Patterson Belknap

Employee Benefits and Executive Compensation Alert
April 4, 2024

Does Your Retirement Plan Need a 'PLESA'?

Pension-Linked Emergency Savings Accounts ("PLESAs") are a special retirement plan feature created under SECURE ACT 2.0. PLESAs were first permitted to be made available to participants as of January 1, 2024. PLESAs, which provide a flexible savings opportunity for non-highly compensated employees, can be added to certain defined contribution plans. New guidance regarding this option has been released, which may be of interest to employers and plan sponsors. On January 12, 2024, the Internal Revenue Service ("IRS") released Notice 2024-22[1] relating to PLESAs (the "Notice"), and the Department of Labor ("DOL") released FAQs related to PLESAs (the "FAQs"). Although both provide greater clarity regarding this new type of plan-related account, they also illuminate a need for additional guidance.

I. PLESA Overview

PLESAs operate as retirement plan-linked savings accounts for non-highly compensated employees. This linkage gives PLESAs the protections of coverage under the Employee Retirement Income Security Act of 1974 (also known as ERISA) while maintaining distribution flexibility generally not found in a traditional retirement plan. (Some of the key differences between PLESAs and traditional retirement plans are discussed below.) Plan sponsors of defined contribution retirement plans, including Internal Revenue Code ("Code") Section 401(k) and 403(b) plans, may choose to provide PLESAs, which operate as special accounts within these plans[2]. Note that it is optional, not mandatory, to offer PLESAs, and, if offered, contributions to a PLESA may (but are not required to) be made at the participant's election. PLESAs are limited in the amount of assets they can hold, which must be contributed to the accounts on a Roth basis. PLESAs must also provide participants specifically delineated access to the assets in the accounts during employment. This additional accessibility may encourage lower compensated employees to contribute, knowing that the assets will be available if needed. Some of the details regarding PLESAs are highlighted below, as clarified by the recent Notice and FAQs.

II. ADMINISTRATION

a. Eligibility and Participation

Only non-highly compensated employees, as defined under Section 414(q) of the Code, are eligible to participate in PLESAs. This means that for 2024, employees who earned $150,000 or less in 2023 from their current employer are eligible to participate in PLESAs. If a PLESA participant becomes a highly compensated employee, they must cease contributions to the PLESA, but the account may continue to be maintained for that participant, and the participant may continue to enjoy the flexible distributions provided from the PLESA. In addition, employees must meet any age, service, or other eligibility criteria of the plan to which the PLESA is linked to be eligible to participate in a PLESA.

b. Contributions and Employer Matches

PLESAs are not permitted to have a minimum contribution requirement or a minimum account balance requirement. Note, however, that the FAQs clarify that PLESAs may generally have administrative procedures requiring contributions to be made in

[1] As of the publication of this client alert, the comment period for matters discussed in this notice and other aspects of section 127 of SECURE ACT 2.0 is open until April 5, 2024.
[2] There is some uncertainty with respect whether governmental 457(b) plans or 403(b)(9) church plans may include PLESAs.

whole dollars or whole percentages of compensation of at least 1%.[3] Contributions to a PLESA do count towards a participant's Code Section 402(g) limit. Automatic contribution arrangements are permitted, provided the automatic contribution rate is no more than 3% and the participant is permitted to change that amount or opt out entirely. If the plan to which the PLESA is linked provides employer matching contributions, employee contributions to the PLESA must be matched at the same rate as other employee contributions to the plan are matched. The matching contributions must be made to the participant's matching contribution account under the plan, not the PLESA. Additionally, for purposes of applicable limitations, matching contributions will be treated as attributable to any elective deferrals made to the plan first, and PLESA contributions second. (This is particularly relevant when it comes to anti-abuse, discussed below.)

The aggregate amount of assets in a PLESA attributable to contributions (not including earnings) must be limited to no more than $2,500 (this limit may be adjusted in future years for cost-of-living increases). Employers may establish lower, but not higher, limits. An employer may choose to apply the $2,500 limit to the participant's total account balance (both contributions and earnings), because that would operate as a lower account balance limit than the legal maximum of $2,500 attributable to contributions alone. No annual contribution limit may be imposed.

c. *Withdrawals and Distributions*

PLESAs also have very specific withdrawal requirements. A PLESA participant must be permitted to take a distribution of all or part of the account at least one time per month, and the distribution must be paid as soon as practicable after it is requested by the participant. Furthermore, the first four withdrawals per year may not be subject to fees or charges associated with the withdrawal. (Additional withdrawals in a year may be subject to reasonable fees.) A distribution from a PLESA is treated as a qualified distribution (under Code Section 402A(d)), meaning there generally will be no 10% early withdrawal tax penalties associated with these withdrawals, regardless of the age or employment status of the participant, and the distribution (consisting of both contributions and earnings) is not includible as income for the participant. The participant is not required to demonstrate an emergency need prior to taking the distribution. The distribution may be made in a variety of forms, including check, debit card, or electronic transfers.

After termination of the participant's employment or the termination of the PLESA by the employer, the participant may roll their account into a Roth IRA, or take a distribution of the account. It is unclear whether the mandatory small account cash-outs which may be made from traditional retirement plans apply to the PLESA accounts of terminated participants. If the small amount cash-outs are not permitted, plan sponsors could find that they accumulate multiple small accounts as participants terminate employment over time. Small accounts can be administratively burdensome for employers and potentially expensive to maintain.

d. *Investment and Administration*

There are specific rules with respect to the permissible investment of PLESA assets, which differ from those of other defined contribution retirement account assets. The PLESA assets must be held in cash (in an interest-bearing account) or in an investment product that is offered by a State or federally regulated financial institution and is designed to maintain the dollar value and preserve the principal with a reasonable rate of return. The FAQs clarify that investments that contain liquidity constraints, such as surrender charges at the participant or plan level, will generally not be acceptable for these accounts. A plan's qualified default investment

[3] Note that such a restriction on percentage of contributions must be applied uniformly and would also require participants to be given the option to make contributions of a whole dollar amount instead of a percentage.

alternative, or QDIA, will generally not be appropriate for the PLESA because of the requirement that PLESAs preserve investment amounts.

A variety of administrative requirements must also be met. PLESA-specific notices must be provided prior to enrollment in the accounts. The plan document must include plan language providing for the PLESA and mandate recordkeeping for the contributions and earnings separately from any other assets under the plan. Consequently, if plan sponsors wish to offer PLESAs, they will be required to amend their plans. Those plan sponsors wishing to include PLESAs in their plans in 2024 or 2025 must adopt the relevant plan amendments by the end of the remedial amendment period (which, for calendar year plans, is by December 31, 2025), consistent with most other SECURE 2.0 related amendments. The PLESA feature of the plan may be terminated by the plan administrator at any time.

III. Differences Between PLESAs and Other Types of Early Distributions

Many defined contribution plans permit participants to take hardship distributions and plan loans, which are alternative ways to take in-service distributions from plan accounts. However, there are several important differences between the more traditional forms of distributions and PLESAs. Unlike plan loans, PLESA distributions are not required or, strictly speaking, permitted to be repaid to the plan account. (As the participant may continue to make PLESA contributions following a PLESA distribution, however, a type of "repayment" or "recontribution" of previously distributed amounts is functionally permitted.) Unlike hardship distributions, there is no cumbersome certification process required for distributions. These differences (as well as the more limited investment options available to PLESAs) may have an impact on an employee's decision to contribute to a PLESA (as compared to making elective deferral contributions generally). It is also notable that the differences will be both positive and negative for plan sponsors, who may be more familiar with the traditional types of withdrawals. The lack of substantiation requirements will facilitate administration, but the potential for frequent withdrawals may be burdensome.

IV. PLESA Anti-Abuse Concerns

The same flexibility that may make PLESA contributions attractive to lower compensated employees with limited accessible savings may also make them easy to abuse. PLESA contributions must be matched by the associated plan's match, if any, however PLESAs may not impose the restrictions that most defined contribution retirement accounts include to inhibit abuse of employer matching contributions. PLESA's lenient distribution provisions, with no restriction on contributions post-distribution, potentially enable a participant to amass a large employer match by simply withdrawing and recontributing the same PLESA dollars over and over again, earning a match each time, while maintaining little to no balance in the PLESA (also known as "churning").

SECURE 2.0 permits a plan sponsor to impose reasonable procedures, solely to the extent necessary, to prevent manipulation of the plan rules to cause matching contributions to exceed the intended amounts or frequency. The Notice expands on the concept of "reasonable" by stating that the policies must balance the participants' interests in using the PLESAs (presumably the ease of access to the account assets) and the plan sponsor's interest in preventing manipulation of the matching rules. The Notice clarifies that certain practices in response to PLESA withdrawals (even if frequent or seemingly abusive) are not reasonable, such as forfeiture of matching contributions, suspension of participant contributions to a PLESA, or suspension of matches on participant elective deferral contributions to the underlying defined contribution plan.

There are some protections available, however. The amount of matching contributions that can be made on account of PLESA contributions is limited to the maximum account balance (currently $2,500 or such lower amount as determined by the plan sponsor),

which limits the amount of matching contribution that can be obtained by possible manipulation of the lenient distribution and recontribution rules. The Notice also highlights the ability of plan sponsors to limit distributions to once a month as a potential method to reduce possible abuse.

V. Conclusion

The new PLESA guidance is welcome as employers and plan sponsors consider offering PLESAs under their Code Section 401(k) and 403(b) plans. However, administrative stumbling blocks remain, and additional guidance is still necessary. Many third-party administrators and recordkeepers are not ready to operationally implement PLESAs in their plan administration systems, and, as a result, plans cannot in practice adopt PLESAs. Further, at this early stage, and with limited available guidance, administrative mistakes may be made, requiring potentially expensive corrections. In addition, as noted above, a special notice is required to be provided not less than 30 or more than 90 days before the date of the first contribution to the PLESA. Although the FAQs provide a list of the information the notice must contain, the anticipated model notice will simplify administration while also providing a greater level of confidence in compliance. Furthermore, we understand that the Form 5500 is currently being revised to reflect PLESA information, so it is not yet clear exactly how much additional reporting will be required by those sponsors, including PLESAs, in their plans. Finally, questions remain, such as whether plan sponsors are permitted to involuntarily cash small account balance PLESAs out upon participants' termination of service.

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