

**Silicon Valley Chapter
American Association of Individual Investors**

Financial Planning Workshops

Retirement Planning I

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Silicon Valley Chapter of American Association of Individual Investors

Please check us out!

- Chapter website: www.siliconvalleyaaii.org
- Meetups: www.meetup.com/AAll-Silicon-Valley-Meetup
- Facebook: www.facebook.com/sv.aa
- Slides and Recordings
www.siliconvalleyaaii.org/financialplanning/
- AAI National website: www.aaii.com
- My email address: dstikes.svaaii@gmail.com

Our Next Event and Special Interest Group Webcasts

- Monthly Event: Saturday February 12th at 9:00am; webcast only
 - Harry Domash - Preferred Stocks: A Relatively Low-Risk Way to Earn 4%-7% Annually
 - Andy Prophet - Dividend Investing: A Personal Journey
- Financial Planning Workshop
 - Debra Stikes: Second Wednesday of each month at 6:30pm
- Investing Discussion Group
 - Lynn Gillette: Fourth Monday of each month at 6:30pm except Dec.
- Computerized Investing Group
 - Don Mauer, Bill Paseman: First Thurs of each month at 6:30pm

Financial Planning Workshops

- Financial Planning ... The Big Picture
- Investing 1: Modern Portfolio Theory, Building a diversified portfolio
- Investing 2: Efficient Market Hypothesis; Can you beat the market?
- Taxes: TCJA, SECURE Act, Tax diversification, Asset location, QCDs
- Retirement Planning 1: Tax-advantaged plans, RMDs
- Retirement Planning 2: Safe withdrawal rates, Bengen's 4% rule
- Risk Management/Insurance: Annuities, Long-term care, Litigation
- Social Security and Medicare: Claiming strategies, Medicare traps
- Estate Planning: Probate, Executor/trustee duties, Philanthropy
- Wrap-up: Case study reviewing previous material

Today we will cover ...

- Retirement Planning
 - The accumulation phase
 - The distribution phase
- Various types of accounts
 - Traditional and Roth IRAs
 - 401(k) plans, etc.
- Estate planning issues with retirement accounts
- Stretching your retirement plan to age 100
- Financial planning software

Retirement Planning

- Typical life cycle
 - Birth Graduation day Retirement day Death
- Goal of retirement planning
 - Accumulate enough assets between Graduation Day and Retirement Day (Accumulation phase)
 - to live comfortably after Retirement Day (Distribution phase)
- Known Unknowns
 - Length of accumulation and distribution phases
 - Return on retirement portfolio, inflation, etc.
 - Sequence of return risk
 - Sequence of expense risk, medical expenses, LTC

Meet Alan

- Graduation Day
 - Alan, a bright young twenty-something, just graduated from Prestige U.
 - Advanced degree in computer sciences
 - Starts work shortly at Giggle Corp
 - Starting salary \$100k per annum
- Fast forward 50 years to Retirement Day
 - Alan is now seventy-something
 - Looking forward to a long and comfortable retirement
 - How will Alan fund his retirement?

How Much Will Alan Need?

- Expenses in Retirement
 - Assume 80% of salary = \$80,000 pa (Today's \$)
- Income
 - Social Security; assume \$30,000 pa
 - Pension; assume Giggle offers none
 - Retirement portfolio must fund \$50,000 pa
- Retirement Portfolio
 - Need \$1.25M assuming Bengen's 4% rule
 - Alan should plan for \$2.5M to be safe.

Alan's Accumulation Phase

- How do we get from \$0 on Graduation Day to the \$2.5M required in the retirement portfolio on Retirement Day?
- Assume Alan starts saving for retirement at age 35 and continues contributing to his portfolio until age 70, i.e. for 36 years
- \$15,000 pa for 36 years → \$2.2M at age 70

Today's \$, assuming 7% CAGR

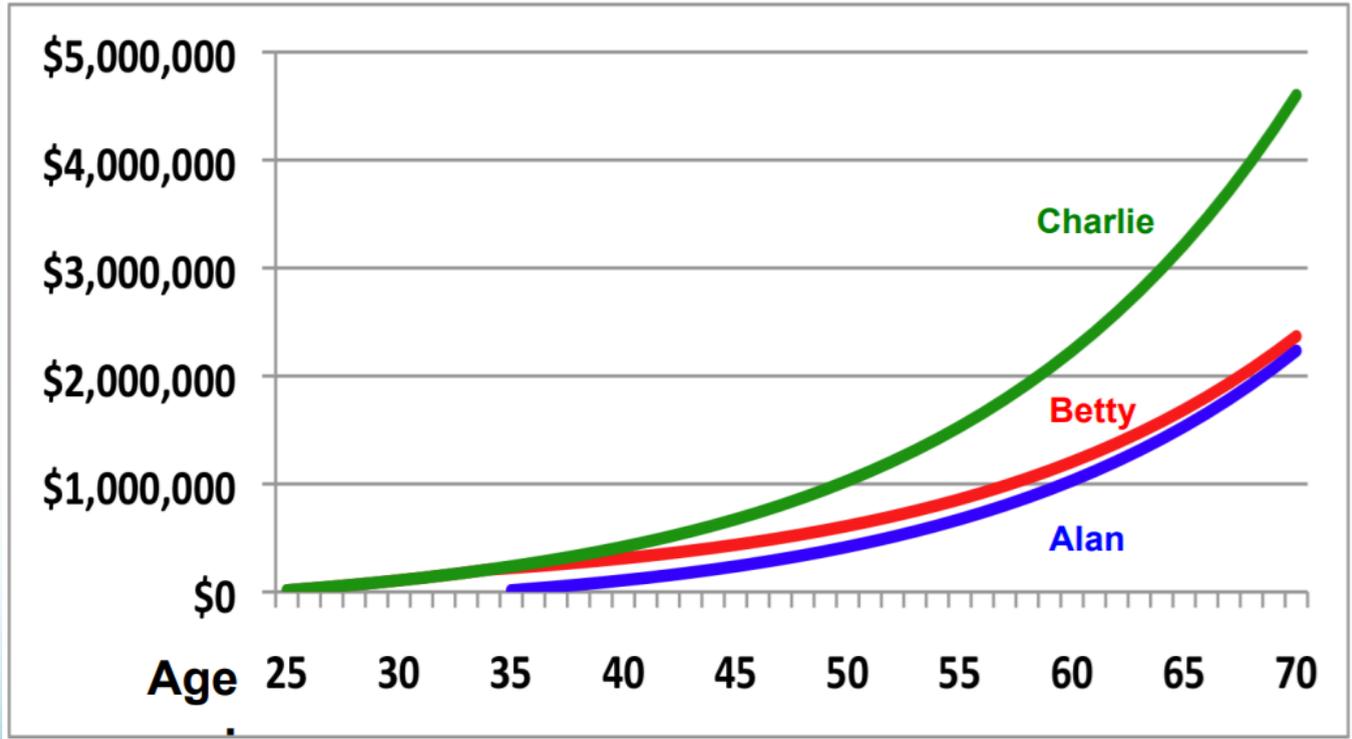
Meet Betty

- Betty is the same age as Alan, and graduated the same year
- She also works at Giggle and earns the same salary as Alan
- But she starts saving for retirement at age 25
- Then she drops out of the workforce at age 35, no longer contributes to her retirement portfolio
- \$15,000pa for 10 years → \$2.4M at age 70

Meet Charlie

- Charlie was a classmate of Alan and Betty and started with them at Giggle
- Charlie started contributing to his retirement plan at age 25, and continued making contributions to age 70
- \$15,000pa for 46 years → \$4.6M at age 70

Let's Compare The Three Plans



Are You On Track For Retirement?

- Recommendations from T. Rowe Price

If you are	Aim to have	0.5x salary saved
30		
35		1x
40		2x
45		4x
50		6x
55		8x
60		10x

FS opinion: 65 Need 15x-20x-25x for 4% withdrawal

- Save at least 15% of your current gross salary
- Michael Kitces: Avoid “lifestyle creep”
 - Goal: 30x current lifestyle expenses for 3.3% withdrawal

Tax Advantaged Retirement Plans

- Employee salary deferral plans
 - Traditional IRA, Spousal IRA, Non-deductible IRA
 - Roth IRA
- Employer sponsored plans
 - 401(k) and 403(b) plans
 - 401(k) and 403(b) Roth plans
 - SIMPLE
 - SEP
 - Individual 401(k) plans
 - Non-Qualified Deferred Compensation Plans
- Pseudo retirement plan
 - Health Savings Account, HSA

Traditional IRA

- Contributions are may be deductible from 1040 income
 - Maybe eligible for Saver's Credit
- Growth within the plan is tax-deferred
- Withdrawals after age 59.5 are taxed as ordinary income
- Withdrawals before age 59.5 are assessed a 10% federal penalty (some exceptions) and possible additional state penalty (2.5% in CA)
- Required minimum withdrawals (RMD) start at age 72
- Failure to take RMD triggers 50% penalty

Traditional IRA Limits

- Must have reportable income
- Contribution limits for 2022:
 - \$6,000 pa, plus extra \$1000 pa catch-up if age 50 or over
- Who is eligible to deduct their IRA contribution?
 - Anyone not covered by an employer retirement plan
 - For those covered by an employer retirement plan

Modified Adjusted Gross Income, MAGI, in 2022

< \$68,000 - \$76,000 for singles

< \$109,000 - \$129,000 for married filing jointly

IRA Rollovers

- Individuals can withdraw funds tax-free from a traditional IRA if they are deposited within 60 days to another IRA
- IRS allows only 1 personal rollover per person every 12 months regardless of the number of IRAs owned (not calendar year)
- Solution is to do a trustee-to-trustee transfer
 - No limit on the number of these rollovers allowed

Required Minimum Distributions, RMDs

- Must start withdrawals at age 72
- RMD is based on age and life expectancy

	<u>2021 Table</u>	<u>2022 Table</u>
Uniform Lifetime Table at age 72	25.6 years	27.4 years
RMD percent	3.91%	3.65%
RMD = % of account value Dec 31 st of the previous year		

- Draconian penalty for missed RMD
 - Penalty is 50% of RMD not taken

IRS RMD Tables

- Table I: Single Life Expectancy
 - For use by beneficiaries
- Table II: Joint Life and Last Survivor Expectancy
 - IRA owner
 - Married and spouse is the sole beneficiary and is more than 10 years younger
- Table III: Uniform Lifetime
 - IRA Owner
 - Unmarried
 - or Married and Spouse is not the sole beneficiary or is not more than 10 years younger

Other IRAs

- Non-deductible IRA
 - Available to those who do not meet the MAGI limit
 - Same contribution limits as the traditional IRA
 - but contributions are not deductible on 1040
 - Earnings on account grow tax-deferred
 - After-tax contributions are withdrawn tax free
 - Cost basis is pro-rated
 - Earnings are taxed as ordinary income on withdrawal
- Spousal IRA
 - Similar to a traditional IRA for a spouse with little or no income
 - Same contribution limits and tax treatment

Roth IRA

- Contributions are not deductible
 - Growth within the plan is tax-free
 - Can withdraw contributions any time for any reason
- Qualified withdrawals of earnings are tax-free
 - After age 59.5
 - Original plan must be > 5 tax years old
 - Otherwise there is a 10% fed penalty plus state penalty except \$10,000 for first home purchase education expenses, medical expenses, etc
- No required minimum distributions
- Good estate planning tool

Roth IRA Limits

- Who can contribute in 2022
 - Income limits
 - \$129,000 - \$144,000 for single taxpayers
 - \$204,000 - \$214,000 married filing jointly
- Contribution limits same as for traditional IRA
 - \$6,000 pa plus \$1,000 catch-up for age 50 or older

Roth Conversions

- Anyone can convert a traditional IRA to a Roth IRA
 - Will owe taxes on deductible portion of contributions and the earnings
- Consider partial conversions to fill up to the top of your current tax bracket
- Can no longer recharacterize a conversion
- Must wait 5 years before withdrawing any converted balances (contributions or earnings)
 - Otherwise if under 59 ½ there is a 10% federal penalty plus state penalty on withdrawal

The “Backdoor” Roth

- Can be used when AGI exceeds Roth limits
- Make a non-deductible contribution to regular IRA
- Then convert the non-deductible IRA to your Roth IRA
- IRS “pro-rata rule” requires total of all IRAs be used to compute the tax owed on conversion
 - Best when there are no other IRAs
 - Beware the pitfall of rolling old 401(k) plans into an IRA when changing jobs
 - Move all pre-tax dollars to 401(k) or 403(b) plans
 - Not included in computation for Roth conversion
 - Convert all after-tax contributions to the Roth IRA

Proposed Build Back Better Changes

- Prohibit converting after-tax assets (Backdoor Roth) from eligible plans to a Roth IRA
- High-income individuals with large retirement balances could not contribute to an IRA
- Additional RMDs on high-income individuals with high retirement plan balances

Traditional 401(k) Plan

- Employer sponsored pension plan allowing employees to defer pre-tax salary
- Employer may require up to 1 year of service before eligible
- Tax implications same as for traditional IRA
 - Pre-tax contributions
 - Earnings grow tax-deferred
 - Distributions taxed as ordinary income
 - 10% federal penalty plus state penalty for early withdrawal < age 59.5
 - RMDs start at age 72; Missed RMD = 50% penalty

Traditional 401(k) Limits

- Limits: \$20,500 + \$6,500 for age 50 or over (2022)
- Employer matching contribution
 - Most common match 50% of first 6%
 - Vesting schedule (up to 6 yrs) for employer contributions
 - Employee contributions always fully vested
- Sponsor must do Average Deferral Test (ADP) to limit benefits for Highly Compensated Employees (HCEs)
- Employer may allow additional after-tax contributions
IRS limits = \$61,000 + \$6,500 catch-up for age 50 or over
- Catch-up is a combined limit for all 401K contributions
- Participant loans allowed by some plans (Beware!)

Responsibilities of 401(k) Plan Sponsor

- The plan sponsor has a fiduciary duty to act in the best interest of the plan's participants
 - Selection and ongoing monitoring of service providers
 - Understand where all the fees are hidden
 - Provide a diverse selection of low cost funds, and benchmark these regularly regarding performance, fees
- If the plan sponsor does not offer an acceptable plan, and live up to its fiduciary obligations, the employee should
 - Discuss the problem with the sponsor and/or HR dept
 - Try to add a few index funds and/or a brokerage window
 - Document problems, perhaps signed by fellow employees
 - Consider legal action
 - c.f. Boeing \$57M and Lockheed Martin \$62M settlements

403(b) Plan

- Usually sponsored by not-for-profit organizations, educational groups, local governments, etc. for the benefit of their employees
 - Teachers, Police, Firemen, etc.
- Similar to a traditional 401(k) plan in most respects

Roth 401(k) and Roth 403(b) Plans

- Similar to traditional 401(k) and 403(b) plans except
 - Contributions are not tax deductible
 - No taxes are due on plan earnings
 - No taxes are due on withdrawals
- RMDs apply at age 72 unless still working for the employer offering the plan
 - Verify RMD plan rules

Savings Incentive Match Plan for Employees, SIMPLE IRA

- Usually set up by small employers
 - Must be 100 or fewer employees
- Employee contributions are optional
 - Limits for 2022
\$14,000 pa + \$3,000 catch-up if age 50 or older
- Employer matches employee contribution \$ for \$
 - Up to 3% of employee compensation
 - Or fixed 2% of all employees' compensation above \$5000 pa, even if some employees choose not to participate
 - Cap on compensation: \$305,000 for 2021

Simplified Employee Pension Plan (SEP) IRA

- For use by small business owner or if you have self-employed income from consulting work, etc.
- Works well for married couple in a family business
- 2022 limits = lesser of 25% of income or \$61,000
- Contribution limits are not affected by participation in traditional or Roth 401(k) plans
- Distributions are taxed as ordinary income
- Can convert to a backdoor Roth year after year
 - Get professional help!

Individual 401(k) Plan

- Suitable for sole proprietors or partners
 - No common-law employees
 - Can contribute as employer and/or employee
- No age or income restrictions
- Employee pre-tax or Roth contributions
 - Limits for 2022
 - \$20,500 + \$6,500 catch-up if age 50 or older
- Employer contributions
 - Limit 25% of compensation
- Limits on total contributions 2022
 - \$61,000 for 2021. plus \$6,500 for age 50 or older

Non-Qualified Deferred Compensation Plans (NQDC Plans)

- Set up by company to benefit well-paid non-owner employees, i.e. officers, executives, managers
- Company owners cannot receive favorable tax treatment
- No Internal Revenue Code limit on deferral amount, but plan may impose limits
- No Internal Revenue Code limit on withdrawal time, but plan may impose limits; “Golden handcuffs”
- Distributions are taxable on receipt
 - Cannot be rolled over to a traditional or Roth IRA
- Risk: NQDC remains in company’s general assets
 - Not protected in bankruptcy, even in a “rabbi trust”
- Get professional help!

Which Retirement Plan Should I Fund First?

1. Fund traditional 401(k) or 403(b) up to match limit first (free money!)
2. Then contribute to Roth IRA up to limit
3. Back-door Roth IRA
4. Complete post-match funding of 401(k), 403(b)
5. SEP IRA
6. Traditional IRA
7. Taxable brokerage account

Health Savings Account

- Eligibility
 - Must have a high-deductible health insurance plan
 - Cannot be on Medicare
- Triple tax benefits
 - Contributions are tax-deductible
 - Investments grow tax-free
 - Qualified medical distributions are tax-free
 - Distributions for non-medical expenses are taxed as ordinary income
- Contribute up to \$3,600/person, \$7,200/family plus \$1,000 catch-up if age 55 or older
- Can make withdrawals after you no longer qualify for contributions

Asset Location

- Tax-inefficient products
 - Corporate bonds and bond funds, zero-coupon bonds, active funds
 - Generate interest and non-qualified dividends and short-term capital gains
 - These are best in tax-advantaged accounts such as IRAs, Roth IRAs, 401(k) accounts
- Tax-efficient products
 - Muni bonds, ETFs, index funds, collectibles
 - Generate qualified dividends and long-term capital gains
 - These are best in taxable accounts

QCD – Qualified Charitable Distribution

- Many IRAs are eligible – Traditional, Rollover, Inherited, SEP (inactive plans only), and SIMPLE (inactive plans only)
- IRA Owner must be over 70 ½
- Direct transfer from administrator to qualified charity
 - Donor Advised Fund is not qualified
- Counts towards RMD
 - Owner must keep track of QCDs to report as non-taxable distribution on their tax return
- Maximum \$100,000

Estate Planning Issues

- Federal estate tax exemption = \$11.7M in 2021
 - Sunsets in December 2025
- Be careful with income tax efficiency:
 - Roth accounts are best
 - No taxes owed.
 - Taxable accounts are good
 - Step-up in basis; no tax if sold immediately
 - Tax deferred IRA accounts are worst
 - Unfavorable tax treatment; no step-up in basis
 - Owe ordinary income tax on distributions
 - Spouse can assume an IRA at death; Stretch RMDs
 - Consider leaving to charity
- Talk to your estate planning attorney!

Inheriting IRA Assets: The “Stretch IRA”

- The SECURE Act (December 2019) eliminated the Stretch IRA except for ...
 - Surviving spouse of original owner
 - Must transfer to the surviving spouse within 10 yrs
 - Minor child < age of majority
 - Person >10 years younger than the decedent
 - Disabled individuals
 - Chronically ill individuals
- For all others the account must be completely distributed within 10 years of the original owner’s death, but there are no annual RMD requirements
- Important to educate heirs now about options
- Talk to your estate planning attorney!

Important to Review Beneficiary Forms Regularly

- Have there been any
 - Births, Deaths
 - Consider designating contingent beneficiaries
 - Marriages, Divorces
 - Marriage/Remarriage often voids beneficiary designations – This is a recent change
 - Beneficiaries reaching the age of majority
- Most retirement accounts pass by contract and not by will or trust

Important to Review Beneficiary Forms Regularly

- TOD accounts also pass by contract and not by will or trust
- Beneficiary designations are often lost when the plan administrator changes
- DIY Estate Planning is strongly NOT recommended. Mistakes can be expensive and not correctable. Get professional help!

What If I Can't Stretch My Portfolio to Age 100?

- Possible solutions to longevity challenge
 - Start saving earlier (Talk to your kids, grand-kids!)
 - Save more during working years
 - Work longer
 - Reduce withdrawals
 - Downsize home, move to a cheaper area
 - Seek higher returns (more risk)
- Other possible solutions
 - Tap into home equity; Reverse mortgage
 - Buy insurance; Annuity

FHA Reverse Mortgage for Seniors

- Home Equity Conversion Mortgage (HECM)
 - Insured by the Federal Housing Administration
- Requirements
 - Be 62 years of age or older
 - Own property outright or have significant equity
 - Occupy property as principal residence
 - Continue to pay property taxes, insurance, and maintain the property
 - Not be delinquent on any federal debt
 - Must undergo counseling, financial assessment

How Much Can I Borrow?

- Maximum loan
 - Lesser of appraised value or \$970,800 (2022)
 - Adjusted for age of the youngest borrower and the interest rate
- Form of loan
 - Lump sum
 - Monthly payments
 - Line of credit (non-cancellable)
 - Combination of the above
- Repayment due on sale, no longer primary residence or death of owner

Costs for a HECM

- Interest, accumulates on loan
- Mortgage insurance premiums
 - Initial: Typically 0.5% of home value
 - Annual: 1.25% of outstanding loan balance
- Closing costs
 - Appraisal, title search, inspections, taxes, etc.
- Origination fee: 1% to 2% capped at \$6,000
- Servicing fees: Capped at \$35 per month
- Most fees rolled into loan; many waived by mortgage lender

HECM Line of Credit

- Converts home equity into easily accessible funds
- No monthly payments on principal or interest
- Lender cannot reduce or cancel line of credit
- Unused line of credit grows over time
- Non-recourse loan, i.e. can never owe more than the home is worth when the loan is repaid
- Can be converted to a monthly cash flow at any time

Uses for a HECM Line of Credit

- Defer Social Security benefits to late retirement
- Allows smaller short term cash bucket
 - Reduces opportunity cost of “dead money”
- Provides flexibility in long-term investment bucket
 - Reduces sequence of returns risk, i.e. need to sell assets in bear markets
- Can extend life expectancy of retirement portfolio
- Can provide living expenses if retirement portfolio is exhausted

Consider an Annuity

- Single premium immediate annuity, SPIA
 - Benefit starting immediately
 - \$1000/month, i.e. \$12,000 pa
 - Cost for 65 year old male: \$211,416 (Jan 2021)
 - Cash flow = 5.7% per annum
- Single premium deferred annuity, SPDA
 - Benefit starting at age 85
 - \$1000/month, i.e. \$12,000 pa
 - Cost for 65 year old male: \$39,385 (Jan 2021)
 - Cash flow = 30.5% per annum

Retirement Planning Software

- Available free from most financial houses
 - T Rowe Price, Vanguard, Fidelity, Schwab, AARP, etc.
- Inputs
 - Marital status
 - Age, spouse's age, target retirement age, etc.
 - Income: Salary, Social Security benefits, etc.
 - Expenses: Fixed expenses, variable expenses
 - Portfolio size and return, inflation rate, etc.
- Output
 - Shortfall or surplus, required savings rate, etc.
 - Confidence level from Monte Carlo simulations
 - Remaining balance data

Problems With Retirement Planning Software

- Beware precision output to 5 significant figures
 - Garbage in ... Garbage out
- Output is only as good as the input assumptions
 - Life expectancy; actuarial tables only give averages
 - Rate of return assumptions for portfolio
 - Sequence of returns risk
 - Tax rate forecast in retirement
 - Inflation estimate
- Compounding the “known unknowns” 35 years into the future is not an exact science!

“Too err is human; to really screw up you need a computer!”

Best Uses for Planning Software

- Learning tool
 - Provides a feel for how all the pieces play together
 - Guides the safety first versus lifestyle trade-off
- Scenario analysis
 - What if I work for 2 extra years?
 - What if I delay taking Social Security benefits to age 70?
- Sensitivity analysis
 - What if the return on my portfolio is 5% instead of 7%?
 - What if inflation is only 2%? How about 4%?
- Even a rough plan is much better than no plan
 - Re-evaluate the plan annually

To Probe Further

- *Want to Create a Retirement Paycheck? ...*, Carrie Schwab-Pomerantz, December 2020
- *Many Retirees Limit Withdrawals to the RMD Amount*, AAll Journal, November 2020
- *Estimating the End (of Retirement)*, David Blanchett, Morningstar, April 2020
- *Converting to a Roth IRA Can Minimize RMDs*, Judith Ward, AAll Journal, March 2015
- IRS Publication 590
- *How to Invest in an Annuity*, Christine Benz, Morningstar, September 30, 2020
- *Can You Save too Much in a Health Savings Account?*, Christine Benz, Morningstar, September 25 2020

Useful Websites

- <http://aaii.com> Broad selection of investing material
- <http://siliconvalleyaaii.org> Previous presentations on various topics
- <https://scld.org/resources/business/> Business & Money
Morningstar Research Center, S&P's NetAdvantage, Value Line
- <https://portfoliovisualizer.com> Free access to a wide selection of tools
- <https://vanguard.com> <https://fidelity.com> <https://schwab.com>
- <https://www.personalcapital.com/financial-software/retirement-planner>
- <https://caniretireyet.com/the-best-retirement-calculators/> Darrow Kirkpatrick
- <https://Livingto100.com> Calculates your life expectancy
- <https://Reversefunding.com> FAQs on reverse mortgages
- <https://Immediateannuities.com> Easy annuity quotes

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