

PERSPECTIVES

PODCAST: An Update on US Retirement Legislation

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There have been some notable developments in the legislative and regulatory landscape in recent months when it comes to retirement issues. In our latest “Talking Markets” podcast, our Drew Carrington, Head of Institutional Defined Contribution at Franklin Templeton, and Michael Hadley, a partner with law firm Davis and Harman, discuss the passage of what’s known as the “SECURE” Act in particular, and the implications for the US retirement system.

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A transcript follows.

Host/Richard Banks: Hello and welcome to Talking Markets with Franklin Templeton.

I’m your host, Richard Banks.

Ahead on this episode: significant movement in Washington on legislation that could lead to major changes in the US retirement system for employees, employers and plan sponsors.

Recently, the House of Representatives passed the “Setting Every Community Up for Retirement Act”- also known as the SECURE Act.

Taking a look at what it all means is Drew Carrington, Head of Institutional Defined Contribution at Franklin Templeton, and Michael Hadley, a partner at the law firm Davis and Harman, who practices in the area of laws affecting retirement plans. We hope you enjoy their conversation.

Drew Carrington: Hey, Michael. It’s great to be back with you. There’s obviously a lot going on, on the legislative and regulatory front regarding 401k plans and the defined contribution system, more generally since the last time we’ve talked.

Maybe the highlight of the last a couple of months would be the passage in the House [US House of Representatives] of the SECURE [Setting Every Community Up for Retirement Enhancement] Act. So maybe, let’s start there. Let’s talk a little bit about what’s in the SECURE Act and where we stand in the legislative process.

Michael Hadley: Since the last time we did this podcast, we now have passage in the House of really the first piece of major legislation on retirement, really since the Pension Protection Act. It’s now called the SECURE Act; the name was changed. So if you’ve heard RESA [Retirement Enhancement and Savings Act] a hundred times a week, we’ve given it a new name. And, highlights of it, it’s very similar to what has appeared in other versions called RESA. A high level, probably the centerpiece, is a provision that will allow unrelated employers to join together in a single plan called an open MEP [multiple employer plan], although this new bill calls it pooled plans.

The SECURE Act also contains provisions we've seen previously to encourage and to help facilitate folks that are saving in a 401k or similar plan to take those savings and actually translate them into some sort of lifetime income, retirement income.

Drew Carrington: As I understand it, there are three components to that lifetime income element. There's a disclosure component and then two other pieces. Maybe you could talk a little bit about what those other two are?

Michael Hadley: Sure. So there's a provision that would enhance portability of annuity and other lifetime income investments that are held within plans. And while it seems like a minor provision, could be very important.

One of the challenges that some 401(k) plan sponsors, employers, have in making available annuities and other types of investments like that is that if he ever decided to discontinue that option or you change service providers, it can be hard to deal with them. But, you don't want to get rid of them because folks may have put in valuable premiums to purchase some guaranteed income. And this provision would allow it to be portable, would allow the employee to say, I'll just take it, take it as an IRA [individual retirement account], and that solves a sort of a grease within the system to facilitate plan sponsors making that available.

Speaking of that, you often hear about fiduciary concerns and the bill would include some relief for plan sponsors who put an annuity in, so they can feel comfortable. While I've done my due diligence on the product, I don't have to worry that in 30 years, the insurance company may not be able to make payments because I'm relying on state insurance regulators.

Drew Carrington: Additionally, as we convert our accumulated balances into income, there's a change to the RMD [required minimum distribution] provisions, which I think was really, we believe is really important because participants, individuals use the RMD as kind of a signal on when to start drawing down their assets.

Michael Hadley: That's right. So for, really, as long as there's been a tax-preferred savings vehicles, IRAs and plans, the rule has been that once you get to age 70.5, you have got to start taking money out. You don't have to spend it, but you have to start paying taxes on it. That's been the rule for a long time, even though we've seen significant increases in longevity, people working longer and spending more time in retirement. Under the SECURE Act, that age would be moved to 72. So even though it's only a year and a half, that's a big difference.

As you say, Drew, most people look to RMDs as to when it's time to start taking money, and the government collects a lot of taxes from distributions at RMD age. And by moving it back just a year and a half, that's a significant delay in tax revenue.

The SECURE Act also includes a provision that will change the rules for inherited IRAs and plans by changing the period over which an inherited IRA, particularly when given to somebody who's younger, the period over which it has to be distributed.

Drew Carrington: The other component which I think will have a really big impact on our plan sponsor clients is a change in the treatment of long-term, part-time employees. One of the issues when people talk about coverage in the 401(k) system is that part-timers have traditionally been, in many instances by design, excluded from plans and SECURE includes some language which would enable changes there, right?

Michael Hadley: That's right. So we started by talking about getting more employers to offer a plan. This tries to get more employees that work somewhere that has a plan, getting them in and saving. Under the SECURE Act provision, if you've got an employee who works at least 500 hours over three consecutive years, and you offer a 401(k) plan, you'd need to allow those folks after three years to contribute to the plan. The employer would not have to give them a matching contribution, although that could be offered, but you'd have to at least give them the opportunity to actually save in the plan. And we could see some employers saying, "You know what, if I have to let him in in three years anyway, I'll just let him in immediately." That would help more folks who, particularly those folks who really are not working full time for whatever reason, to be able to start accumulating savings for retirement.

Drew Carrington: You know, interestingly one of the places where we see part-time employment is actually in older workers who may not be focused on accumulating assets for retirement, but might like the ability to shield at least some of their income from taxes.

Last point on SECURE, they made changes to the safe harbor language around automatic enrollment and automatic escalation. Maybe tell us a little bit about that?

Michael Hadley: So, under current law, if your one 401(k) plan design uses a safe harbor with automatic enrollment and auto escalation, the rules say once you escalate somebody to 10%, you've got to stop. And even plans that don't meet that safe harbor, they are just a regular 401k, a lot of them stop at 10% anyway which probably doesn't make a lot of sense. If you've worked for 10, 15 years, it probably makes sense to go beyond 10%—and this is only automatic enrollment, you can always opt out. Under the SECURE Act, that 10% threshold would be moved to 15%. The Senate's version completely eliminates the cap, but plan sponsors could decide to stop, you know, at 10 or 15%, they just wouldn't be forced to.

Drew Carrington: So there's a lot of things that are in SECURE. Now let's talk about what happened to SECURE in the vote and then kind of what the prospects are for it to actually become law. I think our listeners have probably heard the scale of the of the vote—417 to three in the House. That's pretty comprehensive. So where does it go from here, though?

Michael Hadley: Right. It's so hard to imagine going out onto the street and finding 417 people to agree on anything, let alone 417 members of Congress, but they did, and it was passed in the House and it's currently residing in the Senate. And then, very often a bill that has that kind of bipartisan support can move pretty quickly. For those of you who watch Washington closely, you know, though, that nothing is simple in the Senate. The Senate is really its own very unique body. So what's going on in the Senate is the leadership, which includes Mitch McConnell as well as Chuck Grassley, are trying to move the legislation through what we call unanimous consent, meaning that every senator is polled and asked, "Hey, if we bring this bill to the floor, as is, would you vote for it?" and a number of senators have said, "No, I'm not ready to do that yet."

Michael Hadley: They have a hold and they may have various reasons for that. That whole process, for a lot of reasons, is generally kept confidential so that senators can discuss their concerns quietly. But until those holds are removed, this cannot be brought to the floor of the Senate. Now you might ask, "gee, why doesn't Mitch McConnell—this has 417 votes in the House, it's broad bipartisanship, pretty much accepted, most of the provisions—why doesn't he just bring it to the floor?" He's got 60 votes after all, right? Well, the reason is that even when you've got a bill that has 60 votes, having to move it across the finish line, takes a lot of floor time. There's limited floor time, especially when the Republicans in the Senate are really trying to move judges and an executive nominations.

And, when you bring a bill to the floor, especially a tax bill, there is a lot of opportunity for mischief on both sides. There could be amendments that folks will have to take tough votes on. There could be an opportunity to add stuff that senators have been trying to move. And it's important to remember, that because of our constitution, the Senate cannot just pass a tax bill. They have to take a tax bill passed by the House. And so what happens, when you have the only tax bill that's been passed by the House, is there are lots of senators who say, "I have no problem with that bill, but I have six other things that I've been waiting for to get done." And so, Mitch McConnell at this point has said, "Look, let's try to get unanimous consent. Let's work on that process and if we can clear some of these concerns so that everyone's on board, then we can do it easily without that mischief."

Drew Carrington: And with respect to the holds, as we know, at least part of the objections have to do with a provision that's, in many ways, unrelated to retirement. The original version of SECURE which passed out of House Ways and Means included a provision to allow the use of 529 plan assets to pay for homeschooling expenses. And so that passed out of committee, and then was taken out of the bill before it went to the House floor. That may be a factor which I suppose for those of us in the retirement industry is yet another frustration that something that doesn't have anything to do with retirement would potentially derail the passage of a long awaited retirement bill that includes a number of provisions that no one really disagrees with.

Michael Hadley: And I think everything that I talked about earlier, I think all those are widely supported. I don't know what the holds are, but I don't think any of them were objections to the stuff that we talked about. The retirement provisions have been discussed for a long time, got a unanimous vote in the Senate Finance Committee a couple of years ago. It may also be that some of the objection is just the process, that there's not been a process in the Senate to move the SECURE Act through committee in its current form. So, that could be part of what's slowing things down. I think it's possible these holds get cleared and we could see the bill pass, probably not this week, but it could happen any day. It could also linger for a long time. That's certainly a possibility here. I do think that the provisions that we've talked about are going to pass at some point at some time. But the process going forward is not a 100% clear.

Drew Carrington: Yeah. The legislative process, at this point, because, as you alluded to it, because it's a tax bill, so does it end up on the back of some other "must pass" bill like, you know, funding the government or the debt ceiling or some other "must pass" legislation? Does it become the piece of legislation that other things get attached to? It's, it's very unclear.

Michael Hadley: Traditionally, retirement bills, especially tax bills, have ridden on something else. The big 2001 tax bill was part of EGTRA [Economic Growth and Tax Reconciliation Act], a much larger bill, that passed at the end of the year. And as you say, it's possible that this could get added to a bill to keep the government open or some sort of cats-and-dogs bill, which often passes at the end of the year as folks are trying to get home for Christmas. But that process is much more uncertain, which is why Chuck Grassley and Senator Wyden, the chairman and ranking members of the Senate Finance Committee, would love to move it through unanimous consent. And that's why they really don't want to open the package. They're just as happy to take what the house did, if they can move it and not touch even a comma because the moment they touch a comma, a senator's going to want lots of other commas touched.

Drew Carrington: Yeah, that'd be commas and semicolons and exclamation points.

Michael Hadley: And it's also important to understand that, that means that the effective dates for the SECURE Act probably can't change. Many of them would go into effect as early as next year. So for plan sponsors, for wealth advisors, some of these provisions could kick in really, really quickly, requiring changes to process requiring communicating with your clients. And while we'd love to move those things back to give folks more time, you open up the effective date, then you've got to pass it again in both the House in the Senate.

Drew Carrington: Well, so we don't know where it's going to go, it could be any day, it could be later in the year. But in the meantime, while we have all the, sort of, process related drama around SECURE, we already have what's a, sort of, colloquially referred to as Retirement 2.0 brewing on both sides of Capitol Hill. So in the House, it's Chairman [Richard] Neal's committee, the Ways and Means Committee, has a bill that includes a number provisions that he's proposed in the past.

And then over in the Senate, it's senators Portman and Cardin have come back with a new retirement bill. Between the two bills, you know, hundreds of provisions that affect retirement plans. So, let's talk a little bit about kind of the, the key highlights we ought to be thinking about, as an industry and then, what are the, what are the prospects for those bills, as well. So let's start with the highlights.

Michael Hadley: So yeah. Between those two bills you discussed, and there are some other members of Congress that have other ideas they'd like to get into this, this 2.0, but between the two, yeah, there's probably a hundred which we don't have time to talk about and some of them are pretty in the weeds. But there are some that are really intended to try to, to make major changes to improve the system. I'll give you one example.

There's been a lot of talk about marrying a student loan repayment with a 401(k) plan. So that if you have an employee that's young, perhaps has big student loans, can't contribute to the 401k plan, you might still want to make sure that the employer is putting money in and there was a private letter ruling. Well, these bills would actually formalize the rules in the code and make it easier for an employer to offer that type of arrangement. There's also a provision in the Portman/Cardin Bill that would allow 403(b) plans. These are plans offered to teachers, university professors, nonprofits, allow them to invest in institutional class investing, what are called collective investment trusts [CITs]. Right now, just because of a weird quirk, they can only invest in mutual funds and annuities. So the larger ones don't have access to institutional pricing.

Drew Carrington: Which many 401(k) plans and 457 plans—the governmental employee plans—have access to. So it's just, as you said, just a quirk of the code that 403(b)s don't have access—even large 403(b)s—don't have access to the same kinds of investments that a comparable defined contribution plan would have.

Michael Hadley: That's correct. Mr. Neal also would like to try to get some prominence to an idea he has to actually mandate that all employers except the very smallest offer some sort of a 401(k) or 403(b) plan or, or perhaps a payroll-deduction IRA. That probably can't pass anytime soon with Republicans in charge of the Senate and the presidency. But, he certainly wants to talk about that and feature it.

Drew Carrington: Well, we've seen a number of states, including California, do that sort of mandate at the state level. Those have tended to be Roth IRA programs, not 401(k) programs. And, and because of their Roth IRAs, it means that employers who are in those programs can't do a match, it's post-tax money. So in some ways it, it's kind of his answer to what's going on in the states. Right?

Michael Hadley: That's right. The states are taking it up. A mandate that an employer either have a plan or participate in a state plan is coming in states like California, Illinois, in Oregon. And you're right that Chairman Neal's idea with this bill is to say, let's have some sort of federal solution so that every employer has some sort of plan where you can save through work. And that, that would sort of stop other states from moving forward, so we don't have a patchwork.

Drew Carrington: Yeah. And that builds, in some ways, as well, on the open MEP [multiple employer plan] provisions in SECURE because now it would be easier for smaller employers to join a plan or sign their employees up for a plan.

Michael Hadley: And this, this sort of comes full circle to what we've talked about a lot on these podcasts that policymakers are interested in getting more employers to offer a plan because we know saving at work is the best way. Getting more employees participating in that plan and getting them to save more. And those are the three things that policymakers would like to do to take our system to the next level.

Drew Carrington: And then, help them with the transition into spending in a number of ways there, as well. So let's talk about the prospects on 2.0. Obviously, with SECURE sort of held up, it's hard to visualize how these two bills would move in either House.

Michael Hadley: I think if the SECURE Act sort of stalls, it's possible that that Portman and Cardin may try to add some of their provisions. But, I think they really see this as a long term sort of next steps. I don't think they think it's going to be passed this year, that is 2.0, it's going to be hard enough to get the SECURE Act 1.0 passed. And, they know that if they're going to move a bill they'll probably have to take some of their ideas, as well as bring in ideas from other colleagues to build, sort of, the next big pension program. It is possible that if they can get bipartisan support, maybe next year they could think about trying to move it. After all, if it's bipartisan, that is the kind of thing—really, the only kind of thing—that can move through congress in an election year, not controversial things. But, look, they got a lot of ideas. Some of them have been vetted through committees, many have not. So I would say 2.0, while I think they'd love to try to move it sooner, is probably a next-year issue.

Drew Carrington: Moving over to the regulatory side because it's busy everywhere in Washington, when it comes to DC [defined contribution] plans, let's start with the SEC's [Securities and Exchange Commission's] passage of their regulation "Best Interest" and what kinds of impacts that might have on 401(k) plans, employers, and advisers and consultants to those employers.

Michael Hadley: So on June 5th, the SEC released its long anticipated Reg BI, BI for Best Interest, which imposes a higher standard of care for broker-dealers in dealing with what they call retail customers. So basically, people who are saving for household and family purposes. This will have an impact on retirement savings because those new standards, the new disclosures, the new compliance structures that brokers and other financial advisors will have to put in place is going to apply both to advice given to somebody about their own 401(k) investments and to advice on their IRA. And finally, advice on moving from one of those to the other. So, the SEC was very clear in the final rule that a recommendation to do a rollover is a recommendation covered by the rule, which means that the additional compliance structures, prohibition on certain types of conflicted payments, as well as a higher standard of care that the DOL [Department of Labor] had tried to apply for rollovers is going to be applied to the SEC. At least with respect to financial professionals that the SEC regulates.

Drew Carrington: So anything else in the—I think it was almost-800 page regulation that they promulgated—anything else in there that we need to be thinking about in our industry?

Michael Hadley: So the regulation does not apply to a broker-dealer that's making recommendations to plan sponsors. They're not considered to be retail, as well as, sort of, interactions between financial professionals. If you contrast that with what the Department of Labor's fiduciary rule did, it doesn't cover nearly as much. The fiduciary rule was sort of all encompassing, could apply to anyone regardless of what their job title was. If they said the wrong thing, they could become a fiduciary and it applied to lots more interactions. It also made it very difficult to get paid for your advice. The SEC's rule is much more focused in terms of conflicted payments. It's really focusing a lot on particular types of conflicted payments, like sales contests that the SEC felt we really just need to shut down.

Drew Carrington: So speaking of the DOL and the fiduciary rule, so switching from the SEC to the DOL, the DOL has now come out and said they're going to issue a new fiduciary rule. I'm guessing it'll be a little different than the last one. I think they said they were planning on getting a draft out by the end of the year.

Michael Hadley: And this is a piece of news. This is a little bit of change in their posture. They had said previously, after their rule had been struck down by the courts, that they were going to, sort of, do something that you could be described as clean up. Clean up what the law is now that the fiduciary rule was struck down, but they sort of changed their tune. They said no, now we're going to do a new proposal and the new proposal will harmonize with what the SEC just released. We don't really know exactly what it's going to look like, but it is possible that it could cover rollovers. After all, the SEC's rule does. It will probably provide an exemption from some of the tricky, what we call prohibited transaction rules, that apply when you deal with IRA and plan customers and clients. But, we just don't know yet. And, we expect it's going to take them a while to kind of get it ready. And I would think a proposal at the end of the year is likely, cause it's just a proposal. So there'll be noticing comment. So another thing to say is this fiduciary rule thing is not settled. Uh, it's going to drag on, not only with DOL, but many states are kind of getting into the act as well.

Drew Carrington: Well, it seems like there's a lot of change coming. We need to certainly pay attention to Washington, more so than usual for the retirement plan industry. Thank you very much for your time today and for your insights on everything that's going on in Washington.

Michael Hadley: Thanks, Drew.

Host/Richard Banks: And thank you for joining us for this episode of Talking Markets. We hope you enjoyed the conversation. If you'd like to hear more, visit our archive of previous episodes and subscribe on iTunes, Google Play, or just about any other major podcast provider. So until next time when we uncover more insights from our on the ground investment professionals, goodbye!

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