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THE ANNUITY-WITHIN-AN-IRA STRATEGY

How you could benefit from taking in-service withdrawals from qualified plans


PERSONAL SAVINGS | EMPLOYEE PENSIONS | SOCIAL SECURITY

For many years, Americans relied on the "3-legged stool" approach to prepare for retirement.

In order to keep the stool stable and create a predictable plan for generating income in retirement, an individual would build its three legs using 1) personal savings, 2) employee pensions and 3) Social Security. For numerous members of the Silent Generation (born 1925-42), this was a reliable strategy. But for Baby Boomers and the generations that follow, this concept is not necessarily workable. The pension leg is altogether missing for most workers, the social security leg isn't as sturdy as it once was with only 59% of Americans who report social security will be a major source of income.[1]

Today, savers are turning to a variety of different financial solutions to plan for the future. For example, 401(k)s and other qualified plans are assets individuals commonly use to accumulate funds during their working years that they can access to supplement their income in life after work. Yet, these types of retirement accounts are generally subject to the unpredictability of the markets. In fact, during the Great Recession of 2007-2009, market volatility translated into significant 401(k) losses for numerous workers closing in on retirement. According to U.S. Federal Reserve data, those losses coincided with U.S. household net worth dropping nearly 39% between 2007 and 2010![2] While many who remained invested in the market saw their wealth eventually recover to some extent, those who were planning to retire during this time may have seen their options limited. In 2020 we are seeing a return of this market volatility. In the first quarter of 2020 the U.S. household wealth fell 5.6%[3] as stock markets were hammered by the pandemic, which has since pushed the United States into recession.

When that kind of damage is done late in your career, it can be difficult — if not downright impossible — to recover without making significant changes to your retirement time frame or projected lifestyle. Think how disenchanting it would be to unexpectedly have to modify your vision for the "golden years" you've worked so long and hard to achieve. In order to avoid working longer, retiring later or giving up on some of your most anticipated post-career activities, it's important you put strategies in place today that will help you take care of your tomorrow.

For workers approaching retirement who prefer some level of asset protection while still maintaining growth potential, there may be a way to turn a portion of your qualified plan funds into a stream of predictable income you can't outlive that is protected from market declines. By taking advantage of IRS rules that provide for in-service 401(k) withdrawals, you can use funds that are already earmarked for retirement to implement an annuity strategy that creates a steady stream of income during retirement — without incurring a single penalty — while you are still working and contributing to the 401(k).

This strategy is fairly simple to implement as long as you understand its rules. In this whitepaper, I'll cover considerations for whether or not this may be a good option for your situation, exactly how the process works and the types of features you should consider when selecting the annuity to which your allocated funds will be transferred. I hope this material will serve as a trusted resource for helping you achieve some of your most important wealth management goals for retirement. It is just one more way we at DMI Marketing can help you experience life after work as you have always imagined.

Best Regards,

Your Name

your name

[1]2019 Retirement Confidence Survey, Employee Benefit Research Institute and Greenwald & Associates.
https://www.ebri.org/docs/default-source/rcs/2019-rcs/2019-rcs-short-report.pdf

[2]Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances, Federal Reserve.
Available online: http://www.federalreserve.gov/pubs/bulletin/2012/pdf/scf12.pdf

[3]U.S. Household Wealth Fell 5.6% in First Quarter 2020 as Coronavirus Hit, Reporting by Lindsay Dunsmuir;
Editing by Andrea Ricci, June 11, 2020, The New York Times

BACK TO BASICS: ABOUT QUALIFIED PLANS

With the days of pension plans funding retirement gone for the majority of workers, individuals and couples must turn to various alternatives to plan for the future. Two of the most common types of retirement savings accounts today are IRAs and employer-sponsored retirement plans. Of the employer-sponsored retirement plans available, defined contribution plans, such as 401(k) plans, are the most popular in the United States. In fact, according to the most recent statistics provided by the U.S. department of Labor, there are more than 571,000 401(k) plans throughout the U.S, totaling more than $5 trillion of total assets, covering more 84 million plan participants![4]

As you may know, these qualified plans are established by employers to provide retirement benefits for their employees and the employees' beneficiaries. Qualified plans allow the employer a tax deduction for contributions it makes to the plan, and employees typically do not pay taxes on plan assets until these assets are distributed. Furthermore, earnings on qualified plan assets are tax deferred, which may allow plan participants to defer paying taxes on a portion of their income until retirement, at a time when their tax bracket may be lower. Let's look at a simple example of the power of tax deferral.

The chart below shows how a $100,000 initial payment, compounded at 4% annually, grows tax-deferred. After 20 years, once taxes are paid on a lump-sum distribution, the value of the tax deferred product is greater than the amount accumulated in the taxable vehicle that's grown for 20 years.[5]

Most 401(k) plans allow participants to direct their own investments into a core group of investment products from which participants may choose. These may include a combination of mutual funds, guaranteed investment contracts (or stable value funds), company stock, variable annuities and other financial vehicles. In other words, most, if not all, of the plan assets are then subject to market volatility. Throughout your career, that can provide you with large growth potential, but it also means you can experience losses in the plan when markets decline.

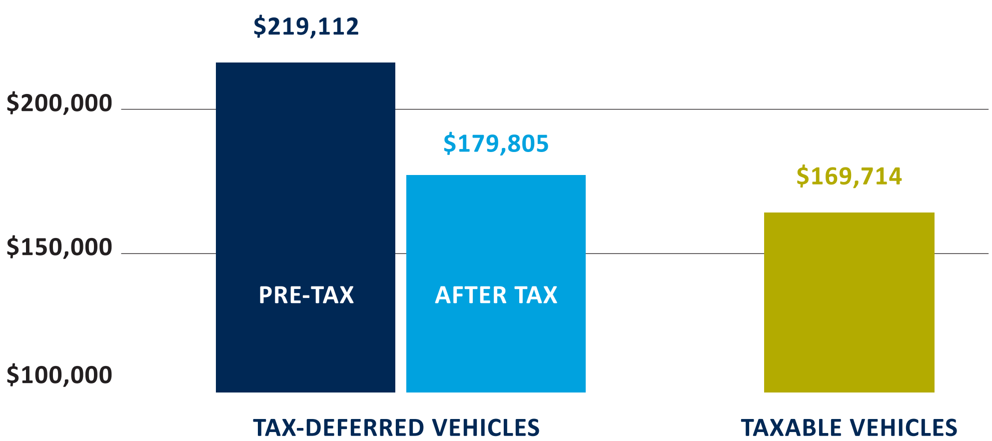
In addition to the potential for loss, average investors may be unfamiliar with how to best allocate funds in their 401(k), making it harder to maximize growth. Caps placed by the plan and/or IRS regulations typically limit the percentage of salary deferral contributions one can make. Plus, there are restrictions on how and when you can access the funds, and penalties may apply if you are under retirement age as defined by the plan when funds are withdrawn.

With the right assistance from a financial professional, you can follow these rules and make the most of your 401(k) while you're still working. But as you inch closer to retirement and your risk tolerance declines, you may still be interested in taking additional measures to protect a portion of your plan from market uncertainty while reaping a host of other benefits that might appeal to your specific situation. That's where in-service withdrawals can come into play.

[4] Private Pension Plan Bulletin Historical Tables and Graphs 1975-2013, U.S. Department of Labor, September 2017 updated Septmeber 2019. https://www.dol.gov/sites/dolgov/files/ebsa/researchers/statistics/retirement-bulletins/private-pension-plan-bulletin-historical-tables-and-graphs.pdf

The Power of Tax Deferral

Growth of a hypothetical $100,000 investment over 20 years, compounded at 4% annually[4]



In this chart, the value of the tax deferred product after lump-sum distribution is greater than the amount accumulated in the taxable vehicle grown for 20 years.

[5]Assumes a 33% ordinary income tax assessed yearly on taxable earnings and at period end on tax-deferred earnings. Actual tax rates may vary from this example for different taxpayers and assets (e.g., capital gains and qualified dividend income). Actual performance of your contract will also vary. Hypothetical interest is not guaranteed and does not represent performance of any particular product or investment. This example does not include any product fees, which would reduce the values shown here.

IN-SERVICE WITHDRAWALS IN ACTION

Now that we've talked about some of the benefits of 401(k) plans and the rules that apply, let's discuss more about what it means to take an in-service withdrawal and how that can be done. First and foremost, you may be thinking, "What is an in-service withdrawal?" An in-service withdrawal occurs when you take money out of your 401(k) or other qualified retirement plan while still working and contributing to the plan. If properly executed, an in-service withdrawal will allow you to initiate a direct rollover of funds from your qualified plan into an IRA without incurring penalties. Keep in mind that you must typically be age 59½ or older to do so to comply with current tax code.

CONSIDERATIONS BEFORE STARTING

Before you jump at the chance to utilize this strategy, it's important you complete a bit of due diligence to make sure it makes sense for your situation. While IRS guidelines generally permit 401(k) plans to offer penalty-free in-service withdrawals, you must first determine whether your particular plan actually contains provisions allowing these pre-retirement withdrawals. Currently, research indicates that in-service withdrawals are available in approximately 70 percent of 401(k) plans.[6] You'll also want to identify any other limitations that may be in place (i.e., withdrawal amounts, type of funds or timing of transfers) specific to your plan.

Next, you'll want to consider any potential tax implications an in-service withdrawal might have before initiating a transfer of funds. The tax code generally permits some funds be used for this purpose and prohibits others from being used, as noted in the chart on the next page.

Purchasing an annuity within a retirement plan that provides tax deferral under sections of the Internal Revenue Code results in no additional tax benefit. An annuity should be used to fund a qualified plan based upon the annuity's features other than tax deferral. All annuity features, risks, limitations, and costs should be considered prior to purchasing an annuity within a tax-qualified retirement plan.

You've likely noticed that the "magic age" of 59½ seems to be a common benchmark for setting rules around these withdrawals. While it's true that many defined contribution plans (such as 401(k) plans) allow in-service withdrawals based upon this minimum age, others may permit them based upon years of work or service credits instead. Withdrawals also may be subject to a vesting schedule.

Meanwhile, some defined contribution plans (such as 457(b) plans) have even greater IRS restrictions governing in-service withdrawals than what we've discussed. It is also possible that your plan sponsor may elect to restrict some or all of the

[6] In-Service Withdrawal, 2019 https://www.investopedia.com/terms/i/inservicewithdrawal.asp

Funding sources of In-Service Withdrawals from a 401(k) plan	
GENERALLY PERMITTED	**GENERALLY PROHIBITED**
Employer-matching and profit-sharing contributions	Employer safe-harbor match or safe-harbor non-elective contributions prior to reaching age 59½
Employee after-tax contributions to a traditional 401(k)	Employee pre-tax and Roth contributions prior to reaching age 59½
Employee pre-tax and Roth contributions after reaching age 59½	

in-service withdrawal options allowable under the tax code. Therefore, identifying the rules under which your in-service withdrawal may be conducted is an essential first step. You may also want to consult with a tax advisor to ensure you avoid the 10 percent penalty tax that typically applies to premature 401(k) distributions.

CONSIDERATIONS FOR INITIATING A TRANSACTION

Once you determine that you have the information you need to proceed, it's critical the withdrawal is handled properly via a direct rollover. Because of IRS regulations, qualified plan administrators are usually required to withhold 20 percent of any distribution made directly to the plan participant for federal income taxes, even if that participant intends to roll it over within the traditional 60-day window that applies to tax-free rollovers. With a direct rollover, however, the funds are transferred from the plan trustee directly to another qualified retirement plan or IRA and are not subject to this withholding.

Most qualified plans have specific forms related to direct rollovers, which your financial professional can help you fill out properly and in a timely manner to complete the transaction. If you choose to roll the funds into a fixed indexed annuity, for example, your financial professional can also help take care of completing the transfer paperwork the receiving insurance carrier will require as well. With a little bit of preparation and help from a trusted professional(s), you can leverage this successfully to take advantage of other benefits an IRA or, more specifically, a fixed indexed annuity can offer.

GUARANTEEING LIFETIME INCOME WITH AN ANNUITY

For some individuals, using an in-service withdrawal to transfer qualified funds into an IRA can offer increased investment options or the opportunity for heirs to stretch the tax-deferral benefits of an inherited IRA over their lifetime or their surviving spouses. While these strategies may be right for some, for many workers nearing retirement, another attractive option may be to roll the funds directly into a fixed indexed annuity. This unique financial solution can help achieve a variety of retirement planning goals that may appeal to you.

Before we dive into specifics, let's first clarify that a fixed indexed annuity is not an investment but rather an insurance product. By taking an in-service withdrawal from your qualified plan, the funds rolled directly into the fixed indexed annuity would be considered a premium — or the funds used to purchase the insurance contract — which you provide to an insurance company in exchange for a series of income payments typically taken starting in retirement that cannot be outlived. In addition to this predictable income that lasts for life, a fixed indexed annuity offers protection from market losses as well as minimum interest earnings, regardless of the economic climate. This combination of benefits can help provide a stable leg in your retirement stool.

GUARANTEES

As we discussed earlier in this publication, a primary reason for moving money out of your 401(k) or other qualified plan when you're closing in on retirement may be guaranteed protection for a portion of funds from market declines and the effect those drops could have on your future. A fixed indexed annuity offers the potential for interest with guarantees to your principal.

More specifically, you'll receive interest credits linked to the positive performance of a particular index. However, if the index declines, you'll benefit from the annuity's zero floor — in other words, the interest credited will be zero and your account value cannot decline. To clarify, you do not directly participate in any stock or equity or bond investments; rather, interest is credited based upon the performance of a chosen index. Because you are not directly invested in the index, the interest you earn will be limited by the insurance company in the form of a cap, spread or participation rate.

In addition to the guaranteed protection, a fixed indexed annuity offers the ability for you to turn the asset into guaranteed[7] lifetime income, regardless of how long you live. This is one of the most sought-after benefits of fixed indexed annuities, and it could provide you with greater assurance that you have predictable income to help take care of planned — or unplanned — retirement needs.

CONTROL

Most annuities offer you the ability to withdraw up to 10% of the annuity's value each year without incurring a surrender penalty (although the funds will be subject to taxes). In addition, many annuities offer additional guaranteed riders, which are available for an additional annual cost. The insurance company puts provisions in place that ensure you retain some control of the asset while the company's interests remain protected. After all, the insurance company must cover the cost required to ensure you enjoy all of the benefits a fixed indexed annuity provides.

Many fixed indexed annuities today are purchased with a guaranteed living benefit rider, which are available for an additional cost. These riders offer an array of benefits that can put you in control. Just a sample of benefits include provisions for keeping up with inflation, extended care benefits, the ability to choose when you turn income payments on and off, and the creation of a death benefit for loved ones. Your financial professional can help you navigate the options available and select a product that is right for your specific needs, taking into consideration how the annuity fits in among your other retirement assets.

FLEXIBILITY

In addition to the guarantees and control that could make a fixed indexed annuity a key part of your successful retirement plan, this financial vehicle may be able to serve your spouse or domestic partner as well. As part of a couple, you may want to secure lifetime income for your other half, rather than just for yourself. Following a direct rollover from a qualified plan, there are some fixed indexed annuities that allow you and your spouse/partner to be joint annuitants on the contract. This can be particularly valuable if your qualified plan represents the lion's share of the wealth you have amassed as a couple.

Again, this is where a relationship with a trusted financial professional can be extremely valuable. He or she can evaluate your current financial situation to select a fixed annuity product that addresses all of the needs you're hoping to cover.

THE RIGHT STRATEGY AT THE RIGHT TIME

The process of preparing for your future can be daunting, particularly when you know there are variables for which you simply can't plan. The concept of protecting a portion of your hard-earned wealth is one that's easy to grasp — and possible to achieve.

By first doing a little research to identify whether your qualified plan allows for in-service withdrawals and determining any other considerations you must make, you can clearly decide if and how to proceed. Then, using a direct rollover, you can move a portion of your qualified funds into a fixed indexed annuity to take advantage of the guarantees, control and flexibility this unique financial vehicle offers.

Now that you understand the annuity-in-an-IRA strategy you can decide if this makes sense for a portion of your assets. Partnering with a professional experienced in retirement income planning can make outlining a path to your goals and navigating the journey easier. An enjoyable retirement is what you deserve, and with the right tools, it can be your reality.

[7]Annuity guarantees are backed by the financial strength and claims-paying ability of the issuing company. Annuities involve fees and charges, including surrender penalties for early withdrawals.

Withdrawals are subject to ordinary income taxes, and if taken before age 59½, are subject to an additional 10% federal penalty.

Contact us today for help using a portion of your qualified funds to create a more stable stool that may help steady you in retirement.

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