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Five Sharp Strategies for Retirement Rollovers

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Over $350 billion in 3.5 million retirement accounts roll over annually (source: Cogent Research 2011). That's a lot of money from a lot of people in a lot of plans. In approaching this market as a financial professional, it's important you know key strategies for helping ensure rollovers are smooth transitions.

Common instances when a client may consider a retirement plan rollover include when they:

- Retire
- Change jobs
- Receive part of a spouse's plan
- Have a retirement plan terminating
- Elect an in-service distribution from a plan
- Inherit money as beneficiary of a plan
- Have multiple plans from multiple employers

Do you have clients considering a rollover opportunity? If so, alert them to five sharp strategies.

One sharp strategy is to organize retirement plans.

For example, imagine buying a beautiful blooming shrub, carefully planting it, and regularly tending to it by watering and weeding. Come the next year, you plant a new one, and that first shrub receives a bit less attention. The year after, you plant yet another new one, and the first gets even less attention. You may even barely notice it's there. And as a result, it suffers neglect and isn't as attractive as before.

The same can happen when minding retirement monies. The more plans one has, the more challenging it is to manage them all and keep them healthy and growing. Sometimes, plan materials sit in moving boxes from two or three jobs ago and quarterly statements go unopened. Less attention is paid to plan rules … plan choices … and plan results.

It can be hard for clients to tend to all the elements in their financial landscape. Consolidating with a rollover can help. It can create a more organized, purposeful retirement plan, creating more time for actual retirement planning.

Another sharp strategy is to minimize income taxes.

Imagine a back yard as a retirement portfolio. IRAs and employer-sponsored retirement plans are the trees in it. Ideally they are left to grow for years, in hopes they will be big and strong and bear the fruit of income benefits come retirement time.

Now imagine if the IRS was to trim back some of that growth before retirement income was needed.

That may be the added challenge of saving for retirement outside a qualified plan. Doing so may trigger current taxes on money being accumulated for long-term needs. And if that happens, lost to taxes are both retirement funds and opportunity for future growth on those funds.

Taking a qualified plan distribution in cash may allow immediate spending needs to be addressed, but such an action does come at a cost. Cashing out a distribution:

- Incurs a 20% withholding tax (the portion of the taxable amount that the previous employer must withhold for federal income taxes);
- Incurs current income taxes (at ordinary income tax rates);
- Incurs a 10% tax penalty for early withdrawal if the recipient is under age 59½; and
- Reduces opportunity for potential future tax-deferred accumulation

Rolling over a qualified plan maintains its potential for tax-deferred growth. Because taxes aren't owed until withdrawals are taken, tax-deferred money receives the benefit of triple compounding:

- The original principal earns interest.
- The interest earns interest.
- The money that would have been paid in taxes earns interest.

The benefits really add up over time. They allow money to grow faster than in a currently taxed alternative earning a similar return. So it's important to make sure any rollover opportunity preserves these advantages.

A third sharp strategy is to optimize diversification choices — with true diversification.

Some clients may think they're diversified simply because they have multiple retirement plans. Multiple plans don't make for automatic diversification. Are similar options always selected, even in different plans? Although names may differ, in form and function they may be more duplication than diversification.

Let's return to our yard to see why this is a risk. Say all the trees in the yard are ash trees that have thrived for years. Why change? Well, there's an insect called the ash borer. And it is destroying ash trees by the millions. So if a yard has only ash trees – no matter how well they've done or for how long – they may all be at risk. But with a diversified variety of trees, one risk, specific to one type of tree, won't devastate them all.

That's the point of diversification. It spreads dollars among different choices subject to different risks. That's not to say diversification assures profits or eliminates loss. But it may help manage volatility. And thus a retirement plan – just like a grove of trees – may be better positioned for overall long-term health.

A fourth sharp strategy is to prioritize financial risks.

Being in a position to enjoy a worry-free retirement requires recognizing the risks that can impede progress.

Of course, "risk" means more than market ups and downs. For example, a retiree who put all their money into short-term fixed instruments paying double-digit rates in the early '80s – and stayed put – likely suffered sub 1% rates on similar ones in recent years. So playing it too safe, and failing to review regularly, is just as real a risk as being too aggressive.

And that's only one example. Other retirement risks include: a longer than expected lifespan … inflation … volatility … health problems … family responsibilities … and more.

It's important to bear the mix of factors in mind when evaluating a rollover. Recognize the varied risks to a secure and comfortable retirement. Seek alternatives that provide growth opportunity, as you look to maintain purchasing power. Address longevity with solutions that can provide income guaranteed for a lifetime. Protect against unexpected needs with flexibility in a rollover vehicle.

These are just some examples. What is key is to first prioritize a realistic assessment of risks. Once you do so, you can take steps to address their effects.

The fifth sharp strategy is to closely watch costs on any rollover opportunity.

Costs, same as taxes, trim performance. The more money that goes to fees and expenses, the less that remains for growth, compounding and ultimately retirement income.

For example, what if you had a choice between a car that averaged 20 mpg and one that averaged 22 mpg? If gas is $4 a gallon and you drive 15,000 miles a year, the annual fuel expense is $3,000 for the first car. It's only $2,728 for the second. A difference of $272 may seem minor. But that's only one year. Cars, like retirement plans, tend to be long-term commitments. Assuming 15 years of ownership, the one with the worse gas mileage costs you $4,080 more. Who wouldn't want that back in their pocket?

Keeping expenses low is important because higher costs mean less money compounding over time. The more money put to work … the more time it is put to work … and the more strategically it is put to work ... the more forces potentially can be mustered on behalf of future financial security. That's why it pays to keep close tabs on costs. Retirement plan owners should know what they're paying. And consider the value they're receiving in return.

Retirement plan decisions may extend over decades. As you help clients scrutinize costs in a rollover opportunity, help them understand that every cent counts as they pursue their chosen course.

Stay Sharp

Admittedly, this is a quick look at a complex topic. It's one thing to discuss rollover strategies in general. It's a whole other thing to apply them to the specifics of a client's situation.

Securing future financial well-being is a challenge for us all. It represents the essence of our profession. As you consult with clients on retirement rollovers, help them create sharp plans of action that address retirement risks in their pursuit of retirement rewards.

A Final Thought: First, Know the Law

Before doing anything, understand the activities of financial advisors recommending IRA rollovers to 401(k) participants are subject to U.S. Department of Labor supervision. If you or your firm is a fiduciary to the plan from which a rollover will take place, be aware that making a recommendation on a distribution or rollover, advising on how to invest rollover funds in an IRA or even answering questions about these matters may subject you to ERISA fiduciary responsibility and prohibited transaction rules. Consult your firm's compliance or legal professionals for information and guidance.

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