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WHITE PAPER

UP CLOSE: MAXIMIZING YOUR RETIREMENT SAVINGS AND INCOME POTENTIAL

On average, baby boomers change jobs 11 times over their working careers.[1] Consequently, it is not uncommon for these investors to have multiple retirement plan balances from former employer plans and numerous types of IRAs scattered about. Investors who have disparate accounts can find it difficult to know what they have, what their options are and whether they are on track to achieve their financial goals. Financial advisors can provide an invaluable service to investors by helping them decode their retirement DNA, that is, 1) identify each of the retirement savings vehicles in which they have been or are involved and 2) understand the key options and features of each vehicle. A retirement DNA analysis creates a solid foundation that allows investors to accurately evaluate options, make informed decisions and execute strategies that can help them maximize their retirement savings and income potential.

Retirement DNA

Like our physical DNA, each of us has distinct retirement DNA that develops with us throughout our adult lives as we move from employer to employer. A person's physical DNA may dictate blue eyes and blond hair while his or her retirement DNA may reveal a 401(k) plan, a savings incentive match plan for employees (SIMPLE) IRA and a Roth IRA. And just as there are ways to maximize one's physical DNA, such as by eating more wholesome foods, taking vitamins and exercising, there are ways to maximize one's retirement DNA through actions and behaviors. Assume an analysis of an investor's retirement DNA reveals a 401(k) plan (i.e., the savings vehicle) that offers a qualified Roth contribution option in addition to a pretax salary deferral option, employer matching contributions and target date funds among other investment options. One way the participant could maximize his or her retirement DNA in this case would be by 1) choosing to contribute a portion of his or her pay, 2) contributing at a level that would entitle him or her to receive the maximum employer matching contribution and 3) using a target date fund for investment purposes. Maximizing one's retirement DNA, from a strategic perspective, entails building retirement assets, ensuring the security of those assets and positioning those assets to create a secure stream of retirement income. However, most people spend little to no time understanding their retirement DNA, let alone how to maximize it.

With a retirement DNA analysis in hand, investors will be better equipped to make informed decisions that could help them save more, secure a source of reliable retirement income, minimize taxes and penalties and achieve legacy planning goals.

Perhaps the best way to understand the value of a retirement DNA analysis and how it can facilitate the retirement savings and income decision-making process is through an example.

[1] Bureau of Labor Statistics, National Longitudinal Survey, July 25, 2012

Liam, a small business owner, is a few years from retiring and wants to get serious about his retirement planning. His main concern at this point is retirement income. He turns to a financial advisor for help. Their conversation proceeds as follows:

Advisor: Can I take a look at your last retirement DNA analysis?

Liam: My what?

Advisor: We need to examine the various retirement savings programs you've participated in over your working career. I call that analyzing your retirement DNA. That way, we can figure out how to maximize your retirement income options. Where have you worked in the past?

Liam names two former employers.

Advisor: Did you have retirement plans through those employers and, if so, what type of plans were they and what did you do with the account balances?

Liam: Well, I had a SEP plan with one and a 401(k) plan with another. When I moved on, I left the account balances behind. I still get the statements for each of them, though.

Advisor: Which plan has the most assets?

Liam: My 401(k).

Advisor: What about for your business now? Do you maintain a retirement plan?

Liam: I have had a SIMPLE IRA plan for my employees and me for five years.

Advisor: How about IRAs?

Liam: Yeah, I've contributed to two different traditional IRAs off and on through the years.

Advisor: Great. So, you've got three traditional IRAs (your two and the former SEP—which is just a traditional IRA that your employer funded), one former 401(k) plan and a SIMPLE IRA. One idea comes to mind already. Did you know you could consolidate all of your IRAs, including your SIMPLE IRA, into one IRA?

Liam: Wow, I didn't know that.

Advisor: Of course you would have to continue to maintain your SIMPLE IRA to receive ongoing contributions. There are some pros and cons to an IRA consolidation strategy that we can discuss later.

But for our purposes now, we can effectively narrow your saving vehicles to two types: IRA and 401(k). Now, let's look at each in more detail to identify their key options and features.

For each, let's answer the following questions.

- Is the creditor protection for the assets full or limited?
- Are there any special tax treatment options available for lump sum distributions (e.g., long-term capital gains tax treatment for net unrealized appreciation in employer stock)?
- Are investment options available under the plan an open or closed architecture — meaning, do you have broad or limited investment options?
- Do you receive investment advice? If so, what kind: one-on-one with an advisor, through online tools, telephone service center or other?
- Do you receive adequate information and education with respect to the plan and its investments?
- Are your statements easy to understand and helpful?
- Are the fees you pay reasonable for the services you receive?
- What options do you have to consolidate your other account balances within the plan?
- Do you have access to a guaranteed retirement income option within the plan?
- What payout options are available for your beneficiaries?

The answer to these questions will reveal the key options and features of each plan and will conclude Liam's retirement DNA analysis. Armed with this information, Liam and his advisor can move forward to determine what to do next.

In this scenario, Liam has four basic options:

- Distribute the assets
- Leave the assets in the plan
- Complete an IRA rollover
- Complete a Roth IRA conversion

Each of the options mentioned carries pros and cons, some of which are explored in the following paragraphs.

Pros and cons of distributing the assets
With this option, Liam would have immediate use of the assets, which may be important depending on his circumstances. But it is critical to also consider the downside of a distribution. The amount:

- Is includable in Liam's federal taxable income for the year
- May be subject to state income tax
- Will be reduced by 20% in order to meet federal tax withholding rules (if the amount is otherwise eligible for rollover)
- No longer has the potential to grow in value on a tax-deferred basis
- May be subject to a 10% early withdrawal penalty if the investor does not qualify for a penalty exception
- Is not protected from creditors

Pros and cons of leaving the assets in the plan
If permitted under the terms of the plan, leaving the assets in his 401(k) plan would have its advantages, including:

- Full creditor protection under federal law
- Tax-deferred growth of assets
- Unique exceptions to the early distribution penalty tax, including, for distributions after separation from service in the year he or she attains age 55 or thereafter, employee stock ownership plan dividends, and pursuant to qualified domestic relations orders
- Institutional buying power and cost effective investment programs in larger plans (note that is not always the case for small plans)
- Special tax treatment for certain lump sum distributions (e.g., net unrealized appreciation in employer stock, income averaging and capital gains)

At the same time, Liam's 401(k) plan may have some limitations, most noteworthy, in the area of investment options, fees, access to investment advice, the ability to consolidate assets, lifetime income options and beneficiary options.

Potentially limited investment options
A plan's investment menu may be limited (as compared with an open-architecture IRA, for example). Also, the available investment options are selected and limited by the plan fiduciaries. The average 401(k) plan offers 19 different investment options.[2]

Fees
Fees may be difficult to decipher in defined contribution plans, making it challenging to determine whether they are reasonable. Most 401(k) plans charge participants a bundled fee that is expressed as a percent of their assets, known as an expense ratio.[2] The specific costs are blurred when using the expense ratio approach to fees. Moreover, in application, participants with larger account balances are sometimes paying proportionally more in fees than participants with smaller account balances, as the following example illustrates.

Example: Suppose the various costs for a plan amount is 0.8% of its total assets, broken down on a per-participant basis as follows:

- Marketing and administrative costs of $100 per year per participant
- Investment management expenses ranging from $200 a year for a participant with a balance of $20,000 to $400 a year for a participant with a balance of $80,000

Assume the plan charges its participants a fee equal to 0.8% of balances to cover all of its costs.

Consequently, the participant with a balance of $80,000 would pay a fee of $640, compared with what would be his or her actual costs of only $500. The participant with a balance of $20,000 would pay a fee of $160 while accounting for $300 of the plan's costs.

Access to investment guidance
While there is a requirement in participant-directed plans for the plan sponsor to offer investment information, there is no such requirement to offer investment advice. Only 32.5% of 401(k) plans make individual investment advice available to participants; those that do not cite fiduciary liability as the leading reason why.[2] The types of plan-provided advice break down as follows:

- 52.5% offer online, third-party investment advisory services
- 50.3% offer phone access to third-party investment advisory services
- 62.8% offer in-person, third-party investment advisory services

[2] Plan Sponsor Council of America, 57th Annual Survey, 2014

Limited ability to consolidate assets

Nearly all defined contribution plans allow rollovers into the plan, but they often place restrictions on the acceptable rollover sources.[3]

Rollover sources accepted	Percentage of plans
Profit sharing/401(k)	99
Governmental 457(b)	48
Rollover IRAs	65.5
403(b) plans	63.8
Pension plans	48.8

SIMPLE IRAs are even more restrictive as they may only receive rollovers from other SIMPLE IRAs.

Limited access to guaranteed retirement income options

Only 8.5% of defined contribution plans offer guaranteed retirement income payout options (e.g., annuities).[3] This may be one reason many retirees are at risk of outliving their retirement savings. Conversely, IRAs are more likely to provide guaranteed retirement income options.

Limited beneficiary options

Employer-sponsored plans often limit the distribution options available to beneficiaries of deceased plan participants and, in some cases, require immediate payouts to beneficiaries. This could lead to an immediate tax liability. In contrast, IRAs are generally more liberal with beneficiary payout options, and they permit lifetime distributions.

Pros and cons of an IRA rollover

Congress created IRAs back in 1975 for two specific reasons:

1) To give individuals not covered by retirement plans at work an opportunity to save for retirement on their own in tax-deferred accounts made available through private financial institutions

2) To give retiring workers or individuals changing jobs a means to preserve the tax-deferred benefits of their employer-sponsored retirement plan assets through rollovers to IRAs

Today, IRAs offer a number of additional benefits to investors:

- The potential for tax-deductible contributions
- The potential for tax-deferred earnings
- Broad asset consolidation opportunities (from prior employer plans and other IRAs)
- Unique exceptions to the early distribution penalty tax, including, paying health insurance premiums for certain unemployed individuals, to purchase a first home (up to a $10,000 lifetime limit) and higher education expenses
- Access to professional investment guidance for those IRA owners who maintain their IRAs with wealth management brokers, independent firms or RIAs
- Open architecture—and a broader investment menu than many employer-sponsored retirement plans—through wealth management brokerages
- The potential for holistic financial planning that considers not only the IRA's assets but all assets and liabilities of the investor

While the benefits are many, IRAs may also have some drawbacks, for example, the potential for higher fees than those in a plan environment (i.e., retail vs. institutional), more exposure to creditors,[4] contribution restrictions based on income level and no access to loans, to name a few. Whether a plan-to-IRA rollover should be done is a question of suitability for the investor, and should only be made after considering factors such as available investment options, fees and expenses, services, taxes and penalties, creditor protection, required minimum distributions and the tax treatment of employer stock.

Additional thoughts on fees

As with all investment vehicles, IRA owners are subject to fees on their IRAs. One must look closely when considering a rollover of qualified plan assets to an IRA to determine whether the fee environment is competitive. For example, leaving a large plan environment for an IRA may result in moderately higher fees. Therefore, it would be important to evaluate whether higher fees in the IRA could be justified if access to any or better advice, planning tools and/or investment choices are available through the IRA custodian. A rollover decision should not be based solely on which option provides the lowest fees, but also on which option provides the best opportunity to maximize retirement savings (and one's retirement DNA) at a reasonable cost.

Pros and cons of a Roth IRA conversion

The benefits of a Roth IRA conversion include those applicable to traditional IRA rollovers mentioned previously (excluding deductible contributions). Additional considerations with respect to options and features would include:

[3] Plan Sponsor Council of America, 57th Annual Survey, 2014

[4] IRAs offer creditor protection at the federal level in situations involving the IRA owner's bankruptcy. Creditor protection outside of bankruptcy is determined according to state law.

- Potentially, tax-free earnings
- No required minimum distributions

The negative side, in addition to those that were listed for a traditional IRA rollover, a Roth IRA conversion would require the investor to:

- Include the taxable amount of the conversion in income (unless the distribution includes after-tax amounts, and he or she directs the plan sponsor to roll over the pretax assets to a traditional IRA and the after-tax assets to a Roth IRA).
- Wait five years before being able to access converted amounts without a 10% penalty (unless an exception applies)
- Forgo a future rollover back to a defined contribution plan

Rollover considerations

Below is summary of some of the many issues that investors may want to consider when faced with the question of whether or not to roll over a retirement plan distribution. Liam and his financial advisor could use this list, or customize one, to summarize and compare his options.

Consideration	Leave assets in plan	Rollover IRA	Roth IRA conversion
Immediate taxation: Yes or no	No	No	Yes[6]
Tax treatment of account earnings: Deferred or tax-free	Deferred	Deferred	Tax-free[7]
Creditor protection: Full or limited	Full	Limited	Limited
Special tax treatment options for distributions: Yes or no	Yes	No	Yes
Investments: Open or closed architecture	Closed	Open	Open
Advice available: More likely or less likely	Less likely	More likely	More likely
If advice available, what type of advice?			
One-on-one: Yes or no	Yes	Yes	Yes
Online tools: Yes or no	Yes	Yes	Yes
Telephone: Yes or no	Yes	Yes	Yes
Adequate education: Yes or no	No	Yes	Yes
Helpful statements: Yes or no	No	Yes	Yes
Reasonable fees: Yes or no	No	Yes	Yes
Ability to consolidate assets: Full or limited	Limited	Full	Full[8]
Guaranteed lifetime income options: Yes or no	No	Yes	Yes
Required minimum distributions	Yes	Yes	No
Beneficiary options: Full or limited	Limited	Full	Full

[6] Unless after-tax assets converted to a Roth IRA and pretax assets rolled to a traditional IRA pursuant to Notice 2014-54

[7] If held for five years and withdrawn after attaining age 59½, death, disability or to purchase a first home.

[8] Through taxable conversion

Conclusion

Investors who want to maximize their retirement savings and income potential should start with a retirement DNA analysis. This assessment creates a solid foundation that can help investors accurately evaluate available options, make informed decisions and execute effective strategies.

About the Learning Center

We are dedicated to supporting financial advisors and their clients with thought-leading insights, up-to-the-minute regulatory and legislative information, the latest research, new ideas and proven tools in financial planning. Our aim is to be a trusted ally, combining knowledge and know-how to deliver the most innovative financial solutions available.

Contact your financial advisor to discuss your financial planning needs and how the Learning Center can assist you.

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