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Pension-Linked Emergency Savings Accounts—An Overview for Plan Sponsors

In January 2024, the U.S. Department of Labor (DOL) and the Internal Revenue Service (IRS) issued new guidance for retirement plan sponsors considering whether to implement the pension-linked emergency savings account (PLESA) feature created by the Setting Every Community Up for Retirement Enhancement 2.0 Act of 2022 (SECURE 2.0). The PLESA feature is effective for plan years on or after January 1, 2024.

When added to a defined contribution plan, PLESAs can allow non highly compensated employees to contribute to short term "side car" accounts for use in financial emergencies. Although PLESAs are intended to encourage greater plan participation and retirement savings among lower income workers, plan sponsors have thus far been reluctant to add the feature over questions on implementation and administration.

This alert provides an overview of PLESAs and the new guidance, concluding with a discussion of several key items plan sponsors should consider before adding PLESAs to their plan.

PLESA Background

An optional provision in SECURE 2.0, plan sponsors can choose whether to include a PLESA component in their defined contribution plans. Furthermore, if a plan sponsor changes its mind and decides to terminate the feature, it can do so at any time without violating the Internal Revenue Code's (Code) anti cutback rules. PLESAs are subject to a number of statutory requirements and offer several plan design choices for sponsors.

- *Eligibility.* Participation in the PLESA feature can be extended to employees who satisfy the retirement plan's age and service requirements, except that highly compensated employees are excluded from participation. Sponsors can choose whether to use an automatic enrollment feature or to require employees to affirmatively elect to participate. If a sponsor opts for automatic enrollment, the maximum rate of contributions is 3 percent of an employee's compensation. Participants must be allowed to reduce the rate of contributions or opt out of the feature entirely.

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- *Contributions and Account Balance Limits*. Participant contributions must be made on a Roth after tax basis, with the maximum account balance set at $2,500, as indexed for inflation, or such lesser amounts as determined by the plan sponsor. Participant contributions more than the maximum account balance can be redirected to their Roth contribution subaccount. Plan sponsors cannot establish minimum account balances or minimum contribution amounts.

  Employer contributions are not permitted. However, if the plan featuring the PLESA has an employer matching contribution component, the sponsor must also match the contributions made to the PLESA at the same rate as other elective deferrals. Employer matching contributions should be made to the participant's matching contribution account, not to the PLESA itself.

- *Withdrawals*. Participants can withdraw all or a portion of their account at their sole discretion (*i.e.*, not subject to hardship criteria) without incurring a 10 percent early withdrawal penalty. Additionally, while plan sponsors are permitted to impose reasonable restrictions on the withdrawal of funds, participants must be able to make full or partial withdrawals at least on a monthly basis. Plan sponsors cannot assess fees on an employee's first four withdrawals in a plan year, but additional withdrawals may be subject to reasonable fees.

Although SECURE 2.0 outlines the general statutory requirements for PLESAs, plan sponsors and service providers have sought additional federal guidance on how to implement the benefit. In January 2024, the DOL and IRS each released separate pieces of guidance with the hope of adding clarity.

IRS Notice 2024 22

In Notice 2024 22 (Notice), the IRS focused the first round of PLESA guidance on anti abuse provisions. Plan sponsors have expressed concerns that participants could leverage PLESAs to cause their matching contributions to exceed the intended amounts or frequency. In the Notice, the IRS noted that some statutory features of PLESAs may be sufficient on their own to prevent abusive practices.

- The total amount of matching contributions attributable to PLESAs is limited to the maximum account balance provided by the plan (*e.g.,* $2,500, or less as determined by the plan sponsor).

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- Matching contributions must be treated as first attributable to the participant's elective deferrals other than PLESA contributions.
- Participants can be limited to one distribution per month.

Nonetheless, the IRS acknowledged that sponsors may want to implement additional measures to discourage abuse. The IRS specified that anti abuse procedures must be reasonable, meaning they balance the interests of participants in using the PLESA for its intended purpose with the sponsor's interest in preventing manipulation of the plan's matching contribution rules. The IRS also described three unreasonable procedures that are prohibited: (1) forfeitures of employer matching contributions; (2) suspension of participant contributions to the PLESA; and (3) suspension of matching contributions on participant elective deferrals to the underlying plan.

DOL FAQs

In the second round of guidance, the DOL released a series of Frequently Asked Questions (FAQs) to provide general compliance information for plan sponsors. The FAQs cover a range of topics, from eligibility and enrollment to reporting and fees. Highlights include:

- *Contributions and Earnings.* Plans cannot place an annual limit on PLESA contributions, but the contributions apply toward the Code section 402(g) limit on elective deferrals ($23,000 for 2024). In applying the maximum account balance ($2,500) provision, plan sponsors are permitted to include or exclude earnings on the participant's contributions.
- *Investment*. PLESA contributions must be held in cash, in an interest bearing deposit account, or in an investment product designed to maintain and preserve principal and provide a reasonable rate of return. The contributions generally cannot be invested in the plan's qualified default investment alternative.
- *Fees.* Plan sponsors can assess reasonable administration fees and expenses on PLESAs or the individual account plan to which they are connected.
- *Reporting*. Plan sponsors must make certain disclosures available to participants at least 30 days before their first contribution to the PLESA and annually thereafter. Plan sponsors can consolidate the PLESA notice with other DOL required notices and disclosures.

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Plan Sponsor Considerations

While the new DOL and IRS guidance sheds light on PLESA implementation, it is unclear whether it will be enough for plan sponsors to seriously consider adding the benefit for their employees. To this point, plan sponsors have been reluctant to consider PLESAs over concerns with administration and compliance. Some plan sponsors have also expressed concern that PLESAs, in allowing employees unfettered access to their retirement savings for any deemed "emergency," are contrary to the sponsor's objective of promoting long-term savings for retirement. This is especially the case where hardship distributions have been made available for employees in the midst of severe financial distress.

Even those sponsors who are interested in taking the lead on PLESAs have faced push-back and delays from recordkeepers. Because the number of sponsors considering PLESAs has been low, recordkeepers have been reluctant to expend the resources necessary to reprogram their systems and process to account for PLESA operations. Given this uncertainty, plan sponsors considering PLESAs will have to weigh their goal of encouraging savings against the potential time and expenditures needed to properly implement the benefit.

If you have questions about PLESAs and the potential impact these legal changes could have on your benefit plans, please contact your Reinhart benefits attorney.

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