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401(k) and 403(b) Retirement Plans Rollover

Introduction

Business retirement plans are a valuable tool when it comes to retirement savings.

There are 2 classifications for business retirement plans; there are qualified and non-qualified plans. The main difference between the two plans is that qualified plans allow an employee to make tax-deferred contributions to the plan and nonqualified plans are not eligible for employee tax benefits.

For this paper we will be focusing on qualified retirement plans.

Qualified plans have two categories, defined contribution and defined benefit plans:

- Defined contribution (DC) plans are employee retirement plans where the end value is based off the contributions and investment performance of the employee's individual account. Contributions to these plans have limits and may vary depending on the plans terms. Investment risk and fund selection is placed on the employee in these types of plans. Contributions made to defined contribution plans are with pre-taxed dollars, which brings tax benefits by lowering the amount of taxable income. Earnings on investments grow tax free which makes DC plans a great way to save for retirement. The most common defined contribution plans are 401(k) and 403(b)

- Defined benefit plans promise a certain benefit at retirement. Contributions can come from an employer or a combination of employee/ employer contributions. Investment risk is placed on the defined benefit plan sponsor and not the participant. Benefits of these plans are usually in the form of monthly payments or a lump sum option upon retirement, and they are calculated by a formula that factors in the number of years with the firm and average salary over the over a certain time. Pension plans are a common form of defined benefit plans.

  Many defined benefit plans give the participant the option of a lump sum payment of all holdings or a monthly payment disbursement option. IGM is able and willing to do analysis of your best option and give advice on what actions to take regarding a defined benefit plan. Analysis of these options is an important factor for making the most beneficial decisions, and should be done well before retiring or leaving your current company.

401(k) and 403(b)

We will now be focusing on the two most common employee retirement plans used by organizations today: the 401(k) and 403(b).

401(k) and 403(b) plans are similar types of defined contribution plans, yet they are for different types of organizations. 403(b) plans are for employees of public schools, and other tax exempt, non-profit organizations. Whereas, 401(k) plans can be used with any for-profit company. Both plans allow an employer to make matching contributions up to a set percentage of the employee's contributions. However, it is common for many organizations with 403(b) plans to not offer matching contributions. Both plans also will offer investment selections for the participant to choose from; however, most plans only offer a limited selection.

As stated earlier, defined compensation plans are a great tool for saving for retirement when they are fully utilized. However, when you reach retirement or your time with a company has ended, you will need to decide what the best strategy for your retirement plan is.

These are the options one can take:

1) Maintain in your plan with your previous company.
2) If you get a new job you can transfer it into your new company's similar plan.
3) Take a lump-sum payment of all holdings.
4) Directly rollover into an IRA.

Options Breakdown

1) *Maintain in current Plan*
   If you choose to maintain in your plan with your previous company you will be subject to the ongoing plan administrative fees (see fee section pg. 4). The administrative fee is in addition to the fees within the funds. You will also be stuck with your limited selection of investments; most plans only offer 20-40 funds. Make sure to understand the fees you are paying and ask yourself what value are you are receiving by paying these fees compared to the alternatives.

2) *Transfer into new company's plan*
   Transfers between similar plans are allowable and they can avoid any current taxes and penalties. If you choose to transfer into your new company's similar retirement plan, be sure to research all your options. Transfers would have similar fees and limited fund selection as stated in option 1. Find out about your new plan's investment options and fees and decide if this option is in your best interest.

3) *Lump sum payment*
If you choose to take a lump-sum direct payment of your defined contribution plan and not roll over into an IRA, there are a few factors that need to be considered beforehand. The money received is considered income, which will be taxed, and could have the possibility of increasing your tax bracket, leading to a higher tax rate. Also if it is done so before the age of 59 1/2 you will be subject to a 10% penalty, unless under special circumstances. A lump sum payment should only be considered if the money is absolutely needed.
If you take personal possession of the lump sum and have intentions of rolling over into an Investment Retirement Account (IRA), that rollover must be completed within 60 days of the distribution. Upon the distribution your payer must apply a mandatory income tax withholding of 20%. Then you must rollover 100% of the distributed funds, including the amount withheld, or become subject to the appropriate income tax. There are no tax payments required if you rollover 100% of your distribution within the 60 day period.

4) *Direct Rollover into IRA*
A direct rollover into will avoid any current taxes and penalties that could be applied. We believe that, in most circumstances, directly rolling over a defined contribution plan into an IRA has the greatest benefit for the individual investor who is retiring or planning for retirement. Rolling over into an IRA will have no administrative fees and offers significantly better investment selections.

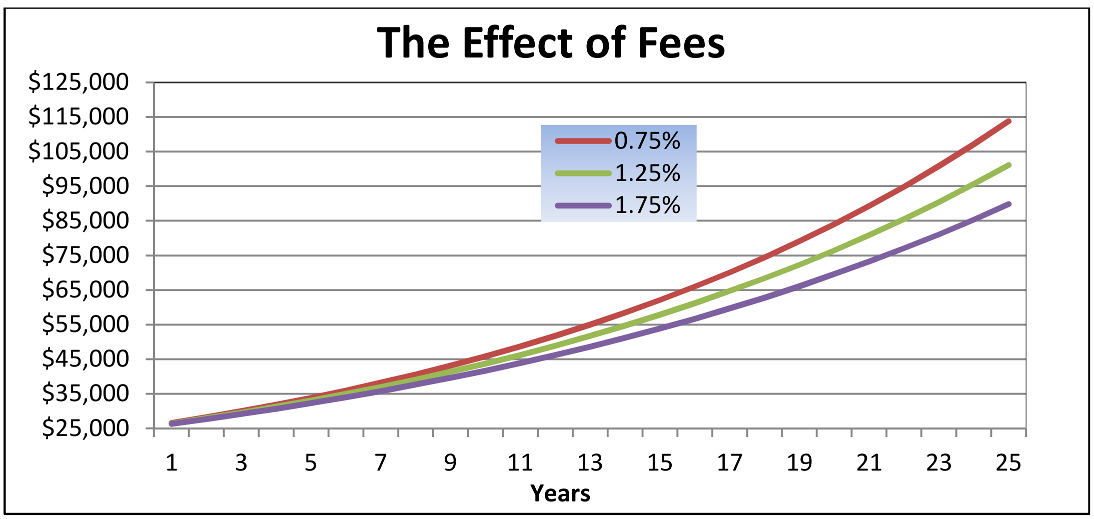
The following is an explanation of the benefits that can come from rolling over your 401k or 403(b) into an IRA, and how IGM can help you in the process.

Investment Selection

401(k)s and 403(b)s offer limited choices of investment options that are selected by the plan administrator. These investment options are usually limited to a selection of mutual and index funds, and for many 403(b) plans the investments are usually limited to just annuity products. In an IRA one can choose from a wide array of investment categories such as stocks, bonds, mutual funds, ETFs and many other options. With all the options to choose from in an IRA, you have the ability to place your money in a variety of investments that can be focused on your specific needs and risk tolerance.

Fees

Many defined contribution plans have a mixture of fees and administrative expenses that are relatively unknown to some investors. The fees range from .2 and 1.8 percent, but some plans are more costly, even more so for smaller companies. The average administrative fee for having a 401k is approximately .80%. This administrative fee is a separate and an additional fee to the expense ratios that all of the mutual funds have. Mutual fund expense ratios are the annual fees charged by individual funds. This expense ratio may be high compared to other funds available in an IRA, and stocks and bonds which have no expenses. The fees from investment options and administrative costs in 401(k)s/ 403(b)s that can have a significant negative impact on long term returns.



The graph above shows the effect that an increase in fees can have over long term returns. With a starting investment of $25000 growing at 7% per year over 25 years, and having an annual fee of .75% per year the total value is $113,805. The total value with a 1.25% annual fee is $101,146. That is a $12,659 difference due to just a .50% annual fee increase. And when the fee is increased by 1% to a 1.75% annual fee, the ending amount is $89,844. That is $23,960 lower than the investment with a .75% fee. With the effect that fees can have on total investment returns, it is important know and understand all the fees that are charged in a 401(k).

Best Option

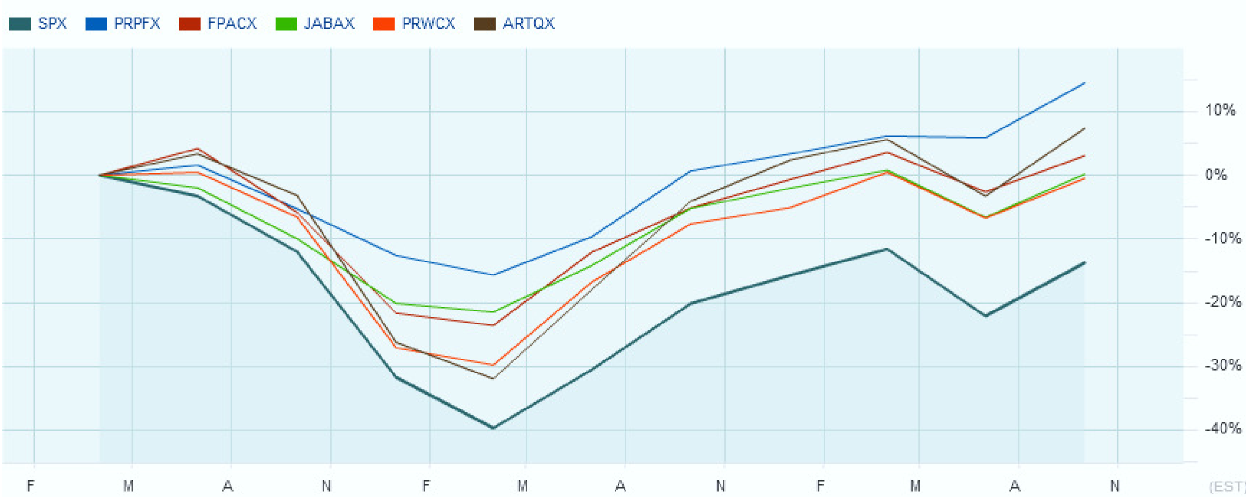
When the fees and limited investment options are taken into consideration we believe a direct rollover into an IRA is the best decision. By maintaining in a 401(k) or 403(b) the fees can be costly and you can be left with unsuitable investment products. The ability to have full control of investment decisions and at a lower cost gives the rollover IRA the clear advantage over staying in a company sponsored retirement plan.

Benefits of an IGM Managed IRA

IGM has experience in the field of retirement plan rollovers into IRAs, and focuses on a broad variety and a diversification of investments. When selecting investments for an IRA, the client's best interests are the top priority. If mutual funds are deemed acceptable, than the mutual funds that may be selected by IGM are top quality funds that have no sales charges and reasonable expense ratios.

The chart below shows some of the larger mutual fund holdings selected by IGM. These selected funds have about half of down side market risk as compared to the S&P 500, which was down 38.5% in 2008. On average, these funds have returned 9.86% over the past 10 years, which is a greater return when compared to the S&P 500's return of 5.33% during the same time frame (as of 7/30/2013).

Fund	Ticker	Morning Star Rating	Expense Ratio	Worst 1 Year Return (2008)	10 Year Adjusted Return
Janus Balanced Fund	JABAX	5	0.88%	-15.22%	8.32%
TRP Cap Appreciation	PRWCX	5	0.71%	-27.17%	9.73%
Permanent Portfolio	PRPFX	4	0.69%	-8.36%	9.11%
FPA Crescent	FPACX	5	1.16%	-20.55%	9.09%
Artisan Mid Cap Value	ARTQX	5	1.20%	-27.56%	13.07%
Averages		4.80	0.93%	**-19.77%**	**9.86%**



(Source: bigcharts.com)

The Graph above shows the funds from the previous chart compared to the S&P 500 Index (SPX) during the time of 2007 to 2010 (the beginning and end of the market downturn).

In addition to the variety of investment options available, IGM offers professional portfolio management at a fee based cost. A managed portfolio entails that each portfolio will have an allocation that will reflect your specific needs, goals, and risk tolerance. The selected investments are watched and monitored by the portfolio manager with the purpose of achieving your objectives.

Investment Growth Management (IGM) is an independent Registered Investment Advisor (RIA) in the state of California. We are held to a fiduciary standard on behalf of our clients. IGM focuses on building and maintaining individual investment portfolios that are consistent to the best interests, goals, and risk tolerance of each client.

IGM can customize and manage a portfolio for you, or if you have questions, contact Michael Redlick at redlick@comcast.net or call 925-588-4743.

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