* But even with all these details and challenges, this feature has much promise to turn generations to come into avid retirement savers—a worthy endeavor indeed. So, stay tuned!

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