Change creates opportunity

Want to get your piece of the exploding IRA market? Learn how cash-strapped workers and retirees can stabilize their heavily impacted 401(k) savings with IRA rollovers and migration into safer money vehicles.

By David F. Royer

The great market crash of 2008 created a lingering recession that is only rivaled by the Great Depression of the 1930s. Today's unemployment numbers (more than 10 percent of the work force) may seem tame compared to the over 25 percent who were out of work after the market collapse in 1929, but there are some major differences between today's unemployed and those of the '30s. Many of today's 15.3 million unemployed came from some of the most prestigious companies in America and many were highly compensated employees who participated in 401(k) s and other company sponsored retirement savings plans.

Some of the biggest layoffs came from iconic companies such as Citigroup, Bank of America, General Motors, Lehman Brothers, American Airlines and AT&T. Even Starbucks let go 12,000 workers after closing 600 stores. Many of these displaced workers have made sizable contributions to their 401(k) plans and are now in a position to roll the proceeds into the more flexible IRA.

According to Alan Gappinger, founder of the Heartland Institute of Financial Education, a nonprofit organization dedicated to adult financial literacy, "human resources departments of many of these companies are eager to offer their retired, about-to-retire and severed employees financial education to help these individuals make educated decisions about what to do with their qualified retirement plans."
The *Wall Street Journal* in November 2009 reported that the Obama administration suspended a Bush-era rule allowing employees to get financial guidance from the advisors who represent the custodians who are managing their 401(k) investments. This recent ruling forces companies to look elsewhere for employee financial education and guidance. This shift creates a new opportunity for independent advisors to work with HR departments of all sizes of companies to offer much-needed financial education to their current and former employees.

You don't need to wait until retirement
A commonly shared misconception about 401(k) plans is that the participant must sever from their employer before they can move money from their 401(k) plan to the more flexible IRA. "Sever" is, unfortunately, a polite term for retire, change jobs or—in today's climate—get fired. A little-known IRS ruling allows 401(k) participants who are 60 or older to withdraw all or part of their account and make a non-taxable transfer to an IRA while they are still working and making contributions to their 401(k) plans. Although the IRS allows this maneuver, 401(k) plan administrators are not required to amend their plan documents to accommodate the ruling. The good news is that approximately 70 percent of 401(k) plan documents allow for in-service transfers to IRAs. Because there is no requirement for a 401(k) plan to allow for in-service transfers, you will need to check with your prospect's plan administrator to find out if in-service transfers are allowed.

When advising your client to do an in-service transfer to an IRA, there is an important issue that you should take into account. Some plans documents impose a blackout period after the rollover. This means the participant may be restricted from making contributions for one or more years after moving their 401(k) to an IRA. In this case they may be forced to forgo company matching funds. For those who desire to continue making tax-deductable contributions and enjoying tax deferred company matching funds, an in-service transfer may not be attractive

5 reasons to roll a 401(k) to an IRA
Why would a 401(k) participant want to move his money out of a 401(k) and roll it into an IRA? Here are some thoughts on the issue:

1. Most 401(k) s and other company plans have limited investment options. They may offer 50 different mutual funds and other investments options, but most of the options are subject to market fluctuations. If we learned anything in 2008 and early 2009, it's that what the market gives can be taken away with little to no warning. Many of these accounts lost as much as 40 percent in 2008 alone. Those who chose to play it safe and moved their 401(k) money into bond funds or funds invested in CDs and other short-term investments were rewarded with little or no growth while inflation and management fees ate away at their principal. IRAs have almost unlimited investment options including annuities that guarantee the principal and offer a competitive rate of return.

2. Plan guidelines can restrict the owner's access to his money. The plan document is essentially the 401(k) rulebook. If it's not in the book, you can't do it! With savings down and unemployment up, you never know when you may need access to your retirement accounts. IRAs offer greater flexibility, allowing the owners to make their own rules if they are willing to pay the tax on the distributions.

3. Direct rollovers avoid the 20 percent mandatory withholding. It's critical that the funds are moved as a trustee-to-trustee transfer. If a check is written to the 401(k) owner, you can count on the custodian withholding 20 percent for the IRS. I have worked with several advisors who have encountered this problem, and they are still battling with the IRS to get the 20 percent withholding back where it belongs.

4. 401(k) s have limited distribution flexibility for the children and grandchildren who are likely to inherit when both the owner and spouse are gone. In 2002 when the multi-generational/"stretch" IRA was born, the children and grandchildren were given new valuable distribution options. They now have the right to spread the inherited IRA distributions over their individual life expectancies, according to Appendix C, Table 1 of IRS Publication 590. This means they are no longer forced into rapid distribution, causing rapid taxation. The 401(k) plan administrators didn't get on board with this valuable income planning tool and are, in many cases, forcing these non-spousal beneficiaries to take full taxable distribution in just five years. Under the "Worker, Retiree and Employer Recovery Act" of 2008 (HR 7327), all employer plans will be required to allow non-spousal beneficiaries to do direct rollovers to properly titled inherited IRAs beginning Jan. 1, 2010. IRAs allow these beneficiaries to take control and choose between cashing out and receiving a lifetime of income.

5. Most 401(k) plans do not allow the Roth IRA conversion. Beginning this year IRA owners with adjusted gross incomes over $100,000 can for the first time convert their traditional IRAs to Roth IRAs. After the conversion tax is paid, the new Roth will grow tax-free and distributions after the five-year holding will also be income tax free. The Pension Protection Act simplified Roth conversions from 401(k) s and other company sponsored plans. Beginning in 2008, owners can convert company sponsored plan funds directly to a Roth IRA. They no longer need to convert to a traditional IRA first then convert the traditional IRA to a Roth IRA.

IRAs in the market

This is another great opportunity for safe-money advisors to capture more IRA rollover accounts. The recent turbulence on Wall Street has many IRA owners frustrated while looking for safety and competitive interest rates. They are also looking more closely at the fees and loads they are paying while their money is at risk. Safety is the easy part. CDs, T-bills, money market accounts, even PayPal accounts can offer safety, but where can they get safety and higher interest rates without the annual burden of fees and loads?

The current low interest rates on most safe-money alternatives make them less attractive to IRA owners who are planning for retirement and need growth to maintain their lifestyles. The average one-year CD rates are around 1.5 percent and the five-year CDs are paying less than 3 percent. Money market accounts are paying about the same as the one-year CD.

With inflation possibly just around the corner, these low-yielding accounts are likely to suffer loss of buying power. So where can your clients find safety and good returns and avoid the drain of annual fees and loads? Annuities are the logical alternative for IRA owners who want to get off the market's rollercoaster ride and enjoy guaranteed growth.

Some annuities offer guarantees as high as 3 percent but are currently paying higher yields, while others offer returns indexed to the market with no downside risk. There are also CD-type annuities that offer interest rates close to 4 percent, which are guaranteed for a number of years. Fixed annuities have all the advantage of safety and competitive returns, and there are no annual fees or loads.

The legislative climate and interest rate environment have created increased opportunities for you to increase your IRA rollover business and capture your share of the exploding trillion dollar IRA market.

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