The Roth 401(k): Is It Right For You?

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THE MINUTIAE

If you think contributing to a Roth 401(k) may make sense for you, consider the following items:

1. If you divert your contributions to a Roth 401(k) from a traditional 401(k), you will experience a decline in your take-home pay as Roth 401(k) contributions are made with after-tax money. The amount of the decline will be greater if you are in a higher tax bracket.

2. Switching to a Roth 401(k) will cause your taxable income to increase; consequently, your eligibility for certain tax credits and deductions may be reduced, such as for daycare expenses and educational costs.

3. Unlike a Roth IRA, for which you must be under certain income limits in order to qualify, the Roth 401(k) has no such limitation. Remember that diverting your contributions from a traditional 401(k) to a Roth 401(k) increases your taxable income and, depending on your income level, may disqualify you from making Roth IRA contributions.

4. If your employer matches your Roth 401(k) contributions, the match will still be on a pre-tax basis. Thus, you will owe income taxes on the matching funds when withdrawn in retirement.

5. After age 70½, you will be subject to required minimum distributions (RMDs) from your Roth 401(k). However, you can avoid RMDs by rolling your Roth 401(k) balance into a Roth IRA.

Although the Roth 401(k) is a retirement investment account, the decision as to whether to contribute to such an account relative to a traditional 401(k) is really a tax question. We encourage our affected clients to check with their tax preparer as to whether the traditional 401(k) or the Roth 401(k) is best-suited for their particular situation.

Lou Conrad Named To Fidelity Advisor Council

Louis E. Conrad II, CFA, COMPASS Wealth Management's founder and president, was recently asked to join Fidelity Institutional Wealth Services' Advisor Council. The Council, comprised of 13 individuals representing registered investment advisory firms throughout the country, provides feedback to Fidelity on its current and contemplated products and services, as well as provides Council members with access to the industry's thought leaders. Council membership is expected to last one year.

When To Begin Collecting Social Security Benefits

At present, the long-term prospects for the Social Security system are rather bleak. Each year, if you have paid into the system, you receive a statement from the Social Security Administration (SSA). On page one of the statement, the SSA now states the following:

> …the Social Security system is facing serious financial problems, and action is needed soon to make sure the system will be sound when today's younger workers are ready for retirement. In 2017 we will begin paying more in benefits than we collect in taxes. Without changes, by 2041 the Social Security Trust Fund will be exhausted and there will be enough money to pay only about 75 cents for each dollar of scheduled benefits.

With the solvency of Social Security in the spotlight and retirement fast approaching for many of our clients, we are frequently asked at what age you should begin collecting your Social Security benefits. Well, as is often the case, it depends upon your specific situation.

FULL RETIREMENT AGE

To determine whether it makes sense to retire early, we first need to determine what Social Security considers "full retirement age" or "normal retirement age". It varies based on the year of your birth.

Year of Birth	Full Retirement Age
1937 or earlier	65
1938—1942	65—66*
1943—1954	66
1955 —1959	66—67*
1960 and later	67

* SSA uses a graduated retirement age depending on the actual year of birth.

REDUCED BENEFIT AT 62

If you retire at your full retirement age, then you will receive your full Social Security benefits. However, if you retire prior to reaching your full retirement age, then your benefits will be reduced permanently. Under normal circumstances, the earliest you can begin collecting reduced benefits is upon reaching 62 years of age. The later your birth year, the more your benefits are reduced by retiring at age 62.

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When To Begin Collecting Social Security Benefits

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Year of Birth	Full Retirement Benefit Reduced By
1937 or earlier	20%
1938—1942	21%—24%*
1943—1954	25%
1955 —1959	26%—29%*
1960 and later	30%

* SSA uses a graduated benefit reduction depending on the actual year of birth.

As indicated in the tables above, someone who was born in 1960 would suffer a permanent 30% reduction in benefits by retiring at 62 rather than their full retirement age of 67. Of course, you could begin collecting after 62 but before your full retirement age, though for simplicity we have only provided data if retirement occurs at 62.

COLLECT BENEFITS EARLY?

Whether to begin collecting Social Security benefits prior to your full retirement age depends upon your circumstances. You may want to collect early if:

1. Without your Social Security benefit you are unable to cover your living expenses.

2. You are in poor health or do not expect to reach your normal life expectancy based on family history or other factors.

SSA provides a "Break-Even Age" calculator on its Web site (www.socialsecurity.gov) to assist you in determining at what age the accumulated value of receiving lower benefits early is surpassed by the accumulated value of receiving higher benefits later. If you expect to live beyond the "break-even age", then it would be to your economic advantage to delay your retirement until at least your full retirement age.

COLLECT BENEFITS LATE?

If you delay collecting your benefits until after your full retirement age, you will be eligible for delayed retirement credits that increase your normal benefit. However, note that no credits are earned for delaying retirement past age 70.

Year of Birth	Annual Benefit Increase For Delayed Retirement
1933—1934	5.5%
1935—1936	6.0%
1937—1938	6.5%
1939 —1940	7.0%
1941—1942	7.5%
1943 and later	8.0%

Aside from the Social Security system's projected long-term financial stress, and the likelihood that either benefits will be reduced and/or taxes will be increased in the future to strengthen the system, the decision of when to begin collecting your Social Security benefits should be based on your particular circumstances. Remember that Medicare will not cover you, under most circumstances, until you reach age 65. Consequently, retiring prior to 65 may leave you without health care insurance unless you maintain coverage under your employer's plan or you have coverage through a spouse's policy.

Did You Know...The Cost Of Long-Term Care Insurance

Depending upon a client's specific circumstances, we often recommend long-term care insurance to help offset the potential cost of care at home or in a skilled care facility. The cost of a nursing home can run in excess of $100,000 annually and can quickly deplete your savings. Normally such costs are not incorporated into a retirement plan; consequently, a lengthy nursing home stay can leave you with insufficient assets for your retirement. Long-term care insurance can offset a portion of these costs.

Clients often ask how much such insurance costs. While premiums vary based on the initial age of the insured and the extent of the coverage, a survey released recently by the American Association for Long-Term Care Insurance provides some guidance. For example, the annual premium for a basic level of coverage for a 55-year-old with a $150 daily benefit averages $1,027,[1] while the annual premium for similar coverage, but with a $240 daily benefit, averages $4,823 for a 65-year-old.[2]

[1] This premium assumes a maximum 3-year benefit period for an individual who qualifies for preferred health and spousal discounts. It also includes an inflation rider of 5% compounded annually.
[2] This premium assumes a maximum 3-year benefit period for a single individual with standard health. It also includes an inflation rider of 5% compounded annually.

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