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Congress Passes Sweeping Overhaul of Retirement System

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Congress passed the most significant changes to the nation's retirement system in more than a decade, a move designed to help Americans save more.

With the U.S. population aging and employers shifting responsibility for retirement saving to individuals, lawmakers have grown concerned that a significant portion of Americans are at risk of outliving their money. Americans between the ages of 35 and 64 face a retirement savings shortfall of $3.83 trillion, with 41% of households projected to run short of money in later life, according to the nonprofit Employee Benefit Research Institute.

One prominent provision of the legislation passed Thursday, which President Trump is expected to sign, encourages 401(k) plans to replicate a feature of old-fashioned pensions by offering products with guaranteed income payments.

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The legislation also seeks to expand retirement plan coverage by making it easier for small companies to join together to offer 401(k) plans and share administrative costs. An estimated 30% of private-sector employees work for employers that don't currently offer a way to save for the future.

Brokers, asset managers, 401(k) record-keepers and insurers are likely to benefit from these measures.

To help participants figure out how to make savings last, the legislation makes it easier for employers to offer annuities—which often guarantee a monthly stream of income, potentially for as long as a retiree lives—in 401(k)-type retirement plans. It protects employers that follow certain procedures from being sued if they select an insurance company to make annuity payments and that insurer later fails to pay claims.

While the insurance industry lobbied hard for the change, the provision has attracted criticism from consumer advocates.

“Given the prevalence of high cost, low-quality annuities, we don’t start with the thought that this is a great idea,” said Barbara Roper, director of investor protection at the nonprofit Consumer Federation of America.

On average, the fees that participants in the largest 401(k) plans pay for investments and administrative services fell to 0.25% of assets in 2016 from 0.34% in 2009, according to research firm BrightScope Inc. and the Investment Company Institute, a mutual-fund-industry trade group. In contrast, the average variable annuity in the retail market costs between 2.18% and 3.63%, depending on the product type and features selected, according to Morningstar Inc.

The House of Representatives overwhelmingly approved the retirement measures on May 23. But that bill, called the Setting Every Community Up for Retirement Enhancement, or Secure, Act, stalled in the Senate because of objections from a few lawmakers over a handful of narrow items. Backers of the legislation recently added it to the spending bill in an effort to gain passage by year-end.

The various provisions of the legislation are estimated to reduce federal revenue by $16 billion over a decade, according to the Joint Committee on Taxation, largely offset by changes related to inherited retirement accounts. The measure includes a provision that requires many people who inherit tax-advantaged retirement accounts after Dec. 31 to drain the accounts within a decade and pay any taxes due. Currently, many beneficiaries can liquidate those accounts, known as Stretch IRAs, over their own lifetimes.

The legislation paves the way for the growing number of Americans staying on the job into their 70s and beyond to continue saving in individual retirement accounts. Starting Jan. 1, it removes the age cap for contributing to traditional IRAs, currently 70 ½, for individuals with wage income. And it allows people with tax-deferred accounts to delay, until after turning 72, the minimum withdrawals the law currently requires starting after turning 70 ½. (The change applies to people who turn 70 ½ after Dec. 31, 2019.)

To encourage workers to save more, the legislation allows employers that automatically enroll workers in certain 401(k) plans to automatically raise employees' savings rates to 15% of annual earnings over time, up from a 10% cap now.

Other features of the legislation include a provision requiring employers to allow certain part-time workers to participate in 401(k) plans.

"With Americans delaying retirement and increasingly working part time, these changes will allow workers to continue to save," said Sen. Ron Wyden (D., Ore.) in a statement following the vote. "While we must do more to ensure financial security for older Americans, passage of this bill is an important step."

For parents and others with 529 education savings accounts, the legislation allows tax-free withdrawals of as much as $10,000 for repayments of some student loans. Parents can also take penalty-free distributions from retirement accounts of as much as $5,000 within a year of the birth or adoption of a child.

Some changes, including those relating to annuities, are expected to take time to implement.

Though commonly offered by traditional pension plans, annuities are currently available in only 8% of 401(k)s administered by Vanguard Group.

While the legislation gives employers some legal protection for their choice of an insurer, that doesn't mean "everyone is going to jump in and be comfortable offering traditional annuity products," said Kelli Hueler, CEO of Hueler Cos. The Eden Prairie, Minn. company offers a service that allows 401(k) participants to purchase institutionally priced annuities when rolling money over to an IRA.

Citing a continuing wave of lawsuits over 401(k) fees, Ms. Hueler predicts employers, especially large ones that are typically the targets of fee litigation, will "take a cautious approach" to adding annuities to their 401(k) plans.

Jerome Schlichter, an attorney whose St. Louis-based firm has pioneered 401(k) fee litigation, said variable annuities, in particular, can be "overpriced."

"Fiduciaries would have to make the case that having a variable annuity as opposed to a mutual fund offers something significantly more to justify the higher price," he said. "Multiple commentators have said they do not."

Andrew Kligerman, an analyst who follows the life insurance industry at Credit Suisse, expects financial services companies to reap benefits from a provision aimed at encouraging companies without retirement plans to join together to offer one using a so-called multiple employer plan, or MEP.

MEPs are allowed now, but only for businesses with a relationship such as a common owner. The legislation does away with that restriction. Mr. Kligerman expects the change to expand the $5.84 trillion 401(k) market by $1 trillion within about five years.

MEPs are potentially attractive to employers because they shift some of the administrative burden and fiduciary responsibility for a 401(k) plan to an administrator.

Peter Swisher, senior vice president of Pentegra Retirement Services, which manages MEPs for banks and credit unions, said that multiple-employer plans are likely to “initially attract smaller companies.”

But as MEPs grow in size, they may potentially drive down 401(k) fees and attract “mid-sized and even some large companies,” said Mr. Swisher.