Key Considerations in a Rollover

Presenter: Doug Hintlian, Regional Vice President, Columbia Management
The Columbia Management Learning Center is dedicated to supporting financial advisors and their clients with thought-leading insights, up-to-the-minute regulatory and legislative information, the latest research, new ideas and proven tools in financial planning.

Our aim is to be a trusted ally, combining knowledge and know-how to deliver the most innovative financial solutions available.
Learning Objectives

After taking this course, you will be able to:

> Better understand the rollover market.
> Identify ways to maximize retirement savings and income potential.
> Evaluate the pros and cons of maintaining an in-plan account balance vs. a rollover/conversion account balance.
> Determine circumstances when an in-service/non-hardship distribution and rollover would be available and beneficial.
> Optimize retirement savings and income with a 401(k) after-tax account contribution feature.
> List the three key factors needed to qualify for special tax treatment on net unrealized appreciation (NUA) in employer stock in qualified plans.
> Compare the pros and cons of a defined benefit plan lump sum vs. an annuity payout.
> Recognize rollover opportunities for survivors of military personnel.
Course Topics

The Rollover Market

Maximizing Your Retirement Savings and Income Potential

The Pros and Cons of an In-Plan vs. IRA Rollover/Conversion Account Balance

Considering an In-Service/Non-Hardship Distribution and Rollover

401(k) After-Tax Account: The Forgotten Contribution Feature

Employer Stock and Net Unrealized Appreciation (NUA)

Defined Benefit Plan Lump Sum vs. Annuity Payments

Rollover Opportunities for Survivors of Military Personnel
The Rollover Market
Who Can Complete a Rollover?

> A qualified plan participant
> An IRA owner
> A spouse beneficiary of either of the above
> A nonspouse beneficiary of a qualified plan participant
What Assets Are Rollable?

- “401(a)” plans
- Traditional IRAs
- Roth IRAs (but only to other Roth IRAs)
- SIMPLE IRAs (after two years of participation)
- Simplified employee pension (SEP) IRAs
- 403(a) plans
- 403(b) tax-sheltered annuities and custodial accounts
- 457(b) plans maintained by state and local governmental entities
### Where Can They Roll?

<table>
<thead>
<tr>
<th>Roll From</th>
<th>Roth IRA</th>
<th>IRA (traditional)</th>
<th>SIMPLE IRA</th>
<th>SEP-IRA</th>
<th>457(b) (government)</th>
<th>Qualified Plan 1 (pre-tax)</th>
<th>403(b) (pre-tax)</th>
<th>Designated Roth Account (401(k), 403(b) or 457(b))</th>
</tr>
</thead>
<tbody>
<tr>
<td>Roth IRA</td>
<td>YES</td>
<td>NO</td>
<td>NO</td>
<td>NO</td>
<td>NO</td>
<td>NO</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>IRA (traditional)</td>
<td>YES³</td>
<td>YES</td>
<td>NO</td>
<td>YES</td>
<td>YES⁴</td>
<td>YES</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>SIMPLE IRA</td>
<td>YES, after two years</td>
<td>YES, after two years</td>
<td>YES</td>
<td>YES, after two years</td>
<td>YES, after two years</td>
<td>YES, after two years</td>
<td>YES, after two years</td>
<td>NO</td>
</tr>
<tr>
<td>SEP-IRA</td>
<td>YES³</td>
<td>YES</td>
<td>NO</td>
<td>YES</td>
<td>YES⁴</td>
<td>YES</td>
<td>YES</td>
<td>YES, after 12/31/10</td>
</tr>
<tr>
<td>457(b) (government)</td>
<td>YES³</td>
<td>YES</td>
<td>NO</td>
<td>YES</td>
<td>YES⁴</td>
<td>YES</td>
<td>YES</td>
<td>YES, after 9/27/10</td>
</tr>
<tr>
<td>Qualified Plan 1 (pre-tax)</td>
<td>YES³</td>
<td>YES</td>
<td>NO</td>
<td>YES</td>
<td>YES⁴</td>
<td>YES</td>
<td>YES</td>
<td>YES, after 9/27/10</td>
</tr>
<tr>
<td>403(b) (pre-tax)</td>
<td>YES³</td>
<td>YES</td>
<td>NO</td>
<td>YES</td>
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<tr>
<td>Designated Roth Account (401(k), 403(b) or 457(b))</td>
<td>YES</td>
<td>NO</td>
<td>NO</td>
<td>NO</td>
<td>NO</td>
<td>NO</td>
<td>NO</td>
<td>Yes, if a direct trustee to trustee transfer</td>
</tr>
</tbody>
</table>

1. Qualified plans include, for example, profit-sharing, 401(k), money purchase, and defined benefit plans
2. Governmental 457(b) plans, after December 31, 2010
3. Must include in income
4. Must have separate accounts
5. Must be an in-plan rollover
The Rollover Market

By 2017, rollovers to IRAs are estimated to exceed $450 billion annually.¹
Why? 78.2 million baby boomers have begun to retire.
As boomers contemplate retirement, their attention will turn away from wealth accumulation as their primary goal and turn, instead, to wealth harvesting.
The change in the investor psyche from wealth accumulator to wealth harvester affects the investor/advisor relationship.
- During the wealth accumulation years, the average investor will use the services of several financial advisors.
- 60% of investors within five years of retirement are driven to consult with an advisor who specializes in retirement income planning.²

¹ Evolution of the Retirement Investor, Cerulli, 2012
² Investors Seeking Retirement Income Turn to Advisors for Guidance, Insured Retirement Institute, April 2011

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Your “Retirement DNA” and Maximizing Your Retirement Savings and Income Potential
Who May Benefit?

- Employees new to the workforce
- Employees who have changed employers throughout their working careers
- Individuals who have multiple IRAs at several financial firms
- Beneficiaries of deceased plan participants and IRA owners
Your **retirement DNA** helps define your ability to accumulate retirement assets and your options for transforming them into retirement income.

Consists of the various retirement savings programs you have or have had access to over your working career:

- Current and former workplace retirement plans
  - Defined benefit
  - Defined contribution
  - 401(k)
- IRAs
  - Traditional
  - Roth
  - Simplified employee pension (SEP)
  - Savings incentive match plan for employees (SIMPLE)
- Workplace retirement plans and IRAs for which you are a beneficiary
Workplace retirement plans
> Is your plan a defined benefit or defined contribution plan?
> Does it have a salary deferral option and are you participating?
> Does your employer provide matching contributions?
> Are you deferring enough to get the maximum match?
> Does your workplace retirement plan have a designated Roth contribution feature?
> Can you make after-tax contributions to the plan?
> Do you have additional income from self-employment?
> Have you left behind plan balances in plans maintained by former employers?
> What are your withdrawal options?

IRAs
> Are you eligible to make deductible traditional IRA contributions?
> Are you eligible to make Roth IRA contributions?
> Have you considered a Roth IRA conversion?
> Does your employer offer a SIMPLE IRA plan and are you participating?
> Does your employer offer a SEP plan?
> Have you considered consolidating your IRAs?
Maximizing Your Retirement Savings and Income Potential

When was your last retirement DNA analysis?

“My what?”

> A retirement DNA analysis can help you maximize your retirement savings and income potential.

Remember:

> Identify each of the retirement savings vehicles in which you have been or are involved.
> Understand the key features of each vehicle and your unique options for retirement saving and income.
An In-Plan Account Balance vs. Rollover/Conversion
Who May Benefit?

- Employees changing jobs or careers
- Employees who are retiring
- Beneficiaries of deceased plan participants
- Ex-spouses of plan participants
Key Considerations

When evaluating an in-plan account balance vs. a rollover/conversion, be sure to compare the following between the options:

- Fees
- Investment options
- Availability of investing and financial planning guidance
- Distributions (e.g., RMDs)
- Taxation of withdrawals
- Creditor protection
- Ability to consolidate assets
- Availability of lifetime income options
- Beneficiary options
- Availability of special tax treatments for withdrawals
- Availability of helpful statements
- Designated Roth contributions and the five-year clock
Key Considerations

Additional considerations for Roth conversions:

- Where will the money come from to pay taxes?
- What estate tax implications might a conversion have?
- How long will the investor hold the Roth assets?
- What about required minimum distributions (RMDs)?
- Why would converting to separate Roth IRAs be advantageous?
Key Considerations

IMPORTANT:

> The taxable portion of a withdrawal from a qualified plan or IRA is generally subject to ordinary income tax, and if taken prior to age 59½, may be subject to a 10% federal early distribution penalty, unless an exception applies (discussed later).

> Clients should take into account any additional potential expenses, such as sales charges and/or penalties for selling or buying investments in the plan and IRA before initiating a rollover.

> Note: Taxable distributions from IRAs and qualified plans are not subject to the new 3.8% net investment income tax that applies to certain investment income of high-net-worth taxpayers starting in 2013.
Congratulations on your new job (or retirement)! What decision have you made regarding your retirement plan account balance?

“I haven’t thought about it.”

- Do you know what your options are?
- Have you considered your plan assets in light of your total financial picture?

“I’m leaving it in the plan (or rolling it over or converting it).”

- Have you thoroughly considered the key tax and financial differences between your options?
- Have you weighed the potentially negative aspects of your choice?

Remember:

> Specific withdrawal options are contained in the summary plan description for the plan.
> Review plan account statements to identify money types and/or employer stock before completing a rollover or conversion.
Considering An In-Service/Non-Hardship Distribution and Rollover
Who May Benefit?

- Employees nearing or over age 59½ who work for employers offering profit sharing, 401(k) plans or 403(b) plans
- Individuals who have changed jobs and rolled their prior retirement benefits into their current profit sharing/401(k) plans or 403(b) plans
- Employees nearing age 62 who work for employers who offer defined benefit plans
- Uniformed services individuals who have at least 30 days of active duty service as:
  - A qualifying reservist
  - Any other category of persons designated by the president in time of war or national emergency
## Key Considerations

<table>
<thead>
<tr>
<th>Plans eligible for in-service distributions</th>
<th>Eligibility provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>401(k)</td>
<td>Age-based (e.g., attaining age 59½)</td>
</tr>
<tr>
<td>Profit sharing</td>
<td>Source-based (e.g., rollover and/or after-tax accounts)</td>
</tr>
<tr>
<td>403(b)</td>
<td>Service-based (e.g., after two years)</td>
</tr>
<tr>
<td>Defined benefit</td>
<td>Special military provisions</td>
</tr>
</tbody>
</table>
Are you familiar with your in-service/non-hardship distribution options?

“Yes, I am.”

- Are there restrictions?
- Have you considered the pros and cons of an in-service/non-hardship distribution and rollover?

“What’s that?”

- Explain an in-service distribution.
- Determine eligibility to receive.
- Explore the special provisions for military personnel.

Remember:

> Amendments for in-service distributions are most often found in the back of the plan document — check there first.

> Review the plan account statements for any money types eligible for in-service distribution.

> Hardship distributions are not eligible for rollover.

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401(k) After-Tax Accounts: The Forgotten Contribution Feature
Employees who have an after-tax contribution option available to them in their workplace retirement plans and would like to:

- Set aside more of their income for retirement beyond $17,500 annually
- Accumulate assets that may be more tax-advantaged when distributed
- Have a potentially tax-efficient way to bulk up their Roth assets
Step 2: Apply Technical Knowledge

In-service/non-hardship withdrawal of 401(k) after-tax account often available before age 59½

1 After-tax contributions equal amounts contributed by the employee.
2 After-tax account balance is the sum of after-tax contributions and associated earnings. Assumest the plan administrator accounts for after-tax contributions separately. Check with your plan administrator to determine how after-tax contributions are tracked.

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“What is your after-tax contribution option in your 401(k) plan?”

“What’s that?”

- Learn what an after-tax account is and whether your plan allows contributions.
- Discover why an after-tax account may be advantageous.

Remember:

> The summary plan description for the plan will list whether an after-tax contribution option is available and, if so, any contribution limits that may apply.

> After-tax contributions are not part of a participant’s 402(g) limit, but they are included as part of the annual additions, actual contribution percentage and top heavy limits. Plan language may also limit after-tax contributions.
Employer Stock and Net Unrealized Appreciation (NUA)
Who May Be Benefit?

> Employees over age 50 who work for large companies with employer stock in their plans
> Employees age 55 or above who are terminating employment with a company that uses employer stock in the 401(k) plan
> Beneficiaries of plan participants with employer stock

<table>
<thead>
<tr>
<th></th>
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<tr>
<td>Up to $17,400</td>
<td>10%</td>
<td>0%</td>
</tr>
<tr>
<td>$17,401 – $70,700</td>
<td>15%</td>
<td>0%</td>
</tr>
<tr>
<td>$70,701 – $142,700</td>
<td>25%</td>
<td>15%</td>
</tr>
<tr>
<td>$142,701 – $217,450</td>
<td>28%</td>
<td>15%</td>
</tr>
<tr>
<td>$217,451 – $388,350</td>
<td>33%</td>
<td>15%</td>
</tr>
<tr>
<td>Over $388,350</td>
<td>35%</td>
<td>15%</td>
</tr>
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</table>

<table>
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<th></th>
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<tbody>
<tr>
<td>Up to $17,850</td>
<td>10%</td>
<td>0%</td>
</tr>
<tr>
<td>$17,851 – $72,500</td>
<td>15%</td>
<td>0%</td>
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<tr>
<td>$72,501 – $146,400</td>
<td>25%</td>
<td>15%</td>
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<tr>
<td>$146,401 – $223,050</td>
<td>28%</td>
<td>15%</td>
</tr>
<tr>
<td>$223,051 – $398,350</td>
<td>33%</td>
<td>15%</td>
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<tr>
<td>$398,351 – $450,000</td>
<td>35%</td>
<td>15%</td>
</tr>
<tr>
<td>Over $450,000</td>
<td>39.6%</td>
<td>20%</td>
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</table>


*Taxable income ranges for singles are different from those shown. The top bracket for 2013 for singles starts at $400,000.
Ellie’s 401(k) plan invests a portion of her employer contributions in the common stock of her employer, Big Time Co. (BTC)

Ellie takes a lump sum distribution including $350,000 of BTC stock:
- Cost basis to the plan = $75,000
- Current value of BTC stock = $350,000
- Ellie’s NUA ($350,000 - $75,000) = $275,000

She sells the stock three years later for $400,000

*Gain on stock after distribution from the plan is taxed at long-term capital gains rate upon sale if held for more than 12 months. Taxed at short-term capital gains rate upon sale if held for 12 months or less.*

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Ellie’s 401(k) plan invests a portion of her employer contributions in the common stock of her employer, Big Time Co. (BTC).

Several years later, as a result of bankruptcy, the BTC stock becomes worthless.

Ellie takes a lump sum distribution of the worthless BTC stock.
Next Steps

“When was your last NUA analysis?”

“I’ve never had one.”

- Ask your team of financial professionals to conduct an NUA analysis.
- Postpone action involving employer stock until an NUA analysis is complete.

Remember:
> ATRA-12 made changes to the capital gains tax rates as well as income tax brackets.
> The company must provide a written statement showing cost basis. Participants should be sure to request one.
> Participants can avoid an early distribution penalty if the distribution occurs at age 55 or older for terminating employees, or at age 59½ or older for active employees.
Defined Benefit Plan Lump Sum vs. Annuity Payments
Who May Be Eligible?

- Individuals over age 50 who work for large employers with defined benefit plans
- Individuals who have changed jobs and left behind benefits in their former employers’ defined benefit plans
- Workers and retirees whose employers have adopted certain pension “de-risking” strategies
### Key Considerations

**Immediate Annuities**

**Pros**
- Investment risks born by the plan or insurance carrier
- Guaranteed lifetime payment*
- Fixed income

**Cons**
- Inflation can erode purchase power of payment
- No access to principal
- Limited ability to transfer wealth to beneficiaries

**Lump Sum Distributions**

**Pros**
- Individual makes investment decisions with assistance from advisor
- More growth potential than annuity
- Withdrawals based on need
- Lump sum rollover to IRA allows for beneficiary strategies

**Cons**
- Possible investment losses
- Could outlive assets

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* Guarantees based on the claims-paying ability of the insurance company or the plan’s ability to fulfill its obligation

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Next Steps

“Are you familiar with your lump sum distribution provision?”

“Are you familiar with your lump sum distribution provision?”

“Yes, I am.”

- Identify the differences between annuities and lump sum distributions.
- List the pros and cons of each distribution option in light of retirement saving and income goals.

“What’s that?”

- Review the plan document or website to identify all distribution options.
- Identify the differences between the distribution options available from the plan.

Remember:

> Many times the distribution forms for the plan only mention an annuity option, which may lead a participant to overlook a lump sum distribution option.

> Identify the source of the annuity payment stream (e.g., does the plan self-annuitize?).
Rollover Opportunities for Survivors of Military Personnel
Who May Benefit?

> Spouses of deceased service members
> Parents of deceased, unmarried service members
> Guardians of children of deceased service members
> Under the HEART Act, a military death gratuity and/or SGLI payment recipient may roll over the amounts received to a Roth IRA and/or Coverdell Education Savings Account (ESA) up to the aggregate sum of the gratuity and SGLI payments

> Effective with respect to payments made on account of deaths from injuries occurring on or after June 17, 2008

> The rollover of a military death gratuity and/or SGLI payment to a Roth IRA or Coverdell ESA must occur within one year of receiving the payment(s)
“Did you know you can roll your death gratuity and SGLI payments into a Roth IRA or Coverdell ESA?”

“No, I wasn’t aware of that option.”

- Identify the potential benefits of a Roth IRA or Coverdell ESA.
- Compare the pros and cons of rolling over vs. keeping the payments.

Remember:

> Survivors of military personnel frequently receive limited service and/or guidance with respect to these payments and often have other financial considerations that require attention.

> Review the potential benefits of saving in a Roth IRA or Coverdell ESA.
Key Considerations in a Rollover Summary
Summary

The Rollover Market

Maximizing Your Retirement Savings and Income Potential

The Pros and Cons of an In-Plan vs. IRA Rollover/Conversion Account Balance

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We know many Americans are concerned...

- 42% fear that they might outlive their savings
- 57% of pre-retirees have not created a concrete retirement plan
- 63% of Baby Boomers don’t feel confident they will have enough money for medical expenses once retired
- 70% of people over age 65 will require some long-term care

1 Cogent Research 2010
2 Healthcare Expenses and Retirement Income, Insured Retirement Institute, January 2012
3 U.S. Department of Health and Human Services National Clearinghouse for Long Term Care Information, 10/22/08
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