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SECURE Act: Changes Exclusive to 401(k) Plans

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The SECURE Act, included as part of the Further Consolidated Appropriations Act, 2020, was signed into law on December 20, 2019. This post highlights changes that are exclusive to 401(k) plans. For a chronological guide to key retirement plan issues raised by the new law, please click here.

Increase to Maximum Default Deferral Rate for Qualified Automatic Contribution Arrangements (QACAs)

Under a QACA, unless an eligible employee opts out of compensation deferrals or elects to contribute at a different rate, the employee is deemed to have elected to defer an amount equal to a default percentage of the employee's compensation. The default deferral rate must be at least 3% of compensation through the end of the employee's first plan year of participation, 4% for the second plan year, 5% for the third plan year, and 6% for the fourth and subsequent plan years. Before the SECURE Act, the default rate could not exceed 10% of compensation. Under the new law, the maximum permissible rate increases to 15% of compensation for the second and subsequent plan years of participation (the maximum rate through the end of the first plan year of participation remains at 10%). This change is effective for plan years beginning after December 31, 2019.

Changes to Nonelective 401(k) Safe Harbor Plans

Nonelective 401(k) safe harbor plans provide a specified level of employer contributions to all eligible employees without requiring employee contributions. The SECURE Act eliminates certain administrative burdens associated with the adoption and maintenance of these plans. The following changes are effective for plan years beginning after December 31, 2019.

Elimination of Annual Safe Harbor Notice Requirement

Prior to the SECURE Act, nonelective 401(k) safe harbor plans were required to provide eligible employees, within a reasonable period before any year, written notice of the employee's rights, obligations, and other required information. The new law eliminates this notice requirement for nonelective 401(k) safe harbor plans. However, plan administrators must continue to provide eligible employees with an opportunity to make or change a deferral election at least once per plan year.

Extension of Amendment Period

Prior to the SECURE Act, a plan could be amended to become a nonelective 401(k) safe harbor plan for a plan year no later than 30 days before the end of the plan year, subject to applicable notice requirements. The new law eliminates the notice requirements and allows a plan to be retroactively amended to become a nonelective 401(k) safe harbor plan no later than (1) 30 days before the end of the plan year, or (2) before the last day of the following plan year if the employer nonelective contribution is at least 4% of compensation (rather than 3%).

Long-Term Part-Timers Must Be Eligible for Elective Deferrals

Because employer-sponsored 401(k) plans may exclude from participation employees who have not attained age 21 and/or completed one year of service (with a minimum of 1,000 hours of service), part-time employees have limited options to save for retirement. Under the new law, 401(k) plans must allow employees with at least 500 hours of service over three consecutive 12-month periods and who have attained age 21 ("long-term part-time employees") to make elective deferrals. Long-term part-timers must be able to commence participation by the earlier of (1) the first day of the first plan year after the eligibility requirements are satisfied, or (2) six months after the eligibility requirements are satisfied. Employers may continue to exclude part-time employees from otherwise applicable nonelective and matching contributions (including 401(k) safe harbor requirements) and from all nondiscrimination and top-heavy testing. For vesting purposes, long-term part-time participants must receive a year of service if they are credited with at least 500 hours of service in an applicable 12-month period. Note that if a part-time participant becomes a full-time employee, these special rules no longer apply to the participant.

These changes are effective for plan years beginning after December 31, 2020. However, for purposes of determining the eligibility of long-term part-time employees, 12-month periods beginning prior to January 1, 2021 will not be taken into account. In addition, the new rule for long-term part-time employees will not apply to collectively bargained employees.

It is expected that further guidance will be provided to address issues such as whether long-term part-time employees must be subject to the same eligibility computation period as other eligible employees and how to treat employees who switch from part-time to full-time and vice versa.

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