



Raymond James & Associates, Inc.

Rick Hadrava
SVP Investments/Branch
Manager
6301 North Western
Avenue
Suite 200
Oklahoma City, OK 73118
877-280-2243
405-471-2777
rick.hadrava@raymondjames.com
www.moneytalkokc.com

In this issue:

401(k) In-Plan Roth
Conversions

Rising Interest Rates: The
Downside of Economic
Recovery

A/B and A/B/C Trusts

What health-care changes
become effective in 2011?

Wealth Management Monthly

Solutions To Help Secure Your Financial Goals

April 2011

401(k) In-Plan Roth Conversions



You may have heard the buzz ... 401(k) plans can now permit in-plan Roth conversions. But is this an option for you?

What is it?

A 401(k) in-plan Roth conversion (also called an "in-plan Roth rollover") allows you to transfer the non-Roth portion of your 401(k) account into a designated Roth account within the same plan. The amount you convert is subject to federal income tax in the year of the conversion (except for any nontaxable basis you have in the amount transferred), but qualified distributions from the Roth account in the future are entirely income tax free. The 10% early distribution penalty doesn't apply to amounts you convert (but that tax may be reclaimed by the IRS if you take a nonqualified distribution from your Roth account within five years of the conversion).

What part of my account can I convert?

Here's where it gets a bit tricky. Assuming your 401(k) allows in-plan conversions (plans aren't required to), you have to be entitled to a distribution from the plan in order to make a conversion. For example, you're generally entitled to a distribution from your 401(k) plan after you terminate employment. If your account balance is greater than \$5,000, you also have the right to keep your money in the plan until you reach normal retirement age (typically 65). So in this case, your plan may allow you to transfer all or part of your account into a Roth account (except for any required distributions and certain periodic payments).

But what if you're still employed? If you want to transfer your pretax contributions and earnings into a Roth account, you'll generally only be able to do so if you're age 59½ or disabled, or you've received a qualified reservist distribution, because those are the only events that can trigger an eligible distribution (hardship withdrawals aren't eligible for rollover or conversion). In some cases, your vested employer contributions (and earnings) may also be available for distribution while you're still

employed--for example, after the contribution has been in the plan for two years, or after you have 60 months of participation (the terms of your plan, and federal law, control). If your plan allows these distributions, it can also allow them to be converted.

Keep in mind that if you're entitled to an eligible rollover distribution, you can always roll those dollars into a Roth IRA instead of using an in-plan conversion.

Some employers aren't comfortable letting employees withdraw their retirement funds while they're still employed. The IRS has addressed this concern by letting 401(k) plans provide for the in-service distributions described above *only* if the employee intends to convert those funds. For example, a plan that currently doesn't let employees withdraw pretax dollars at age 59½ can be amended to allow those withdrawals, but only if an employee intends to roll those dollars into a Roth account--the employee would not be allowed to actually take a distribution of the funds, or roll the dollars over into an IRA.

What else do I need to know?

If you have the choice of an in-plan conversion or a rollover to a Roth IRA, which should you choose? There are a number of factors to consider:

- You can recharacterize (undo) a Roth IRA conversion if the conversion turns sour (for example, the value of the converted assets declines significantly), but you can't recharacterize in-plan conversions.
- In general, the investments available in an employer 401(k) plan are fairly limited, while virtually any type of investment is available in an IRA (on the other hand, your 401(k) plan may offer investments that you can't replicate in an IRA, or that aren't available at similar cost).
- Finally, 401(k) plans typically enjoy more protection from creditors under federal law than do IRAs (consult a professional if creditor protection is important to you).

Rising Interest Rates: The Downside of Economic Recovery

Over the last several years, investors have grown accustomed to historically low interest rates. Ever since the Federal Reserve Board's target fed funds rate--the rate at which banks lend to one another--hit a high above 19% in mid-1981, the long-term direction of rates has been downward. In the last decade, the Fed's data* shows the target rate has never been much higher than 6%. And since December 2008, the Fed has kept it at a previously unheard-of level between 0.25% and zero to try to ensure that credit would be available to promote economic recovery.

Because bond prices typically rise when interest rates fall, that decline in yields has produced a bull market in bonds over the last decade. But what happens when the trend reverses? Even if they continue to remain relatively stable for a while, ultra-low interest rates have nowhere to go but up. When the economic recovery begins to show signs of strength, at some point the Federal Reserve Board will begin to raise the target rate again. When that happens, bond prices also will begin to reverse their long-term direction.

Here are some factors to consider in anticipation of a future with rising interest rates.

Bond maturities: when short is sweet

When interest rates rise, longer-term bonds typically feel the impact the most. In an extended period of rising interest rates, bond buyers become reluctant to tie up their money for longer periods because they foresee higher yields in the future; the later the bond's maturity date, the greater the risk that its yield will eventually be superseded by that of newer bonds. As demand drops and yields increase to attract purchasers, prices fall.

There are various ways to manage that impact. If you own individual bonds, you always have the option of holding them to maturity; in that case, you would suffer no loss of principal unless the borrower defaults. Bond investments also can be laddered. This involves buying a portfolio of bonds with varying maturities; for example, a five-bond portfolio might be structured so that one of the five matures each year for the next five years. As each bond matures, it can be reinvested in an instrument that carries a higher yield. Laddering also can be used with certificates of deposit (CDs).

If you own a bond fund, you can check the average maturity of the fund's holdings, or the fund's average duration, which takes into account the value of interest payments and will generally be shorter than the average maturity.

The longer a fund's duration, the more sensitive it may be to interest rate changes.

Rising rates and other assets

Higher interest rates often are an attempt to prevent rising prices. When prices go up, purchasing power goes down, including the purchasing power of a bond's fixed interest payments. That can make bonds less attractive to buyers. However, not all investments are hurt by higher prices. For example, commodities such as oil and wheat typically do well in inflationary periods; in fact, increases in commodity prices are often what trigger a bout of inflation. If you're primarily interested in the overall value of your portfolio rather than a regular income stream, your financial professional can help you explore whether you should consider diversifying into asset classes that tend to benefit from inflation and that might help counteract the potential impact of falling bond prices.

Though bonds are affected most directly, equities aren't necessarily immune to rate increases. Though many companies borrowed money in recent years to take advantage of low rates and postpone the need to issue bonds for some time, those that haven't may see their borrowing costs increase, which could affect their bottom lines. Even those that squirreled away cash could be hit when they return to the bond markets eventually. Also, if interest rates rise to a level that's competitive with the return on stocks, that could reduce investor demand for equities.

Higher rates aren't all bad news

For those who've been diligent about saving, or who have kept a substantial portion of their investments in cash, higher rates could be a boon. Savings accounts, CDs, and money market funds are all likely to do better at providing income than they have in recent years. The downside, of course, is that if higher rates are accompanied by inflation, such cash alternatives might not keep pace with rising prices. And bear in mind that a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the fund seeks to preserve the value of your investment at \$1 per share, it is possible to lose money investing in a money market fund.

**Source: Federal Reserve Statistical Release Historical Data for Fed funds rate weekly since 1954.*



Bonds don't respond uniformly to interest rate changes. The differences, or spreads, between the yields of various types of debt, such as corporate, government, emerging market, and municipal debt, can mean that some bonds are under- or overvalued compared to others. Don't forget that the total return on bonds is a combination of yield and price return. Financial professionals have many ways to adjust a bond portfolio to help you cope with rising rates.

A/B and A/B/C Trusts

If you're married, a combination of trusts, often referred to as A/B, A/B/C, or A/B/Q trusts, may be useful for estate planning purposes. The combination of trusts can sometimes be used to minimize total estate tax for two spouses, and can provide nontax benefits as well.

A federal estate tax overview

- An unlimited marital deduction is generally available for transfers of wealth between you and your spouse.
- Currently, an estate of \$5 million can be sheltered by a \$5 million basic exclusion amount and a tax rate of 35% applies to any excess. Any unused portion of the basic exclusion of a deceased spouse is portable and can be transferred to a surviving spouse. The \$5 million amount will be indexed for inflation in 2012.
- Absent further legislation, in 2013, the amount that can be sheltered is reduced to \$1 million, the top estate tax rate increases to 55%, and the basic exclusion amount is no longer portable.

The A, or power of appointment marital, trust

The A trust is structured to qualify for the marital deduction. You give your surviving spouse a right to all of the trust's income for life and the power to appoint who receives the trust property at your spouse's death. You would typically fund the A trust (together with a Q trust, if desired) with the amount of your estate in excess of the applicable exclusion amount.

The B, or bypass credit shelter, trust

You would typically fund the B trust with an amount equal to the applicable exclusion amount, or credit shelter amount. You can give your spouse interests in the B trust, but generally none that would cause the trust to be includable in your spouse's estate for estate tax purposes (thus, the B trust bypasses your spouse's estate). You can name the persons who will receive trust income or other distributions from the trust. You can also provide that, at your spouse's death, the trust will continue for the benefit of, or be distributed to, your children or other beneficiaries. Or, you could give your spouse a limited power to appoint property among a limited class of beneficiaries, such as your children from your current marriage.

The C, Q, or QTIP marital, trust

The C or Q trust, typically a QTIP trust, is also structured to qualify for the marital deduction.

You give your surviving spouse a right to all of the trust's income for your spouse's life.

However, you retain for yourself the right to designate who receives the property at your spouse's death. This can be useful when you have children from a prior marriage who you would like to benefit after your spouse's death. You would typically fund the C trust (together with an A trust, if desired) with the amount of your estate in excess of the applicable exclusion amount.

Everything to spouse versus A/B trusts

Because the exclusion amount is higher and portable in 2011 and 2012, some couples may think they do not need A/B or A/B/C trusts. Everything could be left to the surviving spouse who uses both spouses' exclusions. However, there are still tax advantages to using this basic planning strategy as shown in the following example.

Example: John is married to Mary and has an estate of \$10 million. Assume a \$5 million basic exclusion amount that is indexed and portable and a top estate tax rate of 35%. John leaves \$10 million to Mary at his death. The transfer qualifies for the marital deduction, no estate tax is due, and John's unused \$5 million exclusion is transferred to Mary. Everything (except the unused exclusion) doubles in value. Mary's estate of \$20 million is partially sheltered by Mary's applicable exclusion amount of \$5 million (\$10 million basic exclusion plus John's unused \$5 million exclusion). After estate taxes of \$1,750,000 are paid, \$18,250,000 remains for John and Mary's children.

Assume instead that John leaves \$5 million to Mary in an A trust and \$5 million in a B trust for Mary and their children. No estate tax is due. Everything doubles in value. Mary's estate of \$10 million is sheltered by Mary's basic exclusion amount of \$10 million. No estate tax is due. The entire \$20 million (the \$10 million B trust plus Mary's \$10 million estate) remains for John and Mary's children. By using the A/B trusts, estate tax has been reduced by \$1,750,000, and the tax savings go to John and Mary's children.

Other trust benefits

The use of trusts can also provide other benefits, such as control over who receives your property and when, investment management of trust property for trust beneficiaries, avoidance of probate, and asset protection. To learn more, consult an estate planning professional.

A combination of marital and credit shelter trusts can be used to minimize estate tax on your estates, and can provide nontax benefits as well.

Even with a large and portable federal estate tax exclusion, there are still tax advantages to using A/B trusts.





Raymond James & Associates, Inc.

Rick Hadrava
SVP Investments/Branch
Manager
6301 North Western
Avenue
Suite 200
Oklahoma City, OK 73118
877-280-2243
405-471-2777
rick.hadrava@raymondjames.com
www.moneytalkokc.com

This information was developed by Forefield, Inc. an independent third party. It is general in nature, is not a complete statement of all information necessary for making an investment decision, and is not a recommendation or a solicitation to buy or sell any security. Investments and strategies mentioned may not be suitable for all investors. Past performance may not be indicative of future results. Raymond James & Associates, Inc. member New York Stock Exchange/SIPC does not provide advice on tax, legal or mortgage issues. These matters should be discussed with an appropriate professional.

*Prepared by Forefield Inc,
Copyright 2011*

Ask the Experts



What health-care changes become effective in 2011?

The Patient Protection and Affordable Care Act (PPACA), signed into law in 2010, makes significant changes to our health-care delivery system. Here are

some of the most important changes scheduled to take effect in 2011.

The cost of over-the-counter drugs not prescribed by a doctor can no longer be reimbursed through a health reimbursement account or a health flexible spending account, nor can these costs be reimbursed on a tax-free basis through a health savings account (HSA) or Archer medical savings account. Also, the tax on distributions from HSAs and Archer MSAs that are not used for qualified medical expenses increases to 20% (up from 10% and 15% for HSAs and Archer MSAs respectively).

Medicare Part D participants will receive a 50% discount on brand-name prescriptions filled in the coverage gap (i.e., the "donut hole") from pharmaceutical manufacturers, and federal subsidies for generic prescriptions filled in the coverage gap will start to be phased in.

Also, certain preventive services covered by Medicare are no longer subject to cost-sharing (co-payments), the deductible is waived for Medicare-covered colorectal cancer screening tests, and Medicare now covers personalized prevention plans including a comprehensive health risk assessment.

Medicare Advantage (MA) plans can no longer impose higher cost-sharing for some Medicare-covered benefits than would be imposed by traditional Medicare insurance. Also, MA plans cannot exceed a mandatory maximum out-of-pocket amount for most Medicare services. The maximum amount in 2011 is \$6,700, but MA plans can voluntarily offer lower out-of-pocket amounts. Also, the annual enrollment period for MA plans is changed to October 15 through December 7.

The requirement that employers report the total value of employer-sponsored health benefits on employees' W-2s was to begin in 2011. However, the IRS has deferred this requirement until 2012.



Are some preventive care services free?

Generally yes. Under the Patient Protection and Affordable Care Act (PPACA), qualifying health insurance plans must offer certain preventive care

services to you and your family at no cost.

If your health insurance plan is subject to these new requirements, you and your family may be able to receive important preventive health-care services without having a co-payment, deductible, or co-insurance. Many of the covered services are based on your gender, health status, and age. Some of these services include:

- Blood pressure, diabetes, and cholesterol screenings
- Mammograms, colonoscopies, and many other cancer screenings
- Routine vaccinations against diseases such as measles, polio, and meningitis, as well as flu and pneumonia shots
- Wellness counseling for such issues as quitting smoking and losing weight

- Screenings for depression and alcohol abuse

A current list of preventive care services can be found on the government website: www.healthcare.gov.

To be eligible, you must be enrolled in a health plan through your employer or have individual health insurance put in place after March 23, 2010. The preventive care services will then be effective on the next policy anniversary occurring on or after September 23, 2010, or as of January 1, 2011, for calendar-year plans. If your health plan is "grandfathered" (in place on or before March 23, 2010, and has not been materially changed), these benefits may not be available to you.

Free preventive services may only be available for in-network providers (you may have to pay for preventive services received from an out-of-network provider). Also, if your doctor provides preventive services, such as cholesterol screening, and other diagnostic or therapeutic services during the same office visit, you may have to pay for part of the office visit and the other services given by your doctor, but not the preventive services.