Estate Planning in the Era of Defined Contribution Retirement Plans

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Thanks!

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Also thanks to Rajeev, Courtney, and all of the Economic Forecasting Center Staff

It is great to be back in the ATL and at Georgia State

I talked to a lot of folks in my GSU days…

Quoted in:

Wall Street Journal, *Washington Post*, *New York Times*, *USA Today*, *Kiplinger's Personal Finance*, *Smart Money*, *Christian Science Monitor*, *Consumer Reports*, and *Investment Advisor*

Spoke on National Public Radio and appeared on *WXIA* (with Rajeev) and on the *Weather Channel*

Also…Men’s Health Live Radio

Three issues:

1. Why she won’t kiss you?
2. Have your beer delivered by a drone?
3. Are you retirement ready?

Defined Contribution (DC) Plans

Originally intended to be a **supplement** to the traditional defined benefit pension plan

But rapidly becoming the **main engine** to provide retirement income around the world

Requires a **PIVOT** - good decision making during the **accumulation** and **distribution** phases

Review some key DC dates

Cannot begin to take distributions from a DC plan prior to age 59.5 without tax penalty

Must begin to take distributions by age 70.5 or face tax penalty

Distributions must be **at least** the value of the account divided by the applicable life expectancy (27.4 for a 70-year old with spouse beneficiary)

Focus Today: Estate Planning

What happens to the proceeds in your DC plan when you die?

What are the implications of making good (or poor) estate planning decisions?

Types of DC Plans

Employer Plans (e.g., 401k, 403b, 457) are subject to plan rules and possibly, ERISA rules

Individual Retirement Accounts (e.g., IRA, SEP, SIMPLE) do not have employer plan rules and are not subject to ERISA

Can do a tax-free rollover from 401k plan to your *Traditional* IRA

Estate Planning Concepts

Understanding **Asset Transfer Mechanisms** is the key concept.

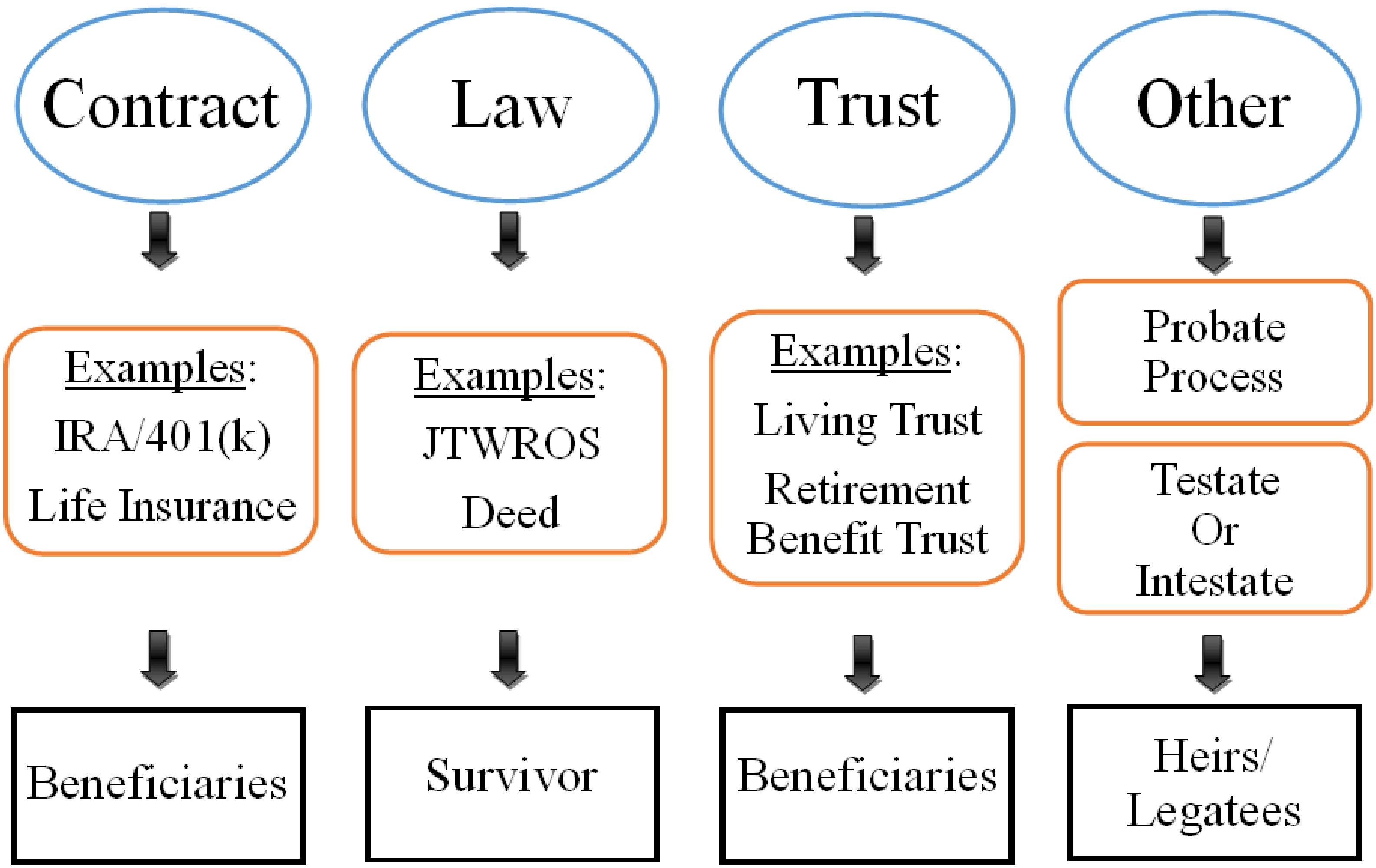
DC plan assets pass by **contract,** namely your beneficiary designation

Many participants in DC plans have not made a beneficiary designation or have not changed an out-of-date designation

Asset Transfer Mechanisms

1. **Contract** – beneficiary is the recipient (examples, 401k, IRA, Life Insurance)
2. **Law** – survivor is the recipient (examples, real estate deeds with JTWROS interests)
3. **Trust** – beneficiary is the recipient of a living or testamentary trust
4. **Other** – heir or legatee is the recipient after *probate* **--** either with valid will (testate) or with no valid will (intestate)

Asset Transfer Mechanisms



Default Protection

What is the implication of dying and not having a beneficiary named in your DC plan?

In an employer plan (401k), the spouse will become the owner of the proceeds unless he or she has expressly disclaimed this right

Is this true in an IRA? No. Spouse share depends on state of residence and other assets in estate.

What if a DC plan participant is not married?

If there is no beneficiary designated by an unmarried person (either never married, divorced, or widowed), the assets pass through the probate process

If the plan participant died without a valid will, the assets would pass by the laws of intestacy in the state of residence

In Georgia, that would be: (1) children; (2) parents; (3) siblings; (4) grandparents; (5) u/a

Secondary Beneficiaries

DC Plans also give you an opportunity to name a *secondary* beneficiary, who will receive the asset if the primary beneficiary is deceased

Secondary beneficiary considerations:

(1) Joint accident can take out the typical primary beneficiary (spouse); (2) Incapacity prior to death; (3) Avoiding probate; (4) Income tax efficiency

Choosing Secondary Beneficiaries

Choice is often about whether to name children as secondary beneficiaries or not

Pros: **Income tax**. Upon becoming owner, the secondary beneficiary can take distributions spread out over his/her (longer) life expectancy

Cons: Beneficiary has **control** over the asset. Will your 401k proceeds turn into a Ferrari?

Income Tax

If you die without a beneficiary, the proceeds of your DC plan enter the probate process and must generally be paid out within **five years**

Naming a trust as a beneficiary is a way to preserve tax benefits and manage the challenge of beneficiary control of the asset

But let us be very careful here…

Back to Asset Transfer Mechanisms

Merely having a living trust in place when you die will not mean that that trust gets DC plan proceeds

The trust must be named as a beneficiary and be valid under state law….examples, an irrevocable Retirement Benefit Trust or a Stand-Alone Retirement Trust

Asset Transfer Mechanisms

A few other key points…

It does not matter what your Will says if you have named live beneficiaries

Example, your never changed your beneficiary on your IRA from your ex-spouse to your current spouse

Litigation time!

Clarity about DC Plan Use Helps

What other sources of income do you have?

Are you (and your spouse) likely to need all the income from your DC plan? Will balance > $0

If you (and spouse) are **not likely** to need DC plan income, this makes *beneficiary choices* and *asset allocation* linkages critical

Longer horizon allows higher equity exposure

Bottom Line

Pay attention to beneficiary designations

Tough for single people and most of us are single at some point in our adult lives

Watch issues with married versus life partners, legally married matters

Understand asset transfer mechanisms

Ongoing Work on the Grant

Develop a streamlined choice architecture to help participants make good beneficiary decisions

Find a “nudge” mechanism to get DC plan participants to re-examine beneficiary choices on a regular basis

Potentially work into the annual benefits renewal process or into vendor web-site materials