The Rollover Reset

PRESENTER / SUBTITLE (IF ANY, ALL CAPS)

Title, Date, etc.

Overview

- State of the rollover market
- Key considerations for rollovers
- Understanding plan distribution options
- Non-Roth after-tax accounts
- Special tax rules for NUA
- In-service rollovers
- Warn Act

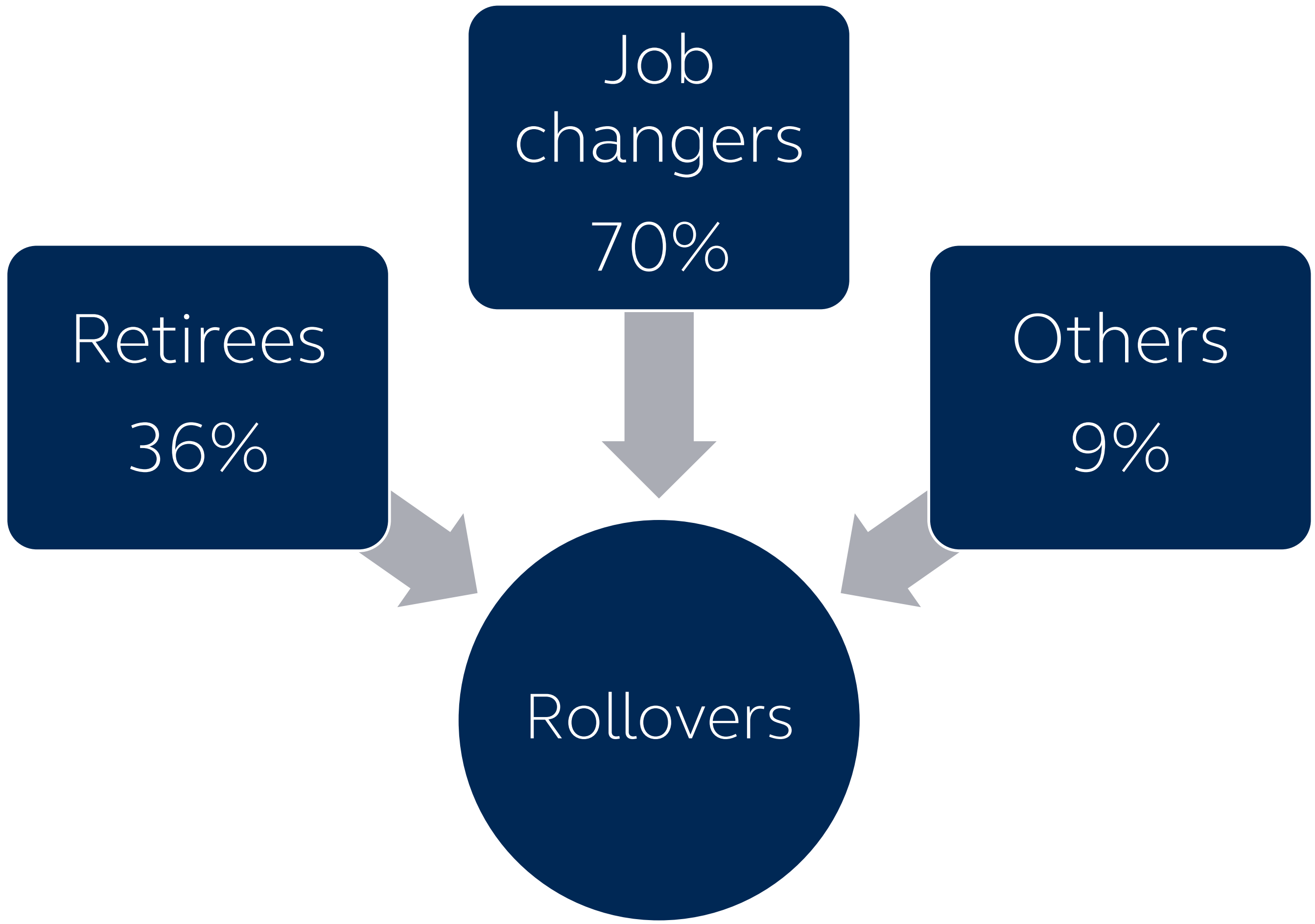
The Rollover Reset:

PTE 2020-02 Improving Investment Advice for Workers & Retirees

Principal®

State of the rollover market

Who Is Driving the Rollover Market?



Source: ICI, Research Perspective, Vol. 27, No.1, January 2021 Note: Includes multiple responses

Rollovers in motion

- Service Separation
- Death
- In-Service
- Prior rollovers
- Plan terminations
- Monthly income
- Lump sum

The rollover market is massive

Rollovers are the greatest source of dollars flowing to IRAs *

Half of retirees choose an IRA rollover***

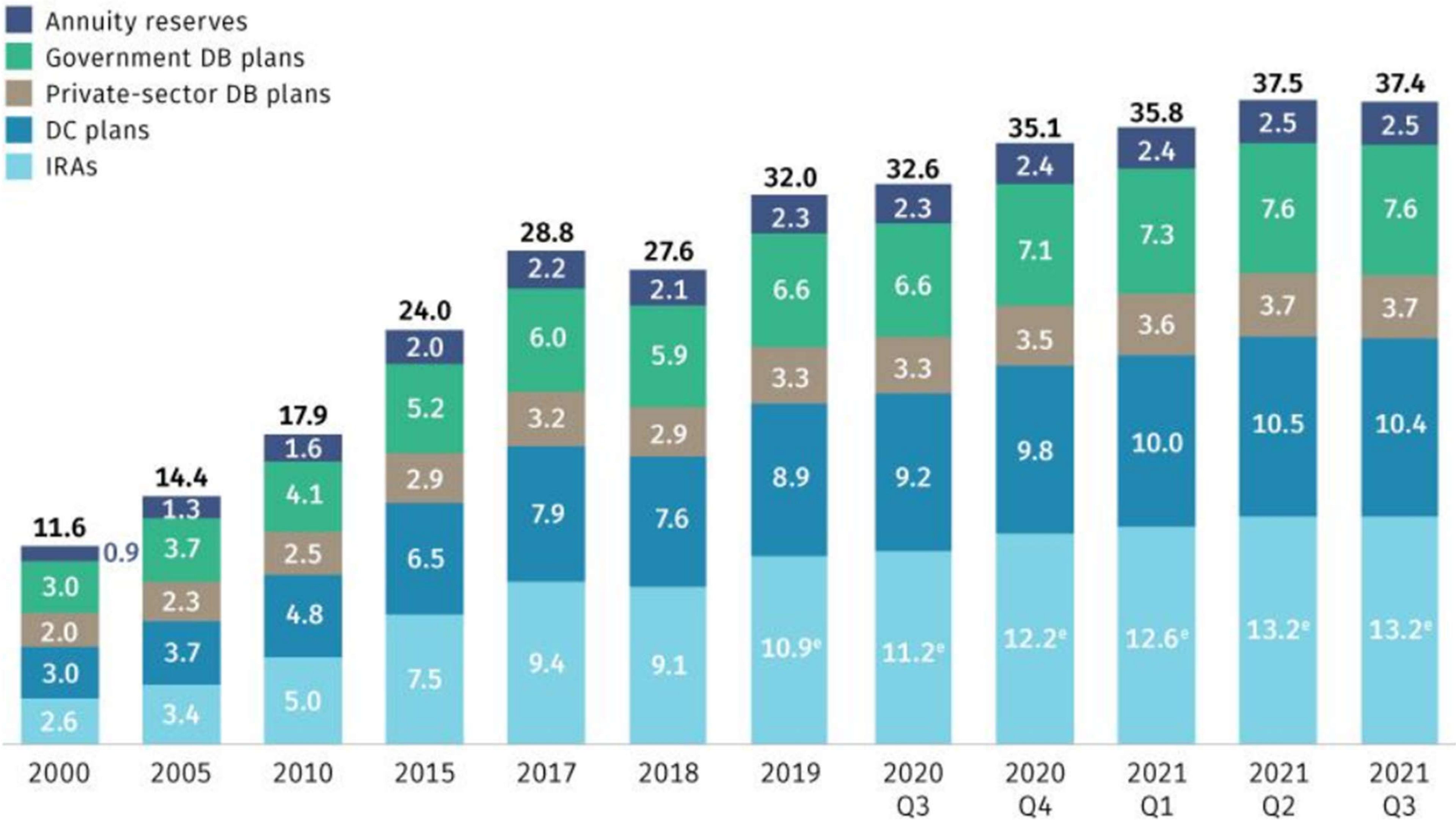
IRA rollovers are estimated to reach $760 B annually over the next 5 years****

The average IRA rollover is $109,155*

The median rollover is $16,373**

*SOI Tax Stats - Accumulation and Distribution IRA, 2018 data; ** RLC extrapolation from SOI Tax Stats 2018 data
***Pew Charitable Trusts Survey of Near and Recent Retirees, October 1, 2021
**** Think Advisor, June 22, 2021

U.S. Retirement Assets



Investment Company Institute, September 30, 2021

Principal®

Key considerations for rollovers

Employer plans that may permit rollovers

Defined contribution

- 401(k)
- 403(b)
- Governmental 457(b)
- Profit sharing

Defined benefit

- Traditional defined benefit
- Cash balance

IRAs

- SIMPLE
- SEP

Who may be eligible to rollover?

Current employees covered by a profit sharing, 401(k), or 403(b) plan

- Many plans allow distributions of profit sharing, matching and/or rollover contributions prior to age 59 ½

Individuals with "rollover accounts"

- Average person changes jobs ~ 12 times during lifetime
- Most rollover accounts are accessible at any time

Employees nearing age 59 ½ who work for employers who offer:

- Defined benefit plans
- 457(b) plans

Principal®

Rules, taxes, and penalties

- Taxable portion of a withdrawal from a qualified plan or IRA is subject to ordinary income tax and may be subject to a 10% federal early distribution penalty if taken prior to age 59½.
- Qualified plans generally required to withhold 20% of the assets unless the distribution goes directly to another qualified plan or to an IRA.
- Taxes and penalties do <u>not</u> apply if the qualified plan withdrawal is directly rolled over to another qualified plan or an IRA.
- Investors should take into account potential tax consequences, as well as expenses, sales charges and/or penalties for selling or buying investments before initiating a rollover.

Principal®

Distributions NOT ELIGIBLE for rollover

- Hardship
- RMDs
- Excess contributions
- Substantially equal periodic payments (72t)
- Loans as distributions

Understanding plan distribution options

A rollover starts with a plan distribution

Defined contribution plans

- Don’t allow for distributions of deferrals prior to age 59 ½, but…
- Many plans allow early access for non-deferral types of contributions

Defined benefit plans

- Permit annuity payments that are NOT eligible for rollover, but…
- Many plans include lump sum distribution option or a lump sum window

IRA-based plans

- Distributable “on demand” of IRA owner, but…
- SIMPLE IRA assets may not be rolled over within the first 2 years of participation

Principal®

What does the Summary Plan Description say?

Read the fine print....

Does the Plan permit

- After-tax accounts?
- Net unrealized appreciation?
- In-service distributions?
- Defined benefit lump sum?

After-tax contributions, Roth conversions, and rollover decisions

Retirement planning that can make a difference

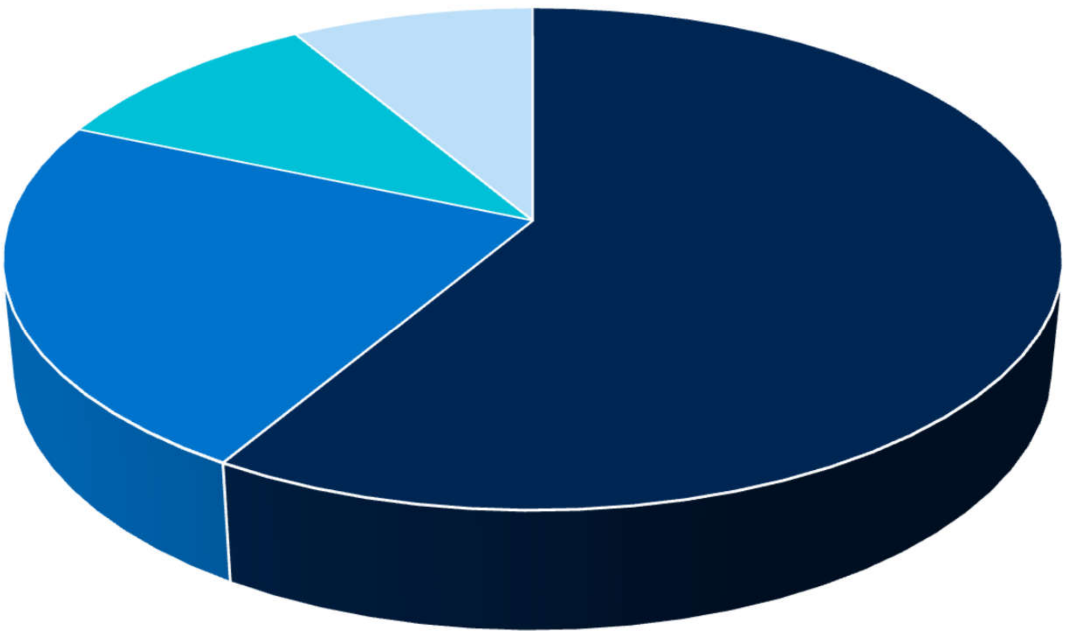
After-tax contributions in 401(k)

For investors who want to save MORE

- Already maxed out other available options
- Desire to create income tax diversification
- IRS allows to split out after-tax and send rollover amounts to multiple destinations
    - ➢ After-tax contributions (or roll-ins) are key
    - ➢ Roth IRA and other plan limits matter
    - ➢ Check SPD for plan provisions
    - ➢ Mega-back door Roth strategy?
    - ➢ Eyes on Washington D.C.

Maximizing contributions to 401(K)

Pre-tax and after-tax



Contribution types:

- Pre-tax elective deferrals
- After-tax contributions & roll-in amounts
- Designated Roth
- Employer
    - Profit sharing
    - Company match

Benefits of tax diversification

Strategy

Holding assets in taxable, tax-deferred, and tax-free accounts

Benefits

- Gives taxpayer withdrawal flexibility
- Allows taxpayers to hedge against tax rate changes

  Example: *Putting some retirement assets in traditional and Roth IRAs*
- Assist in tax bracket management
- Increase portfolio longevity

After-tax contributions in 401(k)

- Many plans allow distributions of an after-tax accounts at any time for any reason
- The accounts are separate from a designated Roth 401(k) account
- Client would like to set aside more of their wages per year for retirement beyond $20,500 ($27,000 if age ≥ 50) in 2022 or…
- Client has after-tax balance from previous employer plan
- Client would like a tax efficient or, potentially, tax-free way to acquire Roth IRA assets
- Roth IRA contribution limits prevent many from building tax-free savings for retirement

Principal®

Distribution planning for Designated Roth & Roth IRAs

Designated Roth

- A separate account in the 401(k), 403(b), or governmental 457(b) plan
- Contributions are elective deferrals made after tax
- Employer matching goes to other account in plan
- RMDs required!

Roth IRA

- IRA contribution limits and eligibility rules apply
- $6K ($7K if 50+)
- Income phase-out ranges are deal-breaker for those with higher income
- No RMDs for account owner

Other key points

- Plan rules limit designated Roth account access while in-service
- Qualifying distributions and ordering rules create confusion
- 5 years and age 59 ½
- If multiple employer plans, timeline is separate unless rolled together
- Roth conversions each have own 5-year timeline

Principal®

NUA and the rollover decision

Income tax reduction and the “ownership mentality”

Net Unrealized Appreciation (NUA)

A strategy for highly appreciated company stock

- Favorably shifts income tax rate from ordinary income to capital gains
- Determining the viability
- Requirements for NUA tax treatment:
  - Employer stock distributed in-kind
  - Employer plan must make a “lump-sum distribution”
  - The lump-sum distribution must be made after a “triggering event”

Principal®

NUA and the rollover decision

Factors to consider for strategy viability

Does the plan allow NUA?

- Publicly traded vs private stock
- Review the Summary Plan Description

Is it right for my client?

- Compare tax rates
- Is the stock highly appreciated?
- Moving retirement savings to a non-qualified account (forfeiting tax deferral)
- A remedy for the highly concentrated position

IRS requirements

- Who is eligible?
- Discuss "lump sum distribution"
- Employer stock in current plan vs previous plan
- Shares distributed in-kind
- Must occur after a "triggering event"

Principal®

NUA and the subsequent sale of stock

- Cost basis is taxable as ordinary income for current tax year
  - ➢ 10% early withdrawal penalty may apply
- NUA = unrealized gain above the cost basis reported in box 6 of 1099-R and is ALWAYS taxed as long-term cap gain
- Not taxed on NUA until stock is sold
- Potential "subsequent gains" may be taxed as short-term gain (ordinary income tax rate) based on holding period from distribution date
- What if losses occur?

A powerful tax planning strategy

NUA case example

- Mary age 65
- $500K in employer plan
- $300k company stock

	NUA Strategy		IRA Strategy
	Taxable Account	IRA	IRA
Account Value	$300,000 (company stock)	$200,000 (other investments)	$500,000 (all investments)
Income Tax (33% rate)	$24,750 (on cost basis of $75,000)	$0	$0
The client decides to sell stock and liquidate the IRA			
Capital Gains Tax (15%)	$33,750 (on NUA of $225,000)	$0	$0
Income Tax (33% Rate)	$0	$66,000	$165,000
Total Tax Paid	$124,500		$165,000
In this example, the client saved $40,500 in taxes			

Assumes there's no growth in value of accounts, a 33 percent income tax rate (combined federal and state), and a 15 percent capital gains tax rate. If the NUA strategy is used, the client must perform a complete distribution of all assets from the 401(k) plan in a single tax year.

Principal®

In-service distributions and plan rollovers

In-service distributions 101

What is a non-hardship, in-service distribution?

- A withdrawal from a 401(k) plan that does not require a "triggering event"
- Separate from "hardship distribution" as per plan design
- Nearly 70% of profit sharing/401(k) plans offer in-service distributions *
- Also allowed in profit sharing, 403(b), governmental 457(b) and certain DB plans
- Check the SPD

Other considerations for an in-service distribution

- Age-based (e.g., attaining age 59 ½)
- Source-based (e.g., rollover account, employer contributions)
- Service-based (e.g., 5 years of service limit)
- Must be rolled to IRA within 60 days to avoid tax and possible penalty
- Benefits of asset consolidation
- More options available for accumulation and income planning
- Most rollover accounts accessible at any time (the average person changes jobs 12 times during lifetime)**

In-service distributions

Evaluate thoroughly before taking action

- Does client wish to defer RMDs past age 72 if still employed?
- The importance of creditor protection for IRAs and state law
- Loans available from plan, not from IRA
- No elective deferrals available until 59½
- Matching and profit sharing may be available sooner
  - 5 years of participation
  - 2 years of accumulation
  - Check the SPD
- Many plans allow distributions of an after-tax account at any time for any reason
- No mandatory 20% withholding if rolling directly to IRA or another plan

The Warn Act

Worker Adjustment and Retraining Notification Act

The WARN Act

Federal law requires notification of layoffs and plant closures

- DOL requires employers with 100 or more employees to provide at least 60 calendar days advance written notice of a plant closing and mass layoff affecting 50 or more employees at a single site of employment.
- Several states have their own versions of the WARN Act including CA, HI, IL, IA, ME, NH, NJ, NY, TN, WI
- Some state websites such as CA, IA, IL, NY post monthly WARN notices

The Rollover Reset

PTE 2020-02

Improving Investment Advice for Workers & Retirees

The Rollover Reset

Rules, regulations, and guidance on conducting compliant rollovers

- FINRA Rule 2111, the "suitability rule"
    - effective 07/09/2012
- FINRA Notice 13-45
    - Issued 12/30/2013
- SEC Regulation BI
    - Effective 06/30/2020
- DOL PTE 2020-02
    - Effective 01/31/2022

Principal®

FINRA Rule 2111

The "suitability" rule, effective 07/09/2012

- Rule 2111 requires that a broker-dealer and its associated persons have a reasonable basis to believe that a recommended transaction or investment strategy involving a security is suitable for the customer.
- "If Rule 2111 is triggered, a registered representative must have a reasonable basis to believe that the recommendation is suitable for the customer, based on information about the options obtained through reasonable diligence, and taking into account factors such as tax implications, legal ramifications, and **differences in services, fees and expenses between the retirement savings alternatives.**" (Emphasis added)

FINRA Notice 13-45:

Conducting Compliant Rollovers; issued 12/30/2013

Balanced discussion to educate clients about their options:

- Leave assets in plan
- Roll over to future employer plan
- Roll over to IRA
- Cash out

Key factors to consider when comparing the four options:

- Fees and expenses
- Services
- Penalty-free withdrawals
- Protection from creditors and judgements
- RMDs
- Employer stock

Principal®

SEC’s Reg BI

- Reg Bi established a “best interest” standard of conduct for B/D’s and associated persons
- To identify potential conflicts of interest and financial incentives for the sale of recommended products
- Related to the DOL’s “fiduciary rule” which was officially vacated by the Court of Appeals in 2018.

Additional background

- Effective June 30, 2020
- Heightened standard vs. previously established “suitability rule” (FINRA Rule 2111)
- Best interest vs. reasonable basis
- Four-legged set of general obligations
  - Disclosure
  - Care
  - Conflict of interest
  - Compliance

Complying with PTE 2020-02

> *"PTE 2020-02 expands the definition of a "prohibited transaction" under ERISA to include any recommendation for rolling over 401(k) assets into an IRA (or from one IRA to another) when doing so would increase the compensation for the advisor."*

Complying With PTE 2020-02, effective 1/31/2022

To qualify for an exemption to this rule, advisors must comply with 6 conditions:

- Acknowledge that they are fiduciaries under ERISA;
- Disclose, in writing, to the client the scope of the relationship and any material conflicts of interest;
- Comply with DOL's Impartial Conduct Standards requiring advisors to provide prudent investment advice, charge only reasonable compensation, and avoid misleading statements;
- Provide written disclosures to clients of why the recommendation to roll over assets is in their best interests;
- Conduct an annual review of the firm's compliance with PTE 2020-02 (and document the results in a written report to a "Senior Executive Officer" of the financial institution); and
- Adopt and implement policies and procedures to comply with the DOL's Impartial Conduct Standards, mitigate conflicts of interest, and document the reasons for recommending rollovers of retirement assets.

Principal®

Complying With PTE 2020-02

Who needs the exemption

- Financial institutions and investment professionals who recommend rollovers to retirement plan participants, including:
- From an ERISA plan to another ERISA plan or to an IRA
- From an IRA to another IRA
- From one type of account to another, such as a commission-based account to a fee-based account

Are you ready?

- PTE 2020-02 went into effect on Feb 16, 2021
- Enforcement began Jan 31, 2022

PTE 2020-02 requires financial institutions and investment professionals to

- Analyze ERISA plan/IRA transfers, most commonly IRA rollovers, with a fiduciary standard of care
- Document details of each ERISA plan/IRA transfer analysis
- Perform an annual retrospective review to detect violations and achieve compliance

Principal®

Are you ready?

What factors to document in disclosure of a rollover recommendation?

Recommendations to roll over assets from an employee benefit plan to an IRA, the relevant factors include but are not limited to:

- Alternatives to a rollover, including leaving the money in the investor's employer's plan, if permitted;
- Fees and expenses associated with both the plan and the IRA;
- Whether the employer pays for some or all of the plan's administrative expenses; and
- The different levels of services and investments available under the plan and the IRA.

Principal®

Are you ready?

Advisors are required to meet a fiduciary standard under SEC regulations …

However, the DOL has stated that this MAY NOT be enough to comply with PTE 2020-02.

- Consult with legal and compliance partners to meet the requirements of PTE 2020-02.
- Develop additional disclosures, documentation, and processes to ensure compliance and provide suitable evidence.
- Consider existing and/or new tools to meet the obligations. Including:
    - Client relationship management (CRM) & transcription services to capture discussions with clients.
    - Financial Planning software & analysis.
    - Validation tools that can help document details of each ERISA plan/IRA transfer analysis.

Principal®

Optional slide depending on audience

Are you ready?

How Principal can help

In partnership with Broadridge Fi360 Solutions and the Pension Resource Institute

Fi360 Solutions' Decision Optimizer

- Single workflow customizable criteria and attestation templates for ERISA Plan/IRA transfers
- Consideration of the importance of each criterion to the investor and the relative differences of each option
- Highly interactive, real-time updates to overall preference, based on all criteria scored
- Documentation of the recommendations and generates output (analysis detail and attestations)

Principal®

Fi360 Solutions' Decision Optimizer
PLAN TO IRA ANALYSIS & DOCUMENTATION
Optional slide depending on audience

RELATIVE ALIGNMENT WITH NEEDS & OBJECTIVES

STAY IN PLAN | NEUTRAL | ROLLOVER TO IRA

Strong | Moderate | Low | Low | Moderate | Strong

CONSIDERATIONS	IMPORTANCE TO CLIENT	BEST ALIGNMENT WITH NEEDS & OBJECTIVES	DEGREE OF DIFFERENCE	WEIGHTED ALIGNMENT
ALL-IN FEES AND EXPENSES	LOW MED **HIGH**: HIGH	Plan	LOW MED **HIGH**: HIGH	Strong
Both plans and IRAs typically have investment expenses and plan or account-related fees. Confirm the level of importance to the Retirement Investor and help evaluate by adding all expenses charged to the plan or IRA account and comparing the two.				
AVAILABLE SERVICES	LOW MED **HIGH**: HIGH	IRA	LOW MED **HIGH**: HIGH	Strong
Some plans may offer a wide range of services such as managed accounts, participant investment advice and one-on-one education sessions, while other plans may offer more limited services. Confirm the level of importance to the Retirement Investor and help compare the level of available services in the plan with the IRA to assess which one best aligns with his/her needs.				
AVAILABLE INVESTMENTS AND/OR PRODUCTS	LOW **MED** HIGH: MED	IRA	LOW MED **HIGH**: HIGH	Strong
Some plans may offer limited choices, while others provide a broad range of investments, including both active and passive strategies, or even brokerage account windows providing participants wider latitude in choosing investments. Confirm the level of importance to the Retirement Investor and help him/her compare the investments available in the plan to what is available in an IRA to assess which one best aligns with his/her needs.				
GUARANTEED INCOME AND/OR INTEREST RATES	N/A LOW **MED** HIGH: MED	IRA	LOW **MED** HIGH: MED	Moderate
Access to guaranteed income and/or interest rate guarantees may be valuable to help manage income and/or investment risk. Confirm the level of importance to the Retirement Investor and help him/her compare the options available in the plan to what is available in an IRA to assess which one best aligns with his/her needs.				
TAX CONSIDERATIONS	N/A LOW **MED** HIGH: MED	IRA	LOW MED **HIGH**: HIGH	Strong
Important tax considerations when evaluating whether to roll over a plan account to an IRA, may include, but are not limited to, application of Required Minimum Distributions (RMDs), application of the additional 10% tax, Roth tax treatment, employer stock taxation, beneficiary implications and more. Confirm the level of importance to the Retirement Investor and help evaluate whether staying invested in the plan versus rolling over to an IRA best aligns with his/her needs.				
DISTRIBUTION CONSIDERATIONS	**N/A** LOW MED HIGH: N/A			
Some plans may offer a wide range of distribution options while others may offer more limited options. IRAs are generally more flexible, but certain products may impose limitations (e.g., surrender charges). Confirm the level of importance to the Retirement Investor and help evaluate whether staying invested in the plan versus rolling over to an IRA best aligns with his/her needs.				

Principal®

Thank You