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SECURE 2.0 Delivers New Rules for Correcting Retirement Plan Errors

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As part of our ongoing series on SECURE 2.0, this post discusses three significant changes to corrections of common retirement plan errors: (1) New rules for correcting overpayments, (2) expansion of the Self-Correction Program under the IRS's Employee Plans Compliance Resolution System ("EPCRS") to cover most inadvertent errors, and (3) making permanent the current EPCRS safe harbor correction method for elective deferral failures related to automatic contribution arrangements. The first two changes—new overpayment correction rules and the expansion of EPCRS—***took effect as soon as SECURE 2.0 was signed into law on December 29, 2022***, making it important for plan sponsors and plan administrators to familiarize themselves with the new rules.

Correction of Retirement Plan Overpayments

Retirement plan overpayments occur when a plan has paid more to a participant or beneficiary than permitted under the terms of the plan. Under both ERISA and the Code, overpayments must be recovered (either from the participant or another responsible party), which until recent changes to EPCRS, tended to create headaches for plan administrators. SECURE 2.0 changes how retirement plan overpayments are corrected in two key ways, which are detailed below.

Plan Fiduciaries Not Required to Recover Overpayments

In a major shift, SECURE 2.0 provides that plan fiduciaries are not required to recover inadvertent overpayments made to participants and beneficiaries, assuming that the plan complies with applicable tax limitations on benefits and the minimum funding rules. As a result, failure to seek reimbursement of an inadvertent overpayment will not be treated as a breach of ERISA fiduciary duty or as a violation of the tax-qualification requirements under the Internal Revenue Code. If the plan fiduciary does not seek recovery of the overpayment, the recipient is permitted to continue to treat the overpayment as eligible for tax-free rollover (assuming the amount would have been eligible but for the overpayment).

If Plan Fiduciary Chooses to Recover Overpayments, Recovery Limited by New Rules

If a plan fiduciary chooses to recover overpayments from a participant, several new rules apply to the overpayment recovery, specifically:

- Cannot seek recovery if the first overpayment occurred more than three years before the participant or beneficiary is notified in writing of the overpayment error, except in the case of the participant's fraud or misrepresentation
- Recovery of the overpayment cannot be made from the participant's surviving spouse or beneficiary
- Interest or collection costs and fees cannot be charged on the overpayment
- The amount recouped each calendar year by reducing annuity payments may not exceed 10% of the full amount of the overpayment; the same 10% rule applies to overpayments recovered by installment payments
- For overpayment recovered through reducing future benefit payments, the benefit may not be reduced below 90% of the periodic payment and the reduction must stop as soon as the full amount of the overpayment has been recovered
- Recovery of the overpayments other than in connection with an annuity (such as lump sums) must comply with rules to be issued by the DOL in the future
- Efforts to recover overpayments may not threaten litigation unless the responsible fiduciary determines that the plan is reasonably likely to recover more than the cost of recovery; collection agencies generally may not be used
- Participants and beneficiaries from whom an overpayment is sought must be permitted to contest the recovery pursuant to the plan's claims procedures

Because these new rules apply immediately, plan sponsors are considering whether adjustments are needed for overpayment recoveries currently in progress. SECURE 2.0 provides that ongoing recovery through installment payments or future benefit payment reductions that commenced prior to SECURE 2.0's enactment may continue undisturbed.

Expansion of EPCRS Self-Correction Program to Cover Most Inadvertent Errors

By way of quick background, EPCRS is a correction program run by the IRS for plan sponsors to correct certain retirement plan errors. EPCRS has three components, one of which is the Self-Correction Program ("SCP"). Unlike the other two components of EPCRS—Voluntary Correction Program ("VCP") and Audit Closing Agreement Program ("Audit CAP")—SCP does not require reporting the error to the IRS or obtaining IRS approval of the correction. However, SCP is generally available to correct significant errors only when such errors are corrected within three years after the plan year in which the error occurred—limiting the utility of SCP for plan sponsors in some cases.

SECURE 2.0 expands the scope of SCP to cover any "eligible inadvertent failure," which is defined broadly to encompass any plan failure to meet the requirements of Code Sections 401(a), 403(a), 403(b), 408(p), or 408(k) that occurs *despite* the existence of the plan sponsor's practices and procedures reasonably designed to promote compliance consistent with EPCRS. To utilize SCP for eligible inadvertent failures: (1) the error must be corrected within a "reasonable period" after being identified by the plan sponsor, and (2) the error must not have been identified by the IRS before the plan sponsor demonstrated a specific commitment to self-correct the error.

SECURE 2.0 also expands the ability of plan sponsors to self-correct inadvertent plan loan failures. Previously, plans were required to correct certain errors related to participant loans, (such as loans in excess of applicable statutory limits or the failure to obtain spousal consent) through the Voluntary Correction Program or Audit CAP. SECURE 2.0 provides that eligible inadvertent failures related to plan loans—including errors previously required to be submitted through VCP or Audit CAP—are now eligible for self-correction.

The expansion of EPCRS appears to be effective on enactment of SECURE 2.0, but Treasury will have a period of two years to update Revenue Procedure 2021-30 (or any successor guidance) to reflect the statutory changes.

EPCRS Safe Harbor for Correction of Automatic Contribution Failures Made Permanent

In general, if an employee is excluded from making contributions or an employee's contribution election is not followed, EPCRS requires that the employer provide a make-up contribution that consists of three parts: (1) a qualified non-elective contribution (QNEC) for the missed deferral opportunity, (2) a corrective matching contribution, and (3) earnings on both the QNEC and corrective matching contribution. However, EPCRS includes a special exception for automatic contribution arrangement failures whereby employers are not required to make a corrective QNEC for the missed deferral opportunity (provided that the plan sponsor meets certain notice and timing requirements and the corrective matching contribution, plus earnings, is made).

Under the current version of EPCRS, the special safe harbor correction for automatic contribution failures was set to expire on December 31, 2023. SECURE 2.0 makes this safe harbor permanent, effective for errors after December 31, 2023. The same correction requirements that currently apply under EPCRS will continue to apply under SECURE 2.0, except that SECURE 2.0 also expressly requires that plan sponsors correct the error for all similarly situated participants in a nondiscriminatory manner.

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