Paying off student loan debt within a retirement plan

44 million Americans
hold more than $1.56 trillion in student loan debt.[1]

On average, 2017 graduates accumulated nearly
$40,000
in student loan debt.[2]

Student loan debt reached an all-time high last year with the average college graduate racking up a $40,000 tab. That staggering figure adds financial strain and leaves employees stressed out. What if you could play a role in helping your employees get out from under student loan debt?

It turns out some employers have made it happen by adopting a student loan repayment (SLR) benefit. Today only 3.2% of employers offer a student loan refinance or repayment benefit according to a recent survey.[3] But it's on the rise with 25% of employers saying they'll improve SLR benefits over the next three years.[4]

Pay down debt while saving for the future

Student loan debt can have a crippling financial effect on employees now and in years to come. Hefty student loan obligations can prevent or delay employees from saving for retirement. Because employers understand the importance of saving early, some turn to their retirement plan as a way to help employees save while simultaneously paying down student debt.

IRS paves the way

Recent guidance from a new Private Letter Ruling (PLR) issued by the Internal Revenue Service helps kick-start discussions on structuring SLR benefits within a retirement plan. While the PLR can only be relied upon by those who request the letter, the ruling allowed employees the choice to receive an employer contribution as either a non-elective contribution based on student loan repayments or a matching contribution based on employee savings within the plan.[5] Because the non-elective contributions are made in lieu of the matching contributions, it's typically budget neutral for employers.

Adding up the benefits

Before you decide to offer SLR benefits inside your qualified retirement plan, take a closer look at some benefits and considerations.

Benefits:

- **More savings –** Since employees can't always afford to save for retirement while making student loan repayments, this might make it possible to start saving sooner.
- **Tax efficient –** Employers receive a tax deduction and don't pay FICA/FUTA on the employer contribution. Employees have taxes deferred until distribution and don't pay FICA tax, unlike other SLR options outside a retirement plan.
- **Cost-effective –** When the SLR benefit offsets or is made in lieu of the plan's matching contribution, it generally won't add costs.
- **Retention tool –** Employers can retain higher-educated employees by applying a vesting schedule to contributions.

Considerations:

- **Added administration –** Employers will need to verify loan repayments and calculate contributions.
- **Disparity –** Employees without student loan debt may challenge the fairness of the benefit.
- **Retirement shortfall –** If employees don't save their own money for retirement to receive a benefit, overall participant outcomes could be negatively impacted.[6]
- **Testing –** Depending on the design, additional nondiscrimination testing may be required unless legislation is enacted to relax the current rules.[7] For instance, minimum coverage, actual deferral percentage and actual contribution percentage (ADP/ACP) testing may suffer if a disproportionate percentage of non-highly compensated employees take advantage of the benefit. And matching contribution methods may not work for ADP/ACP safe harbor plan designs.

SLR benefit programs inside or outside of a qualified retirement plan can offer a way for employees to pay down debt while saving for the future. Take time to understand the benefits and considerations to find out if it's the right fit for your business.

Want to know more? Let's talk. We're here to help consider your options for offering a SLR benefit inside a qualified retirement plan.

[1] US Federal Reserve, "Consumer Credit Outstanding Levels," Q3 2018 and Federal Reserve Bank of New York
[2] Student Loan Hero, May 2018
[3] PLANSPONSOR Defined Contribution Survey, 2017
[4] CommonBond: The Missing Benefit in Financial Wellness, May 2018
[5] IRS PLR #20183012, August 2018
[6] We believe participants need to save 10% plus employer contributions over their career. Based on analysis conducted by the Principal Financial Group®, October 2015. The estimate assumes a 40-year span of accumulating savings and the following facts: retirement at age 65; a combined individual and plan sponsor contribution of 12 percent; Social Security providing 40 percent replacement of income; 7 percent annual market returns; 2.5 percent annual inflation; and 3.5 percent annual wage growth over 40 years in the workforce. This estimate is based on a goal of replacing about 85 percent of salary. The assumed rate of return for the analysis is hypothetical and does not guarantee any future returns nor represent the return of any particular investment. Contributions do not take into account the impact of taxes on pre-tax distributions. Individual results will vary. Participants should regularly review their savings progress and post-retirement needs.
[7] The Retirement Parity for Student Loans Act, proposed December 18, 2018 would permit SLR benefits tied directly to student loan repayments to be treated as matching contributions in lieu of nonelective contributions, which would eliminate many of the concerns related to minimum coverage and nondiscrimination testing as well as ADP/ACP safe harbor status.