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SECURE 2.0: A Deeper Dive into the Provisions Affecting Defined Benefit Pension Plans

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The SECURE 2.0 Act of 2022 ("SECURE 2.0") includes a number of changes that affect defined benefit pension plans. This includes new reporting and disclosure requirements in connection with offering a lump sum window and possible changes to fiduciary duties in connection with annuity purchases in pension risk transfer transactions. We have provided an overview of these rules and other key changes for pension plans below.

I. Pension Plan De-Risking

Plan sponsors have been taking a number of steps to "de-risk" defined benefit pension plans, such as reducing plan liabilities by offering temporary lump sum windows or transferring some or all liabilities of the plan to an insurance company through an annuity purchase. SECURE 2.0 includes provisions requiring reporting, disclosure, and updated fiduciary guidance regarding de-risking activities. These provisions will not become effective until Department of Labor ("DOL") regulations have been issued.

A. Lump Sum Window Disclosures

A lump sum window requires a critical decision for retirees that may affect their financial security for the rest of their lives. Some participants may benefit from taking their pension benefit in an immediate lump sum because the lump sum can give them flexibility to pay expenses or can be invested to enhance their retirement savings. Others may be better served by receiving an annuity providing guaranteed lifetime income. SECURE 2.0 includes requirements that are intended to ensure that participants have sufficient information to make this decision through a standard disclosure.

Specifically, SECURE 2.0 requires a special notice written in plain language to be provided to participants or beneficiaries at least 90 days before the election period for a lump sum window begins. This notice must describe the available benefit options, how the lump sum was calculated, and the relative value of the lump sum. The notice must also describe the tax implications of a lump sum, the ramifications of electing a lump sum, and the procedures for making an election.

SECURE 2.0 directs the DOL to issue a model lump sum window notice. In August, the DOL issued a request for information ("RFI") regarding SECURE 2.0 changes to reporting and disclosure requirements that are within its jurisdiction, including the lump sum window disclosure. The RFI requests comments on a model notice, and suggests that a model notice prepared by the ERISA Advisory Council in November 2015 could be the DOL's starting point.

Failing to provide a required lump sum window notice could result in penalties payable to the participant or beneficiary as well as lawsuits seeking equitable relief by participants and beneficiaries or the DOL.

The new requirements will apply within one year after a final rule is published, which may not be before December 29, 2023.

Additional Considerations. While the decision to offer a lump sum window is made by a company

in its settlor capacity and not subject to the fiduciary rules, communications regarding the lump sum window may be subject to fiduciary standards. Accordingly, fiduciaries should consider whether disclosures regarding a lump sum window are appropriate and sufficient for participants to make an informed decision. As a result, even before the disclosure requirements become effective, it would be appropriate for plan administrators to consider the contents of the SECURE 2.0 disclosure rules in preparing and reviewing any lump sum window communications.

While the new rules appear to only apply to temporary lump sum window programs, similar considerations may apply when adding a permanent lump sum feature (or for existing lump sum features, which are not subject to these rules).

B. DOL/PBGC Reporting of Lump Sum Windows

SECURE 2.0 also requires that certain information be filed with the DOL and PBGC in connection with a lump sum window. This includes both an advance notice describing the terms of the lump sum window (including a sample participant notice) and a post-window notice reporting how many of the eligible participants and beneficiaries actually elected a lump sum (and any other information the DOL requires). The DOL will make the information reported publicly available in a format that protects the confidentiality of the information provided. The DOL will also provide reports to Congress that summarize the lump sum window reporting that it receives.

As with the lump sum window disclosures to participants, these reporting requirements will apply within one year after a final rule is published, which may not be before December 29, 2023.

C. Fiduciary Duties for Pension Risk Transfer Transactions

In a standard pension plan termination, any remaining liabilities of the plan are transferred to an insurance company through the purchase of a group annuity contract. Plan sponsors may also transfer liabilities to an insurance company outside of the plan termination context in order to manage risk. These types of transactions are commonly known as "pension risk transfer" (PRT) transactions. The purchase of an annuity contract in a PRT transaction is subject to fiduciary standards under the Employee Retirement Income Security Act of 1974 ("ERISA").

The DOL's guidance on the fiduciary duties applicable to PRT transactions under Interpretive Bulletin 95-1 ("IB 95-1") generally requires due diligence on the insurer's claims paying ability and creditworthiness with the assistance of an independent expert. Although the PRT market has evolved significantly in recent years, the DOL has not updated its fiduciary guidance since IB 95-1 was issued in 1995.

SECURE 2.0 requires the DOL to review this guidance in consultation with the ERISA Advisory Council to determine whether amendments to this standard are needed within one year after enactment. The DOL has conducted meetings and received comments from a number of stakeholders on the PRT market and on considerations for updating IB 95-1, such as private equity investments in insurance companies, administrative capabilities and cybersecurity policies of insurance companies, and other changes to the annuity market. The ERISA Advisory Council has prepared a report summarizing these considerations for consultation with the DOL.

In practice, independent experts for PRT transactions have already incorporated additional factors, such as data security and privacy policies, that they consider relevant to fiduciaries in addition to the specific factors described in IB 95-1. Because SECURE 2.0 only requires a review of IB 95-1 and not any specific modifications to the guidance, the extent to which new guidance will affect the pension annuity market

is uncertain.

II. Other SECURE 2.0 Pension Changes

In addition to the de-risking provisions described above, SECURE 2.0 includes a handful of other changes applicable to pension plans. These changes include:

- **PBGC Variable Rate Premiums**. Prior to the passage of SECURE 2.0, the rate of PBGC variable rate premiums applied to unfunded vested benefits increased each year through an inflation adjustment. This created a double whammy because unfunded vested benefits would themselves be expected to increase over time as a result of inflation. Immediately as of its effective date (December 29, 2022), SECURE 2.0 froze the rate that is used to compute PBGC variable-rate premiums at 5.2% of unfunded vested benefits. A cap on the total amount of variable-rate premiums ($652 per participant for 2023) and the flat-rate premium ($96 per participant for 2023) continue to be adjusted for inflation.
- **Cash Balance and Hybrid Plan Interest Crediting Rates**. Effective for plan years beginning after Dec. 29, 2022, SECURE 2.0 includes an optional provision relating to the interest rates that may be used by cash balance and other statutory hybrid pension plans to demonstrate compliance with an anti-backloading rule. Generally, IRS guidance required plans to use the current year's crediting rate to estimate all future pay credits for purposes of applying an accrual rule. SECURE 2.0 relaxes this requirement by permitting plans to use a reasonable estimate of future interest rates, subject to a maximum of 6%.
- **Deadline for Amendments that Increase Benefit Accruals**. Discretionary amendments to qualified retirement plans generally must be adopted by the end of the plan year in which they take effect. SECURE 2.0 adds an exception to this rule effective for plan years beginning after December 31, 2023, permitting amendments that "increase benefits accrued" under a plan to be adopted by the employer's tax filing deadline for the tax year that includes the effective date of the amendment.
- **Annual Funding Notice Revisions**. SECURE 2.0 substantially revises the information that will be included in annual funding notices beginning with the first plan year beginning after December 31, 2023 (*i.e.*, the notice due April 30, 2025, for calendar-year plans). Prior to SECURE 2.0, annual funding notices were generally required to include information about the actuarial valuation of a pension plan's assets and liabilities as of the first day of the plan year (*i.e.*, January 1, for a calendar year plan), and for the two prior years. In addition, the notice included market value-based information as of the end of the year.
    - Under the new rules, the notice will include market value-based information as of the end of the plan year and the two preceding years, participant counts as of the end of those three years, and the average return on plan assets for the plan year to which the notice relates. Plans that currently include an interest rate stabilization supplement will continue to provide three years of financial information computed using actuarial values as of the beginning of each year.

  - In addition to these revised calculations, annual funding notices will be required to provide certain information relating to PBGC guarantees and a statement that PBGC termination liabilities may exceed the liabilities shown on the notice.
- **Section 420 Transfers**. Under existing law, employers can use assets from an overfunded pension plan to fund certain retiree health and life insurance benefits. However, these rules were scheduled to sunset at the end of 2025, and they were limited to plans that were at least 125% funded. SECURE 2.0 extends the sunset date to the end of 2032 and relaxes the eligibility threshold from 125% to 110%, provided that the transfer involves no more than 1.75% of plan assets, the plan was at least 110% funded as of the end of each of the last two years, and the transfer does not cause the plan to fall below a 110% funding level. In addition, the cost maintenance period for retiree liabilities is extended from 5 years to 7 years. This provision is effective for transfers occurring after December 29, 2022.
- **Mortality Assumptions**. SECURE 2.0 imposes a new limitation on the assumptions that the IRS can incorporate into a mortality table that pension plans use for various purposes, including determining the amount of minimum required contributions. This rule may affect the figures that appear in statutory mortality tables, which may affect plan sponsors financially, but it does not directly require any changes to plan administration.

In addition, a number of SECURE 2.0 provisions apply to both pension and defined contribution plans, including:

- **Correcting Operational Errors**. SECURE 2.0 expanded a self-correction program and changed certain rules affecting overpayment corrections, as described in our prior blog posts here and here.
- **RMD Rules**. SECURE 2.0 increased the ages for beginning required minimum distributions ("RMDs") and changed certain other aspects of the rules governing RMDs, as described in our prior blog posts available here and here.
- **Increased Cashout Limit**. SECURE 2.0 increases the maximum pension benefit that may be distributed without the participant's or beneficiary's consent from $5,000 to $7,000, starting with distributions made after December 31, 2023. This change is permissive, not mandatory. As under prior law, if the present value of a benefit otherwise subject to cashout exceeds $1,000, distribution must be made by automatic rollover to an individual retirement account.
- **Benefit Statement Delivery**. Effective with respect to plan years beginning after December 31, 2025, SECURE 2.0 walks back to some extent certain safe harbors permitting electronic distribution of retirement plan notices by requiring that participants receive a minimum number of paper benefit statements.
- **Retirement Plan Lost and Found**. SECURE 2.0 directs the DOL to create a retirement plan lost-and-found program. In connection with this new program, plan administrators will be required to submit certain additional information to the DOL starting in 2025.

III. Amendment Deadline

Plan amendments reflecting SECURE 2.0 Act changes are generally due by the end of the first plan year beginning on or after January 1, 2025 (*i.e.*, by December 31, 2025), in the case of calendar-year private sector retirement plans, or January 1, 2027, in the case of governmental and collectively bargained plans.