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SECURE 2.0 and Your Retirement Savings Episode Transcript

Michael Davis: Welcome to T. Rowe Price's CONFIDENT CONVERSATIONS™ on Retirement. My name is Michael Davis, and I'm thrilled to be your host. I've spent my career working to help people build a durable retirement. It is an honor to do this work and an even greater privilege to be here with one of our retirement experts, CERTIFIED FINANCIAL PLANNER professional, Roger Young.

On this Spotlight episode, we'll discuss passage of a significant new piece of retirement legislation commonly known as Secure Act 2.0, which became law in December 2022. This new law has significant effects on those of you who are either saving for retirement or already in retirement.

Roger and I will outline some key provisions in SECURE 2.0 and what they mean for you. Welcome to the show, Roger.

Roger Young: Thanks, Michael. It's great to be here.

Michael Davis: It's great to have you here. It's always good to see you, Roger. So, Roger, why don't we start with this? Why don't you give us a quick background on SECURE 2.0? What is it and why is it so important for our listeners?

Roger Young: Well, the background is I think lawmakers recognized that many people struggle to save for retirement. So, this Act and the first SECURE Act—since you know, there was a 1.0 before 2.0—they're both intended to make it easier to save and for your savings to last. A lot of the changes in this new Act aren't going to apply to everyone. But for the people it does apply to, it can be pretty significant.

Michael Davis: So, our listeners may recall the SECURE Act 1.0 passed into law just a few years ago. What are some of the key differences between 1.0 and 2.0? And why is this new law so important?

Roger Young: The original SECURE Act had a lot of changes and some very big ones. You know, some of the key areas included things involving Required Minimum Distributions. So those distributions that people have to take out of their retirement accounts once they reach a certain age. The ability for older workers to contribute to IRAs was another nice feature of SECURE 1.0.

You know, on the flip side, that Act imposed a requirement for most non-spouse beneficiaries of retirement plans to withdraw the money from those accounts within 10 years. So, there were some things that people generally regard as big positives. Some that were, you know, a negative like that one. Now SECURE 2.0 makes further progress on Required Minimum Distributions, you'll hear us call those RMDs, also makes it easier in different ways for people to save and for people to access their accounts.

Now, we should make it clear upfront a lot of the provisions of this new act take effect at different times over the next several years. And a lot of them depend on what employers and financial services companies choose to do in workplace plans. So, you know, there's a lot to keep track of here. Some things we're going to have to stay tuned, but we'll highlight what's most important right now and which things are going to happen over time.

Now, Michael, I'm curious, how would you characterize the progress from SECURE 1.0 to 2.0 from your vantage point?

Michael Davis: Well, I would say that there have been significant improvements. And you've already mentioned the increased RMD age, Required Minimum Distribution age, which is significant, I think for a lot of people. I think the other provision that a lot of our listeners will care about is long-time, part-time workers. It is much easier for them to become eligible for these plans now because of SECURE 1.0 and with 2.0 they can qualify sooner than they would have under 1.0. So, a lot of significant developments that we think are very positive for the marketplace.

Roger Young: Good. Yeah, I think that's a nice example of something where it's very important to those people who are long-time part-time workers that's not, you know, nearly the majority of folks out there. But for them, it's a meaningful difference in their retirement savings.

Michael Davis: And they get eligibility into retirement plans, which we know makes a big difference for the quality of their retirement.

Roger Young: Excellent.

Michael Davis: So, Roger, back to you now. So, what are the key provisions that impact individuals who are still saving for retirement?

Roger Young: Well, one helpful change in the new Act is that people who are aged 60 to 63 are now going to be able to contribute even more to workplace retirement plans. So that's referred to as a catch-up contribution. And right now, people who are 50 and older can do these catch-up contributions. Now, starting in 2025, for those people ages 60 to 63, that catch-up additional amount is going to be at least 50% higher for them than for the regular catch-up.

So, for example, the catch-up limit in 2023 is $7,500. If that’s still the normal limit in 2025, people in that age bracket, 60 to 63, they would have a catch-up limit of $11,250, which is 50% higher. Now, people in their early sixties are a prime example of people who might need to catch-up and also might be in a position in their life where they can catch-up, where they're past things like perhaps college bills or, you know, other types of expenses, maybe even they've paid off their mortgage. So, they have the opportunity potentially to take advantage.

A second change that I'll mention is that there will be more ways to save in Roth accounts under SECURE 2.0. So, for the first time, Roth contributions will be allowed for SIMPLE IRAs and SEP IRAs, as well as for employer contributions. And there are a lot of rules involved with that. Also, keep in mind, employers can elect to take advantage of that flexibility, but they aren't required to. So that's one of those examples where we're going to have to see how it plays out. We're going to have to see how the specific rules are written and how, you know, those changes are implemented by employers.

The third area I'll mention for individuals who are still saving is access to savings. So, there are typically penalties if you take money out of retirement accounts before you reach that magic, unusual age of 59 ½. The list of potential exceptions to those penalties has now been expanded under this Act. So that includes situations such as victims of domestic abuse, people with terminal illnesses, people who have undergone qualified natural disasters, people who need long term care. So again, the implementation of those might depend on what employers do. And again, those aren't relevant to everyone, but those can be really important for people who are affected.

You know, we tend to caution people, if you can avoid taking money out early from your retirement accounts, we really prefer you to do that to keep your retirement savings on track. But there are cases where that's just not possible and it's better if they're without penalty. Now, the fourth area for people saving for retirement that I'll mention is the writers of SECURE 2.0 recognized a lot of people, such as younger workers, struggle to balance their financial priorities. They might have student loans, for example, or they might be trying to build up an emergency fund, which, you know, all of us in the financial profession say you got to have an emergency fund. And of course, you got to pay off your loans. So, starting in 2024, the Act will allow employers to make matching contributions based on the qualified student loan payments that their employees make. The Act will also allow them to make matching contribution on contributions that employees make to a special type of emergency fund. So, a lot of details with that.

And this is another area where employers may make changes to their plans, but they aren't required to do so. So, we'll stay tuned and see which of those get traction. You know, we know there are some plans out there already who've tested the waters on things like student loan payment matching. But now we'll see if it's something that is important to companies who want to attract talent.

I've listed four. Michael. I'm curious, what are the areas that you think people are most excited about in the in the retirement world?

Michael Davis: I think some of the most important elements are those that you mentioned at the end. The student loan match, I think, is really critical. I think that for a lot of individuals, they've amassed a lot of college debt, as you know, and they're looking for a way to sort of save for or pay that off in ways that are qualified, in ways that sort of support their own retirement savings.

I think also emergency savings is another characteristic of SECURE 2.0 that people are very excited about. Emergency savings is a concept that's been talked about quite a bit. Is there a way to take some small amount of your retirement savings in a qualified way, so hopefully you don't lose the benefit of your retirement savings over time.

So, this emergency savings qualification, we think, is something that is very exciting for a lot of people who would really benefit from it.

Roger Young: Great. Yeah. And it's exciting to hopefully get younger people saving sooner, taking advantage of that, you know, quote/unquote free money in terms of a match, if they possibly can.

Michael Davis: If they can, yeah. And we know just with the compounded savings benefit, the benefit of having them start early, even if they have some debt if they can just save a little bit, that is just a much better way to go than not saving at all.

Roger Young: Yeah, saving early is huge.

Michael Davis: So, Roger, now how about retirees? What do they need to know about SECURE 2.0?

Roger Young: In my view, probably the biggest change in the entire Act for individuals involves Required Minimum Distributions. We mentioned that at the beginning, RMDs. When you reach a certain age, you generally have to start taking money out of your retirement accounts, such as IRAs and 401(k) plans. Now, the first SECURE Act pushed that RMD age from another one of those weird ages - 70 ½ at the time - to age 72 and now with SECURE 2.0 that goes even further so it moves it to

age 73 right away, effective at the beginning of 2023. In 10 years, it's going to get pushed back again to age 75. And we might talk a little bit about that 10-year thing, that's seems a little bit odd, but there's a reason for it. But in any event, 10 years from now, it'll get pushed back to age 75. And it's a recognition that, you know, people are living longer and not everyone wants to have to take money out of their accounts as soon as they as they used to.

So that does a number of things. It gives people more flexibility to obviously keep money in their retirement accounts longer, you know, take advantage of more tax-deferred growth potentially. And of course, that's if they don't need it for spending, they can still take it out if they want to. So, flexibility is generally a good thing.

It also means, though, that people should definitely plan out a strategy for their retirement income and these distributions or any distributions. So, for example, if you wait as long as possible to take money from your accounts, those RMDs could be a lot bigger when they do start than they would have been if you had been taking them out from an earlier age. So why does that matter? Well, it could potentially bump you into a higher tax bracket.

The first SECURE Act also requires that most beneficiaries of retirement accounts, other than spouses, will have to take out the money within 10 years. So, a large balance in those accounts could also bump up the beneficiary's taxes as well. So, you'll want to consider spreading out your distributions and that might mean starting before you actually have to.

Another thing that you might consider is the concept of Roth conversions. That can make sense for some people. That's where you take money out of a tax-deferred account, like a Traditional IRA, and move it into a Roth IRA and you pay taxes at that point. But that can be beneficial to, again, help even out your distributions and limit the effects of higher tax rates at certain points in your retirement. And it can be potentially very attractive if you can do those conversions when your tax rates are relatively low.

Also related to RMDs, Roth accounts in workplace retirement plans will no longer be subject to RMDs starting in 2024. That puts those workplace plans, on equal footing with Roth IRAs. You know, it used to be that a lot of people would think about rolling over an account from a workplace plan to an IRA, partly because of that difference in the treatment of Roth account RMDs. Now they're on more equal footing. Now there are a lot of pros and cons, and we aren't going to go into that whole decision-making in terms of whether you leave your retirement money in your workplace plan or roll it over to an IRA. But this is a change that could affect that decision for some people.

So, Michael, what are you hearing in terms of things that are important for retirees in the Act?

Michael Davis: Well, Roger, that's a terrific question. Actually, for the last few years, we've seen a trend of retirees wanting to keep their assets in the plan for longer post-retirement. Used to be a time when plan sponsors weren't as excited about that, but lately they've been a lot more supportive of this trend. And a couple of reasons for that. One, they get lower costs for the entire plan where there's more assets in the plan. Second, I think they enjoy the fiduciary oversight that they provide to the plan and the benefits that accrue to the individuals in the plan as a result of that really thoughtful institutional oversight. So, these increased RMD ages allow them to keep more money in plan for longer, which I think a lot of people are very excited about.

So, Roger, you've mentioned Roth a few times. Why the greater emphasis on Roth contributions?

Roger Young: Well, now we're getting into one of those kind of interesting nuances of how legislation gets drafted and passed. You know, I mentioned earlier there was a provision that would take effect in 10 years. While legislation is typically evaluated or scored based on 10-year, financial projections. So, with Roth contributions, an individual doesn't get a tax benefit right away. The benefit is that you get qualified tax-free distributions later. So, the government gets tax revenue sooner than if you had made a traditional contribution. So, a traditional contribution reduces a person's taxable income right away. So, a shift toward Roth helps to, quote unquote, pay for the costs of other provisions, at least in that ten-year time frame.

So that's kind of why it seems to have worked out that way. And you can be cynical about it, or you can say, you know, for a lot of people, you know, a nudge towards Roth isn't necessarily a bad thing. It’s often good to have at least some level of Roth heading into retirement, to have some of that kind of tax account diversification, have some flexibility. So, if some people get nudged that way, that's probably all right. But of course, you know, where you have choices make the best choice for you, whether that's Roth or a Traditional account.

Michael Davis: It's always nice when incentives line up with outcomes, and those outcomes can also be beneficial to individuals.

Roger Young: Yeah, that's not a bad thing. Not 100% of the time. But yeah, for a lot of people, it's not necessarily a bad thing to think about Roth at least.

Michael Davis: So, Roger, according to a variety of studies, nearly half of all U.S. workers are employed by small businesses. Are there any provisions in SECURE 2.0 that target these employees?

Roger Young: The first thing that comes to mind, Michael, is for me, the SIMPLE and SEP IRA provisions. So those are, you know, specifically for smaller businesses. And so, the fact that, you know, those can be Roth, you know, gives, again, people a little more flexibility in how they save for retirement. Now, I know that access to retirement savings is a big focus area for us and our clients. So, I'm curious what you would have to add about that one?

Michael Davis: Well, I think that one of the most important provisions is the one that encourages more automatic features in new DC plan creation. Specifically, the provision requires new DC plans to include automatic enrollment and automatic escalation features, starting at a minimum of 3% deferral rate. That rate will increase by 1% each year, up to either ten or 15%, depending upon the plan.

This provision applies to plans established after the date of enactment - December 29th, 2022, for plan years beginning after 2024. This provision speaks to the importance that auto features have had on promoting better retirement savings outcomes for plan participants.

I think it really levelizes those plans with what you tend to see at the large end of the market.

Roger Young: That's great. I mean, we mentioned the term nudge before, so again a positive nudge, gets people going and heading in the right direction on retirement savings

Michael Davis: That’s exactly right. So, Roger, so far we've talked about the positives, but there are always two sides to every coin. Are there any potential challenges that individuals should watch out for with respect to SECURE 2.0?

Roger Young: The first one I'll mention as kind of a new requirement is that high earners and that's defined at least, you know, currently as people who earn over $145,000 from any one employer. Those high earners will need to make any catch-up contributions in their employer plans to Roth accounts starting in 2024. That’s not necessarily bad, but it does limit flexibility a bit for those people.

As we mentioned, a lot of the provisions still need to be ironed out. So, some of the details, we'll have to see how things happen and what employers do or don't take advantage of. So not necessarily a negative, but more of an uncertainty. Overall, though, I just don't see any drawbacks of this Act that are nearly as big as that 10-year distribution requirement for most beneficiaries that was in the first SECURE Act. Anything else that, you know, you see as a negative or a disappointment in the Act?

Michael Davis: There are areas where there's more work to do. So, for those plans, those 403(b) plans, these are plans that are accessed by many public workers, teachers, health care workers. They don't have access to the same types of vehicles that are accessed in the corporate environment, the 401(k) environment. And those lower cost vehicles can certainly provide a benefit.

And so, there were some provisions that were in the drafts of SECURE 2.0, but when it was passed, those drafts didn't make it to the final version. So, there's still some work to do to give access to those individuals, to those low-cost vehicles. And we/others are going to continue to watch developments on the Hill to ensure that those provisions are one day passed.

Roger Young: Are you telling me I need to mark my calendar for December of this year and next year for SECURE 3.0?

Michael Davis: Perhaps the year after. And the year after.

Roger Young: Always in December. Always in December.

Michael Davis: Always seems to be in December. So, Roger, I'm afraid our time is actually up. But as a parting thought, what do individuals need to know or do in 2023?

Roger Young: To me, it's really all about updating your planning. Again, none of this is, drop everything to make changes really quickly. But think about your plans. For example, if you aren't going to be 73 before this year end, you might have gotten a reprieve on your Required Minimum Distributions. You can take advantage of that time to develop or revise your strategy for retirement income and how you'll take money out of your accounts.

If you're approaching retirement, you know, especially if you're a higher earner and might be subject to some of these things we've talked about, you know, think about how the new provisions on catch-up contributions might help you or affect your mix of accounts. And of course, just stay posted, stay on top of the news. a lot of things are still subject to change. So, keep aware of what your employer is doing or what potential employers where you might be down the road are doing.

Michael Davis: Well, thank you, Roger, so much. And thank you so much for joining us today and sharing such great insights. It's always wonderful to speak with you. And I'm sure our listeners enjoy hearing from you.

Roger Young: Thanks. I enjoyed the conversation.

Michael Davis: Again, I'm Michael Davis. I want to thank you all for listening. If you like this episode, please rate us and subscribe wherever you get your podcasts. Until next time, be well and I wish you all many confident tomorrows to come.

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