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Retirement Planning Insights

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Up Front

Family vacation and the Schwab/TD acquisition

My family and I went on vacation in early-November. We visited Las Vegas, the Hoover Dam, Grand Canyon National Park, Sedona and Peoria, AZ. My kids gained an appreciation for the awe-inspiring beauty of the Grand Canyon. They also learned Vegas is incredibly cheesy looking in the daylight.

We took a few hundred pictures of the canyon but didn't think to get one decent picture of the four of us. Here is the closest we got to a family photo:

Changing gears…on November 25, Charles Schwab formally announced plans to buy TD Ameritrade. While the transaction is still subject to various approvals, it looks like the acquisition is likely to happen, with a target closing date of mid-2020.

I use TD Ameritrade to custody the accounts I manage for clients. Specific details have not been announced regarding what may eventually happen between the two firms. However, the preliminary guidance is TD accounts will ultimately become Schwab accounts, though the expectation is that won't happen for a year or two as it will take time for the firms to fully implement their integration plans. TD stated they are operating business as usual until then. As such, there are no imminent changes in the relationships Tenon Financial or our clients have with TD.

-Andy

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Retirement Planning News

Changes to Required Minimum Distributions

The IRS proposed increasing the life expectancy data used in determining Required Minimum Distributions from tax-deferred investment accounts such as IRAs, 401(k)s and 403(b)s. If approved, the changes are expected to take effect in 2021.

With any type of tax-deferred account, the IRS requires you to eventually withdraw money…and treat it as taxable income. These mandatory withdrawals are called Required Minimum Distributions ("RMDs").

You must begin taking RMDs from your tax-deferred accounts no later than December 31 of the year you turn 70 ½, and then by December 31 of each year thereafter. However, there is a special optional delay provision which applies *only* to your first year's RMD. Specifically, your first RMD can be delayed until April 1 of the year *after* the year you turn 70 ½.

The amount of money which must be withdrawn each year is a percentage of your tax-deferred account balances as of the prior December 31. The percentages start relatively small and gradually increase as you age. The RMD amounts start at 3.65% (in the year you turn 70 ½) and go up to 52.63% (in the year you turn 115, and each year thereafter).

Technically, the RMD amounts are fractions, not percentages. However, I find it's generally easier to think about them in terms of percentages. For example, in the year you turn 70 ½, you need to withdraw at least $^{1}/_{27.4}$ of your account…or roughly 3.65%.

The RMD figures are based on standard life expectancy assumptions. Currently, they are based on life expectancy data which were last updated in 2002. Since then, life expectancies have increased but the RMD figures have remain unchanged. Now, the IRS is finally working on updating the data and incorporating it into revised RMD factors.

The proposed changes aren't huge, but they are nonetheless improvements. For example, under the proposed changes, the first year RMD would decrease from 3.65% to 3.44%.

Why does this matter??? There are STEEP penalties on *not* taking RMDs which were supposed to be taken. Specifically, the IRS charges a 50% penalty on any RMD amounts which were not taken. As an example, if you failed to take an RMD of $20,000, you'd have to pay a $10,000 penalty. Clearly RMDs require close attention.

Practical Retirement Planning

Pros and cons of 401(k) and 403(b) rollovers

A "rollover" is when you move money from one retirement savings account to another. For example, if you have a 401(k) at a previous employer and want to consolidate it into your 401(k) at your current employer, you can rollover the balance from the old plan into the new plan. Alternatively, you can roll it into an Individual Retirement Account ("IRA"), which is a retirement account you open outside of your employer.

Financial advisors usually recommend you rollover money from your 401(k) or 403(b) into an IRA. But are there times when you'd be better off leaving the money in your old plans??? It depends. Here are the main factors to consider when contemplating a rollover:

Benefits of doing a rollover:

- **More investment options** – 401(k) and 403(b) plans often limit their investment options to only a couple dozen funds and/or annuities. IRAs generally allow investment in any stock, bond, mutual fund, exchange-traded fund, annuity, etc. Some IRAs even allow alternative investments such as real estate and private investments.
- **Access to professional advice** – In most cases, when working with individual clients, financial advisors cannot directly deduct their fees from 401(k)s or 403(b)s. Therefore, there usually aren't ways for advisors to be compensated for working with clients whose money is only in employer plans. As such, in order to be able to work with most advisors, you normally must roll your employer plans into an IRA, as IRAs do allow advisors to deduct their fees.
- **Potentially lower fees** – There are costs associated with administering 401(k) and 403(b) plans. Those costs are passed on to you, the participant, in the form of account maintenance charges or increased fund expense ratios. In an IRA, there are usually no ongoing account maintenance charges or increased fund expenses.
- **Less financial clutter** – If you've changed jobs a few times, you likely have multiple retirement accounts at your old employers. This means you have multiple statements, website logins and accounts which will eventually be subject to RMDs. You can help make your financial life more streamlined by rolling all your accounts into one IRA.
- **More withdrawal options** – some 401(k)s and 403(b)s limit the type and frequency of withdrawals you can make. IRAs usually have no such limitations.

Benefits of keeping money in employer plans:

- **Potentially better creditor protection** – 401(k)s are covered by federal regulations which protect the plans from bankruptcy and most other lawsuits, including personal injury claims. IRAs and 403(b)s generally have the same bankruptcy protection but may not have the same level of general creditor protection; outside of bankruptcy, the level of protection varies state-by-state.
- **Ability to delay RMDs** – when money is in your employer plan, RMDs often don't need to begin if you're still working, even if you're older than 70 ½. With an IRA, RMDs need to start at 70 ½ regardless of your employment status.
- **Penalty-free withdrawals start earlier** – IRAs typically don't allow penalty-free withdrawals until age 59 ½. Many employer plans allow penalty-free withdrawals as early as age 55 if you have since retired or otherwise terminated your employment.

If you have a 401(k) or 403(b) and would like to know if a rollover may be beneficial for you, we'd be glad to assist. Feel free to contact us at **hello@tenonfinancial.com**.