Special Report – July 2013
What They Never Told You About Your 401(k)

Prepared by Stephen Geist
Host of the radio show "The Retirement Guy" every Saturday at 7:30 AM on KNUS 710 on your AM dial
AND…Visit Steve's website at: www.RetirementWize.com

Hello! My name is Steve Geist, I'm a Financial Strategist and I specialize in Safe Retirement Plan Solutions that are tailored with care. More specifically, I help my clients tackle complicated retirement issues and guide them towards easy-to-understand solutions designed to safely preserve and grow their retirement wealth.

In this Special Report let's talk about Employer-Sponsored Defined Contribution Plans such as 401(k)s, 457 plans and 403b's. And let's talk about Wall Street's greedy motives for these plans – all at your expense.

Now I admit that I'm not a big fan of employer plans – especially for people in or near retirement. I believe them to be mostly a failed experiment and a con job perpetrated by Wall Street and Plan Administrators mostly for their own selfish gain.

401(k) Never Meant to be a Retirement Plan

401(k) plans have grown in prominence since a loophole in an IRS regulation allowed workers to contribute their own money to these accounts on a tax-deferred basis beginning in the early 1980's. By 1990, 401(k) plans had about $900 billion in assets. By 2011, the figure had swelled to $3.9 trillion according to the Federal Reserve! Today 50 million employees in the U.S. are invested in 401(k) type plans.

But what's so interesting is that according to a 2005 article in TIME magazine, the 401(k) was never intended to be a retirement plan. Actually, according to the article, the 401(k) legislation was implemented in 1978 during a time when highly paid corporate executives were in a 70% tax bracket on the upper layer of their income.

The 401(k) was intended to provide those corporate executives with an avenue to defer compensation to a future time when they would most likely be in a lower income tax bracket. And it worked. The top marginal tax rate today is 35% instead of 70%.

Nonetheless, today it is the mindset of 78 Million Baby Boomers and other working Americans that their 401(k) plans are, indeed, individual retirement plans. And many people have or will become very dependent on their 401(k) plan for a source of income in retirement.

Wall Street's Selfish Motives for Your Money

Retirement experts, me included, find that employer-sponsored plans today, such as the 401(k), have numerous shortcomings, including high fees paid by the plan participants and low investment returns paid to the plan participants. The 401(k) and other employer-sponsored tax-qualified plans have been sold by Wall Street as gospel truth to the American public for over thirty years on the basis of what's best for Wall Street profits; not what's best for the plan participants.

As Americans plough trillions of dollars of their pre-tax earned income into these plans, Wall Street is there to rake in billions of dollars in up-front commissions. Once your money is inside these plans, Wall Street continues to make money through management fees and commissions resulting from the continuous sale and trading of the investments inside the plans. With these types of plans, Wall Street doesn't really care if your money grows or not because they get paid either way.
And the biggest problem with employer-sponsored plans is that they do not provide retirees with any kind of adequate guarantees for retirement peace of mind.

SPECIAL REPORT TIMEOUT

In case you belong to a group, club, church, association or any type of organization that invites outside speakers to give interesting talks – please know that as a community service, I would be delighted to speak at your next group meeting. And I would speak on a topic that would be both informative and relevant to Retirement. Just call my office and let me know how I might be of service.

Your Dependence on Your 401(k)

By depending on your 401(k) to be your entire retirement plan solution means that you are not adequately addressing most of the major issues in retirement such as 1) having adequate guaranteed income to live on (no matter how long you live); 2) the effects of inflation on your money over a long time horizon; 3) efficient tax strategies to keep the IRS from becoming your number one beneficiary; 4) the impact on your retirement from the catastrophic costs of long term care; and 5) maximizing your estate for your loved ones. Employer plans do not help you adequately address any of these important issues.

When 401(k)s were first introduced in the late 1970s, most workers still had pensions. Back then, 401(k)s were intended merely as supplements to pensions.

Today's harsh reality is that the switch from pensions over to employer-sponsored direct contribution plans now challenges you, the plan participant, to manage your money with little or no help from qualified retirement advisors. When and how you invest your money into your 401(k) is entirely up to you. If you, as the employee, don't make the right contributions into the right investment mix at the right time, you are at high risk for poverty during retirement.

Wall Street's Stranglehold over Employer-Sponsored Plans

To demonstrate the stranglehold Wall Street has over millions of employees in America, a recent 2012 Workplace Benefits report by the Wall Street power house Bank of America found that a whopping 82% of employees are willing to give up a portion of their pre-tax earnings in order to "secure guaranteed retirement income". That's a lot of people drinking the Wall Street kool-aid.

According to this report, in order to raise participation rates (and thereby capture more of America's pre-tax earnings), many plan sponsors are turning toward automatic enrollment. And to further the stranglehold, Bank of America recommends that companies integrate their 401(k) plan enrollment with their annual health care enrollment. This is nothing short of you being forced to participate in Wall Street's risk-based, non-guaranteed fee-generating investment machine.

The report also recommends that employers offer the enticing lure of increased contribution rates by offering automatic increase for all eligible employees. The report stated "Allowing participants to schedule gradual contribution rate increases over time makes it easier for them to commit to saving more and helps put them on an even better retirement track." Once again, this kind of mindset is good for Wall Street and Plan Administrators but questionable, at best, for the plan participants.

Redesigning the employer match was another recommendation in the report. Instead of employer's current typical match of 100% up to 3% of a participant's contribution, the report says employers should change it to 50% of 6% or 25% of 12%, in order to make employees have to contribute more in order to earn their "free" company match.

That results in no additional cost to employers; just another lure to capture more of America's pre-tax earnings to generate more and more fees and commissions for Wall Street.

The Father of the 401(k)
There was an interesting article in the November 2011 issue of Smart Money Magazine that talked about the "Father of 401(k)." A man by the name of Ted Benna is credited with creating the employee retirement savings plan three decades ago. And he did it by seizing on a loophole in the IRS legislation of 1978.

So while Mr. Benna says he is proud to be the father of the 401(k), he also thinks he created a monster. According to Benna, 401(k) plans, which he intended to be as simple for employees as pensions, now offer too many investing options and too many opportunities to make mistakes. Mr. Benna says "I would blow up the system and restart with something totally different."

According to Benna, the original 401(k) plans were simple to understand and could be explained to employees in just a few minutes. But as the plans were embraced by employers and Wall Street as a way to replace pensions, Benna says 401k's have been made so complex, you need to be an investing pro just to make sense of them.

Powerful Reasons to Roll a 401(k) Over to an IRA
So, having provided some insight into Wall Street's shenanigans with your money inside employer-sponsored plans, let me give you three powerful reasons why you would want to move your money out of a 401(k). Especially a 401(k) at an employer you no longer work for. And roll that money – tax free – into an IRA.

Reason #1: Most 401(k) s and other Company Plans have limited and risky investment options
By limited I mean your plan administrator may offer some mutual funds and other investments to pick from, but most of the choices are subject to market risk with little or no safety or guaranteed lifetime income to replace the pension they took away from you.

If we learned anything in the 2008 market meltdown, it's that what the market gives can be taken away with little to no warning. Many 401(k)s lost as much as 40% of their value in 2008 alone.

Those who chose to play it safe during the market downturn and moved their 401(k) money into low-yield investments offered by their Plan Administrator, those people were rewarded with little or no growth while inflation and management fees ate away at their principal.

To make matters worse, and as reported in the Wall Street Journal on April 28, 2013, millions of workers saving for retirement in employer plans risk losing part of their nest eggs not just from market volatility but also if interest rates begin to increase from the current historical lows.

The cause for concern: target-date mutual funds inside 401(k)s and other employer plans. These are funds supposedly designed for investors who lack the time or expertise to balance their investment portfolios. These types of funds will typically increase bond holdings as you approach your retirement target date, which is pegged to your expected retirement year.

So, in theory, more bonds should make your 401(k) portfolio safer because bonds tend to be less risky than other assets such as stocks. But if bond yields rise and bond prices slump, as many experts predict, the target-date funds inside your 401(k) could suffer losses.

And what's so alarming is that many employees might be invested in target-date funds without realizing it. That's because many companies use these funds as a default option in their 401(k) plans. For example, most funds targeted to a retirement date of 2015 and 2020, these funds hold between one-third and one-half of their assets in bonds—as compared to only 10% to 20% bond positions in some 2040 target date funds. The magnitude of any bond losses in target-date funds would depend on many factors, including the size and speed of an interest-rate increase, the percentage of bonds held in the portfolio and the types of bonds held.

IRAs, by contrast, have almost unlimited investment options beyond stocks and bonds including an index annuity, which is a tax efficient choice that guarantees the preservation of your principal, offers good growth potential, runs on auto pilot and provides a guaranteed lifetime of income.

Reason #2: 401(k) Plan Guidelines can restrict your access to your money
The 401k plan document is essentially the rulebook. If it's not in the book, you can't do it! For those who have tried, you know that with all the strings attached, it can be a great frustration to try to access your money in an employer-sponsored plan. It's your money, you earned it, but with many employer plans you generally can't get at it except for hardships or to take out loans or when you finally retire.

Please understand that if you lose your job or change jobs, and if you have taken a loan against your employer plan, then you have just 60 days to repay that loan before it becomes a taxable distribution. That's because the IRS does not allow loans to transfer from one plan to another. And keep in mind that job termination isn't the only reason participants default on their loans. Sometimes people die or are disabled, making it impossible for them to repay the loan.

So again, if you default on the loan, you will lose the portion of your retirement savings associated with the loan; you will pay income taxes on the loan amount as if it were a voluntary distribution; and you will pay other penalties depending on your eligibility for that distribution.

By great contrast, IRAs offer greater flexibility because they allow you to make your own rules about when and how to take money out of the IRA

Reason #3: The fees and expenses in your employer-sponsored plan.
This is a big one!!! How much does your 401(k) cost? It's a surprisingly difficult question to answer but the amount you're charged for your employer plan can make a huge difference in how much you'll have in retirement.

The attempt to navigate the maze of fees charged by an army of Wall Street middle men who administer your plan and its investments is currently an exercise in guesswork. Chunks of your hard-earned cash are siphoned off to pay a long list of people including plan administrators, trustees, stewards, bookkeepers, lawyers, compliance experts, and the investment advisors who manage the mutual funds. The fees that most people currently see on their quarterly statement barely scratch the surface.

For example, let's examine just the fees associated with the mutual funds in your plans. It's a lot more than you think.

In selecting mutual funds, most investors know to check the expense ratio, which is the standard measure of how costly a fund is to own. But that's not the real bottom line. There are other trading and transaction costs related to the buying and selling of securities in your fund portfolio which are not reported in the expense ratio. And those expenses can make a fund two or three times as costly as advertised.

One reason trading and transaction costs go unreported is their complexity. Trying to quantify a fund's trading expenses can be about as easy as performing brain surgery. And Fund firms on the whole aren't clamoring to disclose more information about these costs. So, investors are left trying to piece something together from snippets of information disclosed in a prospectus or other materials.

What exactly are these costs? There are four main components: brokerage commissions, bid-ask spreads, opportunity costs and market-impact costs.

SPECIAL REPORT TIMEOUT

In addition to hosting the Retirement Guy radio show, which I have done now for well over three years, I also conduct free (open to the public) educational events. I hold these workshops throughout the Denver area throughout the year. I have made these presentations to thousands of people both in and near retirement over the past several years. If you would like to meet me in person and learn about retirement, in a public setting, then please call or email me with a request for the date, time and location of my next event.

The brokerage commissions that a fund pays to buy or sell securities are the simplest piece to understand. But the SEC doesn't require commissions to be factored into expense ratios.

The other three components are much harder to quantify. Bid-ask spreads deal with the difference between the lowest price at which a seller is willing to sell a security and the highest price a buyer is willing to pay. The gap between them is the spread.

Market-impact costs, and the resulting opportunity costs, are often the largest component of trading costs; as much as 1½ times brokerage commissions. And what's important to understand is that trading costs are not required to be disclosed by the firms that sell the funds.

So what is the impact of fees and expenses on your 401(k)? Take for example a 401(k) with a mutual fund portfolio with an expense ratio of 1% (remember that doesn't include all the ancillary costs mentioned above). And 1% may not sound like a whole lot. But when it's chipped annually from your retirement nest egg, the cumulative effect can be significant.

Over the course of a career, a worker who makes $75,000 per year and saves 8% of that annually in a 401(k); that worker would lose 2.8 years' worth of savings in a target-date fund with a 0.2% fee and would lose 11.6 years' worth of savings in a mutual fund with a 1% fee. This data is according to an analysis by Towers Watson.

By the way, according to the 13th edition of the 401k Averages Book released in January 2013 by the Investment Company Institute; the average expense ratio for small plan participants was 1.46% and 1.03 % for large plan participants.

According to a recent analysis by Demos, a nonpartisan research organization: The average American couple could pay nearly $155,000 in fees for their 401(k) plans over their careers. That would reduce their eventual nest eggs by more than 30%!

This insight into plan fees and the recent revealing studies point a huge spotlight on what many experts say is an unending problem: high fees that significantly drain American retirement plans year after year.

You need to review your statement

So I ask you. Not counting your contributions or your employer's match each year, how much has your 401(k) actually grown in value over the last 13 years since the year 2000? In fact, when was the last time you even opened and reviewed your quarterly statement for your employer plan?

According to an August 2012 survey by LIMRA: Two-thirds of Americans with defined contribution plans spend less than five minutes examining their plan disclosures. Not surprisingly therefore, almost 9 out of 10 plan participants either did not know the fees they paid or did not think they paid any fees for their plans.

But now, since July 1, 2012, the Labor Department now requires that mutual-fund firms and other 401(k) service providers must disclose details about the fees they are charging to run the plans. This supposedly means that you, as a plan participant, will now see those fees detailed in quarterly and annual statements.

So I encourage you to take some time with your next 401(k) statement. Once you are able to see the amount of fees associated with your employer-sponsored plan you may decide to pursue an IRA with investment choices, like index annuities, that have little or no fees or expenses to diminish your account value.

The In-Service Distribution Rule

If you're finally beginning to see the light about the risky, non-guaranteed investment choices and annual fees in your employer's plan, here's a way you can put your money somewhere else. It's a little known fact, but most workers age 59½ and older can roll over 401(k) funds while they're still working and contributing to their plan.

IRS rules allow workers to empty their 401(k) accounts once they hit age 59½. They can roll part or all of the money into an IRA without paying tax now. The same goes for participants in government and not-for-profit savings plans such as 403b's and 457 plans. Keep in mind that the IRS permits this rollover starting at age 59½, but your Plan Administrator doesn't have to allow it. So check with your employer to see what they will allow you to do with your money.

Why do an In-Service Distribution?

One obvious reason to consider an in-service rollover is to escape a bad plan that has expensive or mediocre mutual funds to choose from. Some small plans have annual fees that top 2% a year. So, if you're stuck in one of these high-fee plans, you can chop your costs by rolling your 401(k) money into an IRA where the investment, such as an index annuity, has no fees or commissions.

The Index Annuity has no rival in its combined ability to ensure safety, offer opportunity for growth that is automatically captured annually, and provide income that adjusts for inflation and lasts a lifetime. The Index Annuity surpasses variable annuities, target-dated mutual funds, laddered bonds and dividend-paying stocks. And, most Index Annuities have no fees except for an income rider fee of less than 1 percent designed to guarantee lifetime income. A 401(k) cannot guarantee a lifetime income.

How would an in-service withdrawal look in real life?

Let's consider this hypothetical example: Jim is 60 years old and wants to retire in five years at age 65. He has been contributing to his 401(k) for many years and has built up a balance of $400,000. Over the past several years, Jim has witnessed dramatic market swings in the value of his 401(k). Now he wants to take some of the market risk off the table and add some retirement income guarantees.

So, Jim, with the help of his financial professional, who is not affiliated with the 401(k), decides to shift part of his 401(k) funds into an individual retirement annuity. Jim checks with his employer to confirm that he is eligible for an in-service distribution.

Jim wants his money protected from investment risk. He wants the opportunity for growth and he wants guaranteed income for life. So, he decides on an index annuity with an optional rider that enables him to maximize his lifetime withdrawals based on his retirement schedule. As a result, Jim directly rolls over $200,000, tax free, into an index annuity which is established as an individual retirement annuity.

When Jim turns 65 and retires, he chooses to begin receiving payments under the income rider of his Index Annuity. He is guaranteed to receive $16,600 each year for the rest of his life, regardless of how the stock and bond markets perform. And the income off this annuity will double if needed for Long-Term Care. So, along with his other retirement assets, including the remaining assets in his 401(k), Jim can rest much easier knowing that his future is more secure than if he had left all his money in his 401(k).

Maybe better to own a Roth IRA than a Roth 401k
Another reason to do an in-service rollover to an IRA is if you're leaving retirement money to your kids or grandkids instead of to a spouse. It's important to know that a spouse who inherits either a 401(k) or an IRA can roll it into his or her own IRA with all the flexibility that an IRA offers its original owner.

But kids, grandkids or other non-spousal heirs who inherit an IRA can't do that. What they can do is keep the money in what's called an "inherited" IRA, and thereby be able to stretch out withdrawals and tax deferral for decades. Also, a non-spousal beneficiary can not convert an inherited IRA to a Roth IRA. That means that while your kids, or grandkids can inherit your 401k and can convert it to a traditional IRA, your kids or grandkids can not convert it to a Roth IRA.

Remember that contributions to a traditional 401(k) are made with pre-tax dollars. Since January 1, 2006 some 401(k) plan participants have had the option to make after-tax contributions into a Roth 401(k) instead of into their traditional 401(k).

As with a Roth IRA, investment earnings in a Roth 401(k) cannot be withdrawn penalty-free until five years after an employee first began to contribute to the Roth 401(k) and not until after he or she reaches age 59½. And one added rub here is that the IRS requires that the owner of a Roth 401(k) must begin to take distributions from the plan no later than age 70½. By contrast, this distribution rule does not apply to Roth IRAs. So, another strategy would be to take part or all of your 401(k) or similar employer plan and roll it directly into a Roth IRA while you're still living and thereby bring a great tax-free benefit to your heirs when you pass away.

And for those of you currently younger than 59½
What if you're younger than age 59½ and you've developed a great dislike for your employer plan where you are still working?

Well, employees are permitted to receive distributions of employer contributions prior to age 591/2 under a frequently forgotten rule. In Revenue Ruling 68-24, the IRS said employees may be given access to contributions in a qualified retirement plan if the contribution had been in the plan for at least two years or if the employee had been a participant in the plan for at least five years.

In order for these distributions to be made without violating the two-year/five-year rule, employees were precluded from participating in the plan for a six-month period after receiving a distribution. However, the six-month exclusion rule is not required by statute, and many individually designed plans do not impose a suspension of benefits.

But a word of caution here: If you're younger than 59½ and you spend the cash, instead of rolling it over to an IRA, then you'll owe an extra 10% penalty on the taxable amount, just as you would if you took a loan from your 401(k) and switched jobs without repaying the loan.

Here's another idea if you're younger than 59½ and you're tired of your current employer plan. You might consider actually reducing your current contribution to your employer plan all the way down to just the employer match. You would then invest the difference into an IRA or any of the many other investment strategies that your financial professional could recommend for you.

For example, instead of contributing to your 401(k) above the employer match, you could invest the difference into a properly designed cash-value life insurance policy. This is an alternative which, among other benefits, can provide tax-free income from the cash value build-up of your policy and provide a highly leveraged tax-free death benefit for your beneficiaries such as your spouse.

In Closing

I'd like to alert you to a program that was aired on PBS Frontline on April 23rd, 2013.The title of the show was "The Retirement Gamble." This excellent program shined a light on Wall Street including its greedy motives for your Employer Sponsored Retirement Plan. As I've pointed out in this chapter, for people in or near retirement, I believe these employer plans to be mostly a failed experiment and a con job perpetrated by Wall Street and Plan Administrators mostly for their own selfish gain. The Frontline program strongly supports this premise.

A recent survey conducted by E*Trade in association with Harris Interactive found that 32% of the respondents have yet to roll over a 401(k) from a former employer because they find the process too confusing, intimidating or time-consuming. 41% said they believe that opening an IRA account takes too much time, and 56% said they believe managing an IRA requires more financial know-how than they currently have.

Opinions (and actions) on 401(k) plans were even more vague: 32% who currently have a 401(k) are not confident it will ever grow enough to meet their retirement needs, 28% don't review their statements or have difficulty at present to keep track of their account performance and 21% do not know what fees are being charged as part of their 401(k).

So the message in this Special Report is two fold. First, be smart about the real dangers of assuming that your 401(k) will serve adequately as your sole retirement plan. And second, planning is the single, most effective technique to have a safe and secure retirement.

In all the years I've been helping people win the game of retirement, and when studying the characteristics of families who are truly financially independent, I find one common theme. **They make a constant effort to plan for their future.**

I wish you a long, happy and financially secure retirement. And if I can be of any assistance, please do not hesitate to contact me.

Sincerely;
Stephen Geist
Financial Strategist and Safe Retirement Plan Specialist