PLAN DESIGN | PLANSPONSOR March – April 2024

Catch as Catch Can

SECURE 2.0 creates a new way to build emergency savings.

Reported by ELIZABETH HARRIS | *Art by* SIMONE VIRGINI

Can a $2,500 emergency fund make a meaningful difference for employees? That is just one of the questions plan sponsors may be asking themselves as they consider a provision of the SECURE [Setting Every Community Up for Retirement Enhancement] 2.0 Act of 2022 that permits a new type of emergency savings account to be added to benefit rosters this year: the "pension-linked emergency savings account," or PLESA.

This new savings vehicle—what is also referred to as a sidecar emergency savings account—could help employers and employees address the sometime competing needs of saving for retirement and having accessible funds for meeting more immediate and unexpected expenses. This tension between helping employees address short-term vs. long-term goals is already prompting discussion among some plan sponsors as they evaluate whether and when to incorporate the new emergency saving option, according to David Amendola, senior director, retirement with WTW in Stamford, Connecticut.

"What is straightforward is the overarching need that employers are really grappling with in terms of employees who have a significant amount of financial precarity," Amendola says.

Awareness has been building in recent years that many individuals and families live paycheck to paycheck and struggle to accumulate the rainy day funds needed for unplanned expenses. In a Bankrate survey fielded this past December, just 44% of U.S. adults reported that they have adequate savings to cover an emergency bill of $1,000 or more. Further, one-third of respondents to this annual inquiry into emergency savings, conducted jointly with SSRS, said they would need to borrow money to cover unexpected costs.

A recent look at savings trends among Fidelity Investments' corporate defined contribution plan participants showed an increase in the percentage who tapped their retirement account in last year's third quarter vs. in Q3 2022. This "underscore[s] the need to help retirement savers develop emergency savings," says the company's report. Among the 22.9 million participants in Fidelity plans as of last September 30, 2.3% made a hardship withdrawal during Q3, up from 1.8% during Q3 2022; at the same time, 2.8% took a loan, up from 2.4% in 2022. Also on the rise were in-service withdrawals, which reached 3.2% in Q3 last year, also higher than the prior year's 2.7%.

PLESAs

While the SECURE 2.0 provision describes the accounts as pension-linked, they are actually established and maintained within a defined contribution plan, says a recent Department of Labor FAQ about the accounts. Employees who are not highly compensated—the threshold for "highly compensated" is $155,000 this year—will be able to defer up to $2,500 in Roth contributions into a PLESA.

The accounts may contain investment products from a regulated financial institution designed to preserve principal and to offer liquidity and a reasonable rate of return. The plan fiduciary selecting the investments for the retirement plan also selects those for the PLESAs. Employees may tap those funds as often as monthly without facing tax penalties typically triggered by early plan withdrawals, the FAQ say. But reasonable administrative fees can be imposed after four withdrawals per year. Participants also would not need to demonstrate an emergency to gain access to these funds, the FAQ state. Additionally, sponsors may automatically enroll employees, after giving prior notification, at a rate of up to 3% of pay, and allow for opt-out at no charge.

Importantly, the IRS notes that eligible workers may save in a PLESA even if not contributing to the company's DC plan.

Together, the DOL FAQ and initial IRS guidance for employers offer some much-needed insight for plan sponsors, Amendola says. "The totality of the guidance so far is very, very helpful," he says of the two agencies' information. "It provides a substantial level of clarity such that an employer could look at all of this and say, 'I think this makes sense, or I could design it in a way that makes sense, and I'm relatively comfortable with it.'"

It also helps eliminate tax confusion concerning employer matches, in that the IRS demonstrates that an employee could put in $2,500 in a calendar year, receive a match from the employer and withdraw the entire amount in the same year, Amendola says.

Even so, he foresees two potential issues that could slow adoption: Some recordkeepers do not yet offer this choice, and some plan sponsors may decide to focus their efforts elsewhere.

"The biggest issues are how the recordkeepers view it: Are they going to take it upon themselves to move the needle?" Amendola says. "It's going to take a little time to shake out, but it's a very potentially [effective] provision."

The breadth of SECURE 2.0's new provided-for offerings and the differences in how quickly major recordkeepers can accommodate sponsors wanting to adopt PLESAs could mean that the introduction of the accounts, may be moderate at first, says Percy Lee, of counsel with Ivins, Phillips & Barker, Chartered, in Washington.

Adopt or Not?

"In terms of the decision of whether to adopt these accounts, the easy question is going to be, 'Does your recordkeeper allow emergency savings?'" Lee says, urging sponsors to weigh whether the feature will ultimately make sense for their plans. "All the recordkeepers will eventually allow emergency savings, but right now a lot of the major recordkeepers are focused on the mandatory changes of SECURE 2.0."

As employers consider the optional features of the legislation broadly within the context of the existing plan design philosophy, plan demographics and participant needs, Lee says, a decision for or against implementing PLESAs "depends on whether the employees have shown a need for this type of short-term liquidity."

To help with the decision, Amendola too advises sponsors to review employees' needs, including to look at the prevalence of their hardship loans in the past. The sponsor can also factor in other access they might have to an emergency savings option,

"One thing that's critical is trying to leverage whatever data or analytics [sponsors] have access to," Amendola says. "At the root of this is trying to think through what is potentially going to have the most impact for that particular employer's employees and also what [is it] trying to get out of this?"

Employers that regard their retirement plan as a key talent attraction and retention tool might therefore lean toward an emergency savings choice—whether PLESAs or another savings option—since employees will either want them now or in the future, he says. For some employers, the question will be more philosophical: Do we view the retirement program as one that should incorporate financial resilience support tools? And other employers may decide they do not want to incentivize people to put money in and then take it out, he says.

Tags	emergency savings account, emergency savings sidecar accounts, employee retention, retirement plan leakage, SECURE 2.0 Act of 2022
Reported by	Elizabeth Harris
Reprints	To place your order, please e-mail Reprints.