New Year, Long-Overdue Overhaul of the Retirement Industry

How the *SECURE Act* will affect Americans' retirement plans

The *Setting Every Community Up for Retirement (SECURE) Act* was signed into law late in 2019, marking the second time in three years new tax legislation passed at year-end. Why is it significant? The *SECURE Act* gives retirement savers a more robust toolkit to save for retirement. As Americans live longer and take increasingly diverse paths to retirement, the new legislation will, on balance, help to bolster retirement security.

The *SECURE Act*, which was signed into law by President Donald Trump on December 20, 2019, gives retirees greater flexibility with their retirement accounts and offers new incentives for businesses to set up workplace retirement plans. This is the most significant overhaul of the retirement industry since President George W. Bush signed the *Pensions Protection Act* back in 2006. While that piece of legislation was about shoring up pension protections and allowing more workers to benefit from those plans, the *SECURE Act* includes several provisions that are designed to help both employers and retirement savers gain more control and transparency as they plan for their retirements.

While some of the provisions are administrative in nature, other sections will have a direct impact — both positive and negative — on investors and plan sponsors alike. There is a lot to digest, but here are the main points you need to be aware of and how they might affect you.

1. Eliminating the Stretch IRA

Takeaway:
Plan assets for inherited IRAs and 401(k)s must be withdrawn within 10 years of death

Let's start with the bad news. In the past, a non-spousal beneficiary could have taken the required minimum distributions (RMDs) on the inherited IRA over their lifetime. For adult children or grandchildren, the ability to "stretch" the IRA over 30, 40 or even 50 years of tax deferral was a very valuable tax planning tool. Under the new law, a non-spousal beneficiary will have to empty the inherited IRA within 10 years. On the plus side, annual RMDs are not required; conceivably, one could empty the account in the final year.

The rule also applies to 401(k) and other defined-contribution accounts. Spousal RMDs are still delayed until the end of the year when the deceased IRA owner would have reached age 72.

Still, there are exceptions. Provisions have been made for minor children, a disabled or chronically ill beneficiary, or if the recipient of the IRA is less than 10 years younger than the deceased owner. For minors, the exception applies until the beneficiary reaches the age of majority and then the 10-year rule takes effect.

2. RMD start date extended to age 72

Takeaway:
More time to compound your returns

Previously, you would have had to start your RMD by April 1 of the year after you turn 70½ (which was one of the oddest date calculations in the IRS system). The *SECURE Act* simplifies this age requirement by pushing back the RMD to age 72, provided you have not already had to start your RMDs. This means you get almost two additional years of tax-free compound growth in your IRA when your retirement account is near its peak.

Delaying withdrawals makes a difference
*IRA Portfolio Valuations at Age 72**

3. IRA contributions past 70½

Takeaway:
Work longer, save longer

Similarly, the *SECURE Act* enables Americans to contribute to their traditional IRA up until age 72, so long as you have earned income, up from the previous age limit of 70½. ROTH IRA contributions continue to have no age-based restrictions.

4. Mandated lifetime disclosure of income

Takeaway:
More clarity on the *actual* value of your 401(k)

Big balances in a 401(k) are common, but it can lead participants to overestimate how much of an annual income it would provide. Participants are frequently shocked to find out a $1 million 401(k) balance can only support a $40,000/year distribution (on average). The *Act* now requires 401(k) providers to supply participants with a lifetime income disclosure statement, which will estimate the monthly income their 401(k) balance could produce if their account balance were used to purchase an annuity today. These "lifetime disclosure statements" will help participants track their progress relative to their long-term goals.

5. Enhanced auto-enrollment plans

Takeaway:
It's easier for plan sponsors to make retirement planning a priority

As Tom Cruise once famously said in Jerry Maguire, "Help me … help you." Under the *SECURE Act*, auto enrollment in certain plans becomes more attractive, which means participants will have less of an incentive to opt out. First, the law encourages companies to automatically enroll new employees in 401(k)s to get their plans started. The law also increases the qualified automatic contribution arrangement (QACA) to 15% after the first year of participation, up from 10%.

6. New part-time worker eligibility

Takeaway:
Greater flexibility for part-time savers

Starting in 2021, the new retirement law guarantees 401(k) plan eligibility for employees who have worked at least 500 hours per year for the past three consecutive years. In the case of part-time workers, the employee must be 21 years old by the end of the three-year period.

*Assumes a 3% return per year, with no new contributions. Both portfolios valued $1 million at age 70.5. Under the old RMD rules, required distributions are deducted before factoring in the annual return.

7. A new small business 401(k) credit

Takeaway:
More incentives for small businesses to help employees save for retirement

Small businesses have always found it challenging to offer employees retirement plans, but the *SECURE Act* addresses this issue by including several provisions to help small businesses provide retirement plans.

UP TO $5,000	$500
new increase to tax credit to help cover start-up cost	new tax credit to help small business cover start-up cost

First, the new law increases the tax credit available for a small business's retirement plan start-up costs by 50% to cover up to $5,000 of those expenses. Second, a new $500 tax credit was created for a small business's start-up costs for new 401(k) plans that include automatic enrollment. The credit is available for three years and is in addition to the existing credit. The credit is also available to small businesses that convert an existing retirement plan to an auto-enrollment plan.

8. Pooling plans across industries

Takeaway:
Smaller businesses will have the flexibility to participate in multiple employer plans

The *SECURE Act* makes it easier for numerous unrelated employers to pool assets and participate in multiple employer plans administered by a pooled plan provider. In 2021, a multiple-employer plan (MEP) will allow employers to leverage their combined scale to lower administrative costs and participate in a "pooled plan."

9. Eliminating 401(k) leakage

Takeaway:
Retirement accounts are more focused on retirement

At Procyon, we believe any withdrawal from a retirement account for purposes other than retirement spending as a form of "leakage," since it is savings "spilled" from the retirement goal. The *SECURE Act* makes it more difficult for employees to access their 401(k) for any purpose other than retirement. For example, the *Act* prohibits 401(k) loans made by automatic credit and debit cards, which can be counterproductive to savings. While there are still a few ways to make withdrawals under the new law, such as the birth or adoption of a child, the new provisions are a positive development that will help savers stay disciplined.

10. Annuities in 401(k)s

Takeaway:
Expanded lifetime income options

The new law also makes it easier to offer annuities in 401(k) plans. The thinking is to offer lifetime income options that one can't outlive, for those participants who want them. Annuities will now be portable from one employer to another without penalty, allowing for greater flexibility. Annuities have a cost to them, so whether this turns out to be good or bad for savers will depend mainly on what products are developed.

11. Special Credit

Takeaway:
Definition of compensation expands, helping students and caregivers

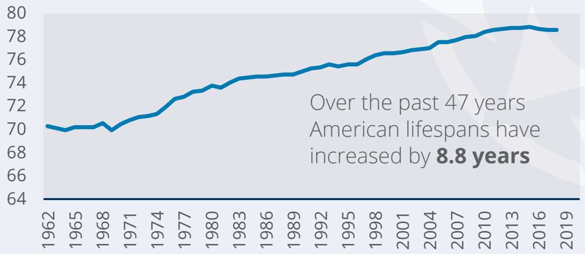
You generally can't contribute more than your earned income to a retirement program. Now grad school and care providers who receive grants, fellowships or stipends can treat them as compensation and save for their retirement as well.

Procyon's Perspective

As with any piece of new legislation, there are always pros and cons to consider. On balance, we see the *SECURE Act* as offering some significant steps on the government's part toward the tax treatment of retirement plans.

The long-discussed **extension of the RMD requirement from age 70½ to 72** for 401(k) plans is an important component of the new *Act*. This provision has been a long time coming. It takes into account our increasing lifespans over the past 20 or 30 years. By pushing the age back to 72, it means Americans will be able to increase the tax efficiency of their investments, especially if the individual doesn't require the added funds in those early retirement years. By leaving the funds in the IRA longer, individuals can increase the tax efficiency of their investment and lower the risk that they will exhaust their funds in retirement.

Life expectancy at birth, total (years)*



No benefit comes without a cost, however. In this case, the greater tax-efficient growth spelled the **end of the Stretch IRA**. If you were planning to stretch out the distributions of these assets over multiple decades, you are now going to have to do so more quickly. Similarly, if your estate plan factored in a Stretch IRA, then you may want to rethink your estate planning strategies to lower your tax burden.

The *SECURE Act* will make it easier for small businesses to set up **automatic enrollment** in 401(k)s for their employees, which could help them attract and retain employees. At the same time, by allowing employers to **increase the qualified automatic contribution arrangement (QACA) to 15%,** there is a better chance those Americans will have a well-funded retirement. While employees always have the right to change their contribution, we find if a company sets a low threshold, say 3%, many employees take that as a suggestion from the company that a 3% contribution is ideal when in reality it usually needs to be much higher.

One provision in the *SECURE Act* that shouldn't be overlooked is the **new quarterly reporting requirements.** While some 401(k) providers currently provide participants with an estimate of the income their balance could produce, under the *SECURE Act* it will be a requirement. This information is essential since it will allow plan sponsors to work with clients to help them understand how much they need to accumulate over time to cover their monthly expenses. For many, these new reports may serve as a wake-up call for investors who will be able to see how their retirement income compares to their current expenses. These "lifetime income disclosure statements" will help participants see how they are doing in relation to their long-term goals. The implementation date will be one year after the IRS has issued "interim final rules," created a model disclosure statement, or released assumptions that plan administrators can use to make the annuity equivalent calculations.

*Source: The World Bank (https://data.worldbank.org/indicator/SP.DYN.LE00.IN?locations=US)

We will continue to keep you abreast of important developments regarding the *SECURE Act* and the retirement industry. This is a good opportunity to revisit retirement and estate plans to make sure they account for the new provisions under the *SECURE Act*. If we can be of any help to you regarding these items, please contact us.

Call (844) PROCYON today

Do you need alternative options for your retirement plan? Contact us to learn more about how Procyon can help your firm prudently manage your retirement plans, endowments and foundations.

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