EDITOR'S NOTE

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Modernizing the Rules for Retirement Plans

Two bills addressing retirement savings are under consideration in the House of Representatives and in the Senate as we go to press. Though separate bills, there is a great deal of overlap between the two and both have bipartisan support. Each adjusts current law instead of making large changes.

The House bill is the Setting Every Community Up for Retirement Enhancement Act of 2019. H.R. 1994, also known as the SECURE Act, repeals the maximum age for making contributions to a traditional individual retirement account (IRA). The bill also raises the maximum age for when retirees must begin taking required minimum distributions (RMDs) from 70½ to 72.

The Senate bill is the Retirement Enhancement and Savings Act of 2019. S. 972, referred to by the less-catchy acronym of RESA), similarly repeals the maximum age for making contributions. It does not alter the RMD rules for current account owners. Instead, it tightens them for non-spousal beneficiaries of inherited defined-contribution plans [e.g., 401(k) plans] and IRAs.

Currently, withdrawals from inherited IRAs can be based on the beneficiaries' life expectancy. This allows the duration of an IRA to be "stretched" by naming a younger heir (e.g., a grandchild) as the beneficiary. RESA would require that the "entire interest of any designated beneficiary of the employee as exceeds $400,000 (as of the date of the death of the employee) will be distributed within five years after the death of such employee." Though the quote makes direct reference to defined-contribution plans [e.g., a 401(k) plan], the rule change applies to other qualified plans such as IRAs. Children are exempt from the five-year requirement up to the age of majority (generally between 18 and 21) as are those who are chronically ill or are not more than 10 years younger than the deceased account owner.

Increasing the age at which RMDs must begin will be welcomed by those of you who do not need the distributions. While my first thought was that this part of the legislation is a tax break, upon further reading my opinion has changed. I now think it is a good idea. The existing requirement of taking withdrawals by age 70½ dates back to the Tax Reform Act of 1986. Since then, life expectancies have increased. At the same time, people are working longer. To the extent that people postpone retirement out of financial need, giving them 18 additional months before withdrawals are required can help.

I'm in favor of removing the age limitation on making IRA contributions for similar reasons. It can help those who haven't saved enough. I would also like to see the cap on annual IRA contributions increased from the current $6,000. Doing so would help those who don't have access to an employer-sponsored plan.

The two bills do include clauses intended to expand access to defined-contribution plans. The SECURE Act would require employers to provide long-term part-time workers access to the plans. Both bills contain clauses intended to reduce barriers for multi-employer plans (MEPS), with the intent of encouraging more small businesses to band together and offer such benefits.

The House bill smartly raises the contribution cap for plans with auto-escalation features to 15% of pay from its current 10%. Auto-escalation increases an employee's contribution rate either annually or when a raise is given. They're a good practical application of behavioral finance because they make saving more the status quo as opposed to relying on employees to voluntarily increase their savings rates.

One provision in both bills that resides in the "remains to be seen" realm is the option to do a trustee-to-trustee transfer from a workplace retirement plan to an annuity provider. The idea of allowing workers to transition into a product with lifetime guaranteed income is a good one—especially for those who possess little familiarity with retirement withdrawal rates and portfolio allocation strategies. Where I have a reason for concern is in the execution. Will the contracts be well-constructed and low-cost? Will there be safeguards to keep the less scrupulous players from trying to compete for these dollars? I hope the answer to both questions will be "yes," but implementation is key.

After looking at both bills, my overall opinion of them is favorable. While no legislation is perfect, I think they are good steps forward. The fact that both share much in common and have bipartisan support increases the odds of a unified bill being passed. However, neither bill gets people to save early and consistently. This remains the responsibility of individuals.

Wishing you prosperity,