SECURE Act likely to have a positive but small impact

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MarketWatch Blog by Alicia H. Munnell

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The legislation addresses big problems with baby steps

In December 2019, Congress passed the SECURE Act, the first major piece of pension legislation since the Pension Protection Act of 2006. Proponents have characterized the passage of the SECURE Act as "a great victory for plan sponsors and American workers." I would characterize the legislation somewhat differently – the changes are generally positive but their likely impact small.

On the positive side, any bipartisan piece of legislation on a substantive issue, such as retirement policy, is a wondrous thing that should be applauded. Similarly, the legislation addressed the two major challenges in our retirement system – the lack of universal coverage and the question of how participants can best draw down their accumulated assets once they reach retirement. The problem is that the legislation takes only baby steps to solve these two large problems.

On the coverage front, the problem is that, at any moment in time, less than half of private sector workers are participating in an employer-sponsored retirement plan. Some may pick up coverage at some point in their worklife, but their balances will be very small. Others will have to rely only on Social Security, a program that is replacing a declining share of pre-retirement income.

The main way the SECURE Act addresses coverage is by broadening access to potentially low-cost Multiple Employer Plans (MEPs) by getting rid of requirements that: 1) participating employers must share a nexus; and 2) one “bad apple” hurts the entire barrel (i.e., a single employer who violates a requirement can disqualify the entire plan). (The legislation also allows long-term part-time workers to participate in 401(k)s, but this provision probably affects only about 3 percent of the adult workforce.)

Making MEPS more accessible, however, does not mean that employers will take advantage of the option. Policymakers have tried for decades to close the coverage gap by introducing streamlined products for small businesses – those most likely not to offer a plan. These simplification initiatives, however, have clearly not reversed the trend toward declining coverage over time. In my view, the only way to have a meaningful impact on coverage is to impose a mandate on employers without a retirement plan to automatically enroll their employees in an Individual Retirement Account or some other arrangement. Employees can always opt out if they do not want to participate. MEPS, which are voluntary, are unlikely to move the coverage needle.

The other major issue is that 401(k) participants face a major challenge in figuring out how to draw down their assets – if too fast, they exhaust their resources; if too slow, they deprive themselves of necessities. Increasing the share of withdrawals in the form of annuitized income could help. The legislation encourages 401(k) sponsors to offer annuities by providing legal protection – essentially, as long as sponsors choose an established provider in good standing with regulators, they cannot be sued if the provider becomes insolvent. The legislation would also improve the portability of lifetime income options to avoid taxes and surrender charges.

Even with this safe harbor, few plans are likely to offer annuities. And expensive commercial annuities are not the most efficient way to solve the drawdown problem. The cheapest and most effective way to increase annuitized income is to delay claiming Social Security benefits. The challenge is to design a mechanism whereby participants use their 401(k) balances to support themselves while they postpone claiming.

In terms of the smaller provisions in the SECURE Act, the legislation includes two that I like. First, sponsors would be required to annually report estimates of the income that could be generated by participants' balances. This change would help people to think more in terms of lifetime income rather than asset balances, and perhaps encourage people to save more. A second good provision is the requirement that heirs must withdraw IRA assets within ten years of receipt.

The only provision I don't like is the increase in age from 70½ to 72 for the start of required minimum distributions. This unnecessary loss of revenue helps only rich people.

But I don't want to end on a negative note. The legislation is a positive step forward and draws attention to major challenges in our retirement income system. But the impact will be modest. If, on a scale from 1 to 100, the landmark Employee Retirement Income Security Act of 1974 (ERISA) were 100, I would put the Pension Protection Act of 2006 at 25, and the SECURE Act at 10.