Retirement Times

October 2020

To Roth or not to Roth

Many Defined Contribution retirement plan participants are uncertain as to benefits of allocating their contributions to traditional vs Roth options. This is for good reason. There are two key major determiners as to the benefit of contribution to Roth:

1) Will they be in a higher or lower tax bracket in retirement?
2) Will tax rates increase, stay the same or decrease in the future?

If you know for sure that tax brackets will increase in the future, the Roth option allows post-tax contributions grow and be withdrawn with no (higher) taxes later.
Simple, however no one knows whether income tax will be greater during the balance of their contribution period, or in retirement, than it is today.

One supposition we hear frequently is that "taxes always go up." Actually, this is not the case. History shows that income taxes move both up and down over time. Admittedly, there is some logic to the assumption that, with our national debt being considerably greater than ever and increasing, tax increases seem probable. One plausible compromise approach may be utilizing both traditional contributions up to maximum employer match, and Roth for non-matched employer contributions.

The percentage of companies offering a Roth 401(k) option alongside a traditional plan has grown steadily in recent years, requiring greater need for participant education. The Plan Sponsor Council of America's 62nd Annual Survey of Profit-Sharing and 401(k) Plans, released in December 2019, showed that nearly a quarter of participants (23%) elected to contribute to a Roth in 2018 when given the opportunity, up from 19.5% in 2017 and 18.1% in 2016.[1]

For those that also have a Roth IRA, remember the SECURE Act 2019 eliminated the "Stretch IRA" that had allowed beneficiaries to gradually take distributions from inherited IRAs over the course of their lifetime. Now those who inherited an IRA since the beginning of 2020 and thereafter have 10 years to withdraw the assets or face taxation of the money all at once (spouses and disabled beneficiaries are among the exceptions to the rule). The Roth IRA option can mitigate this issue for high net worth clients looking to transfer their estate. Roth 401(k)s have the same 10-year distribution limit for beneficiaries, but they have the potential benefit of reducing tax liability as Roth 401(k) distributions are not taxed like traditional 401(k) or IRA distributions (although they do count as income).

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1. https://www.research.net/r/3RQD8R2

Defined Contribution Recordkeeper Consolidation Continues

Empower recently announced an agreement to acquire MassMutual's retirement plan recordkeeping business. The acquisition is expected to capitalize on both firms' experience and expertise to the benefit of retirement plan participants and plan sponsors. Plans currently utilizing MassMutual are being notified of this action and should expect no changes or disruption to current operations during the next 4 to 6 months, with any potential changes likely 18 months away.

While MassMutual's retirement plan products and services are considered among the best in the industry, and their market share has grown substantially over the past decade, providers must generate increasingly greater scale and make significant sustained investments in technology, product offerings and the customer experience to meet future competitive customer demands.

Empower is an acknowledged industry leader in the retirement business and is well positioned to continue to make the investments necessary to compete successfully over the long term. Empower has been active in acquiring other retirement plan businesses over the past decade and possesses a great deal of experience. This acquisition will increase Empower's participant base to more than 12.2 million individuals in approximately 67,000 workplace savings plans. Due to their combination of expertise, product strengths and business scale they are expected to remain a long-term industry leader.

Together the consolidated firm will serve a broad spectrum of employers including: include mega, large, midsize and small corporate 401(k) plans; government plans including state-level plans to municipal agencies; not-for-profits such as hospital and religious organization 403(b) plans, defined benefit and collectively bargained Taft-Hartley plans.

Retirement plan recordkeeper consolidation has been accelerating since the early 2000s beginning with acquisition of some smaller entities who were not able to keep pace with the growing customer needs and product sophistication. More recently we have seen consolidation among the larger recordkeepers, including top tier providers like the Wells Fargo's acquisition by Principal, Empower's acquisition of Great West, Putnam, JP Morgan, and MassMutual's acquisition of the Hartford over the past decade.

As with previous similar occurrences, we anticipate this consolidation will be a positive for the industry, plan sponsors and their participants as it will likely lead to enhancements in technology, plan level and participant services, and financial economies of scale.

Plan Documents… Save or Purge?

Many ERISA plan sponsors are unclear regarding a primary fiduciary responsibility concerning plan document retention (which and when documents may be purged). Most plan sponsors adopt an assumed “reasonable” amount of time to retain documents prior to purging them. Unfortunately, IRS rules may not always be complicit with what may be assumed to be “reasonable”.

The purpose of this communication is to underscore the important plan record retention so that you may not fall prey to the type of fiduciary breach described in the following paragraph.

Recently a random IRS 401(k) plan investigation shed an uncomfortable light on the issue of plan document retention. When pressed to produce certain specific documents that were not readily available, the plan administrator decided to contact the plan’s service provider. The plan administrator was informed that the Third Party Administrator (TPA) purges its files after each plan restatement and expects the plan sponsor to meet any document retention obligations under IRS or ERISA. This is actually standard procedure for many TPAs. (https://ferenczylaw.com/solutions-in-a-flash-to-purge-or-not-to-purge-that-is-the-question/)

Depending on the document category, there are different standards for how long documents need to be kept. For example: participant benefit records must be retained “as long as a possibility exists that they might be relevant to a determination of the benefit entitlements of a participant or beneficiary.”[1] While the regulations were never finalized, the Department of Labor (DOL) has taken the position those record retention obligations apply beginning when the DOL issued its first set of proposed regulations under Section 209 on February 9, 1970 because employers were put on notice of the obligations. As such, plan sponsors should consider whether benefit plan records need to be maintained indefinitely.

Record retention rules are accessible in both the DOL regulations as well as ERISA statutes. Statutes of limitations on plan sponsor liability for administrative functions concerning retirement plans also are codified.

Due to the length of regulations on this topic we urge you to review the AICPA link below for a thorough list of document retention regulations.

1. https://www.aicpa.org/content/dam/aicpa/interestareas/employeebenefitplanauditquality/resources/planadvisories/downloadabledocuments/ebpaqc-plan-advisory-retaining-and-protecting-plan-records.pdf

This Month's Participant Memo

Participant Corner: Budgeting for Retirement

This month's employee memo encourages employees to conduct a regular examination of their retirement plan to determine whether any changes need to be made. Download the memo from your Fiduciary Briefcase at fiduciarybriefcase.com. Please see an excerpt below.

There are all kinds of "rule of thumb" numbers floating around for how much income you'll need in retirement, but they are just that — guidelines, not hard and fast rules that will necessarily apply to your particular situation. Budgeting for your retirement is a bit of a guessing game however clarifying your goals and expectations will make it easier.

Reduced Expenses

How do you know what you'll need to retire? That depends entirely on how you end up living in retirement. If you're intending to stay in the same place with the same spending habits, then take your current monthly expenses and deduct the things that may no longer apply — things like:

- Mortgage, if you will pay it off before you retire
- Work clothing
- A second vehicle if you won't need one anymore
- Insurance on the second vehicle

- Gas for commuting
- Starbucks on the way to work
- Lunch out on workdays
- Dinner on days you work late
- Work-related tools (physical tools or software and a new laptop every other year)
- Wage tax if your state has one (although you can still be taxed on Social Security)
- Tax savings from a lower income tax rate

Sounds good so far, doesn't it? Well before you start celebrating prematurely, there are things that may cost more. That's where your vision for retirement comes in.

Budget Busters

You may plan to stay right where you are and do the same things you do now other than going to work. Fair enough. Nevertheless, you may still need to add a few things:

- If you stay in your current home, even if it's paid off, you may have higher maintenance bills over time as the home ages. Little things like paying someone to clean the gutters aren't a budget buster, although a new HVAC system or a new roof could be. Include a set-aside in your budget for home maintenance
- Property taxes also tend to creep up over time. Take a look at your past tax statements and get a feel for the average annual increase. Playout annually for 20 or so years and add the increases into your budget
- Increased medical costs: On average a 65-year-old man will spend $190,000 for medical needs during retirement; a 65-year-old woman will spend $215,000[1]
- Remember our gutter-cleaner from above? You may need a lot more help around the house as time goes on in terms of your daily activities, like meal preparation and cleaning. Best to plan for that now
- Is your spouse's retirement income a significant part of your plan? What happens to that income if he or she dies? In the case of Social Security, the surviving spouse has the choice of receiving the higher benefit (their own or their spouse's) but not both, meaning a reduction in total income

Very few people simply stop working without substituting other activities and those other activities often come with a price tag. Clear your mind and think about your "typical day" and "typical month" in retirement.

- Where do you see yourself living? In your house? In an apartment or condo? In another city or even another country?
- What will you do all day? Do you have hobbies or activities you intend to pursue? Knitting is relatively cheap; however, a heavy photography habit can be a budget buster all on its own
- Do you want to travel? If so, where will you travel and how? A personalized tour of the Serengeti is pricey; a high-end cruise can be costly as well. Going to a low-cost destination for a week or two and staying in an Airbnb is much less expensive. Make a list of the places you want to visit and what

you want to do there. Research the least expensive ways to do that. Then create an annual travel budget and plug it into your retirement plan

Think Outside the Box

While doing this visioning exercise, don't limit yourself to your current environment or activities. Think expansively.

You could keep your home for a few years to transition into retirement and then downsize. Or you could downsize first, sell the house, buy something less expensive and put the difference into investments.

Maybe you don't need a house at all. A condo or even an apartment may be right for you. While apartment rents tend to increase over time, they also give you the flexibility to move at least once a year.

Some retirees take mobility to a higher level by selling their house and cars and buying a motor home or boat to live on. While you can spend extravagant amounts on either of those, just as you could on a new home, you can also find good deals on pre-owned. You could save on property taxes and have a high degree of mobility.

An increasing number of Americans are opting to stretch their retirement budgets by moving to an area with lower costs, either in the U.S. or outside of it. The five U.S. states with the lowest cost of living are Mississippi, Arkansas, Oklahoma, Missouri and New Mexico.[2] Although if you currently live in Massachusetts, Oregon, New York, California, Washington, D.C., or Hawaii almost anywhere else you move is probably going to be cheaper than where you are now.

While exact numbers aren't available, the State Department estimates that about 9 million Americans live outside of the U.S.[3] Many expats choose to relocate to save on housing and other costs of living, including medical care. You may be able to maintain a significantly higher standard of living during retirement by moving to another country.

Retirement isn't just a time to quit working; it's a time to enjoy the fruits of all of those years of labor — to open your mind and your horizons to new experiences, people and places. Getting there isn't hard. And with a good plan, you can.

For more information on budgeting for your retirement, please contact your plan's financial professional.

Sources:
1. https://money.cnn.com/2018/05/07/retirement/expenses-in-retirement/index.html
2. http://worldpopulationreview.com/states/states-with-lowest-cost-of-living/
3. https://en.wikipedia.org/wiki/American_diaspora

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For more information on reaching your retirement plan goals, contact your plan's financial professional at (630) 778-8088 or info@partnerswealth.com.

Sources:
1. https://money.cnn.com/2018/05/07/retirement/expenses-in-retirement/index.html
2. http://worldpopulationreview.com/states/states-with-lowest-cost-of-living/
3. https://en.wikipedia.org/wiki/American_diaspora