VOL. 36, NO. 1 SPRING 2023

BENEFITS LAW JOURNAL

From the Editor

SECURE 2.ZERO: Congress Wastes an Opportunity to Improve Retirement Outcomes

By David E. Morse

A $1.7 trillion spending law is a terrible opportunity to waste. Yet, the Washington sausage makers turned some great proposals for improving retirement outcomes into SECURE 2.0 – 357 pages of new, complicated rules that will barely budge the needle. Too bad for workers without a retirement plan or those who would like a better way manage their retirement savings.

Let's look at the most significant problems Congress attempted to address and where they misfired.

COVERAGE GAP

Most employees without access to a workplace savings plan do not save on their own due to factors like inertia, present-day bias, overoptimistic expectations of Social Security benefits and general confusion. To shrink the retirement plan coverage gap (one-half of private sector workers are not covered by any type of plan), SECURE 2.0 attempts to make it easier and less costly for small employers to offer a 401(k) or other defined contribution (DC) plan. Starting in 2024, an employer without a retirement plan will be able to adopt a "Starter 401(k)" – a regulation-lite 401(k) with limited employee contributions and no employer contributions. In reality, any employer could get to the same place, at roughly the same cost and effort by adopting a regular 401(k) and simply choosing not to make employer contributions. Despite the clever name, the Starter 401(k) will entice few new employers to adopt a plan. In fact, adding yet another plan option may further confuse employers and increase their reluctance to offer a plan.

In a more likely enticement, SECURE 2.0 allows small employers an improved tax credit to cover the costs of implementing a plan and subsidizes a few years of employer contributions. Higher credits (money) may persuade employers on the fence. However, realistically, if the existing credits were not sufficient for time-challenged and confused small business owners, I doubt the added credits will do much.

In another slight improvement, building on the original SECURE Act, SECURE 2.0 requires employers sponsoring 401(k) or 403(b) plans to cover part-time employees. These part-timers, who must work at least 500 hours a year for two years, only will be entitled to make unmatched contributions and can be ignored for discrimination testing. Any change that increases coverage is welcome, even if it only helps part time employees after they have put in a couple of years.

Tweaks and gimmicks aside, SECURE 2.0 left on the white board a proven method guaranteed to significantly improve coverage: provide all employees with access to a workplace savings program. It should be obvious that employer financial incentives and new retirement plan alternatives have maxed-out in effectiveness in encouraging employers to extend workplace savings opportunities. The still yawning coverage gap only can be closed with a requirement that employers facilitate (without having to contribute or administer) a savings vehicle. That program could be nationwide (like the United Kingdom's NEST), state-administered auto-IRAs or one of the many private sector plan alternatives, with automatic payroll withholding, contribution escalations and easy employee opt-outs. Existing state auto-IRAs, already enabling over 630,000 workers to save for their own retirement, are proof of concept that these programs work without costing employers and taxpayers a penny. It is time to move on to solutions that ensure that every employee is offered a workplace savings program.

AUTO-ENROLLMENT

Congress recognized that even with access to a workplace program, people would like some help with their savings and investment decisions. To address this problem, Congress turned to a proven nudge: auto-enrollment and escalation. The Internal Revenue Code and ERISA already encourage, through regulatory safe harbors, 401(k) plans to enroll new employees at a minimum payroll savings rate, gradually increasing until a set percentage is reached (typically around 10%), and offer a diversified default investment, with the ability to opt-out or choose their own savings rate or investments. SECURE 2.0 mandates auto enrolment/escalation for all new (adopted after 2024) 401(k) and similar plans. By grandfathering existing plans, Congress missed a huge opportunity to improve savings outcomes for all participants in 401(k)s without auto-enrolment. Instead only the relatively few individuals to be covered by new plans and businesses will benefit. Payroll systems and plan providers already have built the necessary auto infrastructure. Congress should have required all plans to adopt auto enrollment and escalation.

SAVERS MATCH

SECURE 2.0 turns the existing savers credit for low-income workers into a new federal matching contribution. This 50% savers match of up to $2,000 covers contributions to a 401(k), 403(b) or IRA. However, the mechanics for determining who meets the income limit, who made (and did not withdraw!) a matchable contribution and how to get the funds to the individual's retirement account will be challenging. Anything that encourages lower income workers to save for their retirement is positive, but it remains to be seen how much actually ends up in retirement accounts because of the new credit. Significantly, the savers credit takes effect in 2027, leaving much time for political infighting leading to refinement or repeal.

LEAKAGE AND DISAPPEARING MONEY

A surprisingly large amount of money earmarked for retirement either is spent before retirement or "disappears." SECURE 2.0 will help address this problem by making it easier for job-hoppers to consolidate their DC accounts, save for both emergencies and retirement and (possibly) connect "lost" participants with their "missing" retirement accounts. To assist the some 40% of Americans without the cash to cover a $400 unexpected expense, SECURE 2.0 adds new rules allowing 401(k)s and other DCs to do double duty as emergency rainy day accounts. Mostly limited to lower-paid employees, up to $2,500 can be stashed in a Roth subaccount for penalty-free withdrawals to cover a range of financial emergencies. Other changes remove some of the tax penalties on early hardship withdrawals and reduce administrative complexity. Besides keeping folks from payday loans and credit card debt, having both a retirement and rainy day account in a single plan can reduce retirement leakage by allowing participants to mentally separate the two types of savings and leave retirement funds untouched.

SECURE 2.0 also will aide job hopers in bringing old 401(k) accounts to their new company 401(k). FinTech firms have been developing ways to help workers manage their DC accounts as they change employers. SECURE 2.0 will make it easier for plan sponsors to allow outside providers automatically to transfer funds from the old to new employer plan. The rule, effective next year, will require safeguards such as employee notices and opt-outs and fiduciary assurances.

Incredibly, SECURE 2.0 more than undoes these useful anti-leakage rules by increasing forced cash-outs of account balances when a participant leaves a job. Starting this year, plan sponsors may automatically cash-out accounts of under $7,000 (instead of the old law's $5,000). Forced cash-outs tend to either be spent or evaporate in low return/expensive IRAs. Increasing the limit will increase leakage. Granted small accounts left by former employees are a nuisance to plan providers and sponsors. However, the solution should look to efficiently keep this money in a retirement vehicle, not making it easier to evaporate.

Beyond leakage, a great deal of retirement money disappears – because the participant forgets about old plans, dies, becomes incapacitated or corporate mergers, name or address changes, bad records and the like cause a plan and participant to lose track of one another. This is a problem for both the participant (obviously) and employers forced to spend resources attempting to locate lost participants while recordkeeping former employees' accounts. SECURE 2.0's "solution" is a favorite political expediency, "the Study" – this time tasking an already overworked Department of Labor with creating a database, without added funding and (crucially) without an actual place to park retirement moneys until the participant (or beneficiary) is found. The solution should have harnessed existing Internal Revenue Service and Social Security data to help plans and participants to connect and allow the Pension Benefit Guaranty Corporation, which already holds and invests some participant money, to manage the accounts of participants that are not found. Existing technology makes this a relatively easy lift.

Winston Churchill reportedly said that the United States always does the right thing after exhausting all the other alternatives. With SECURE 2.0, we are getting closer to that point. But America is aging rapidly and every wasted day hurts.

The views set forth herein are the personal views of the author and do not necessarily reflect those of the law firm with which he is associated.

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