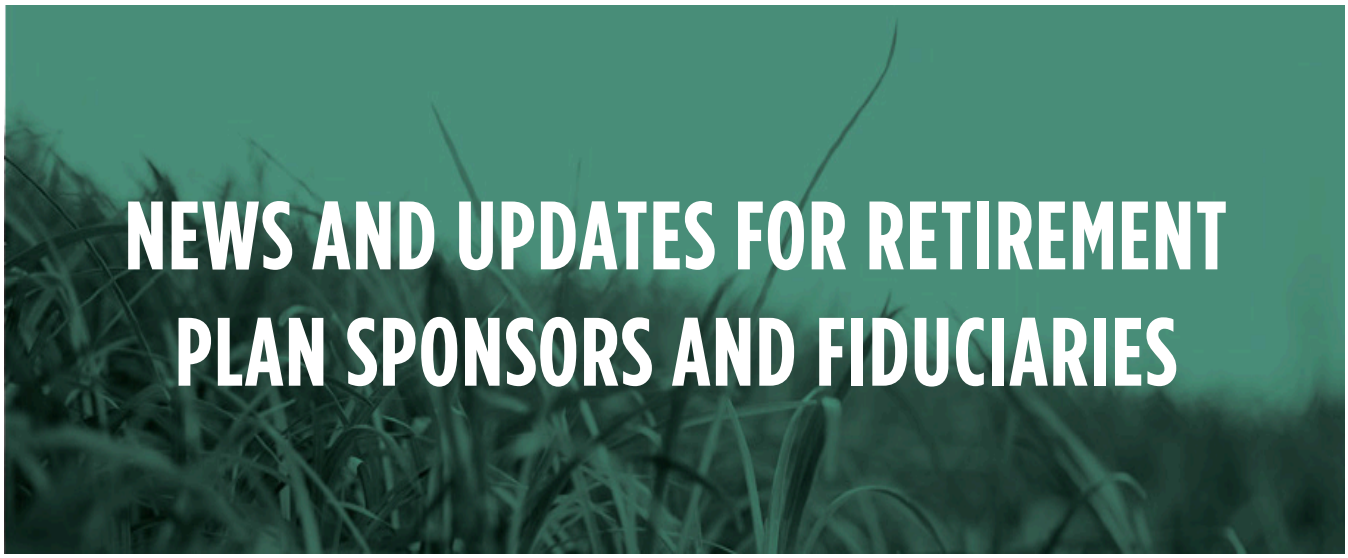
HHM WEALTH ADVISORS DECEMBER 2018

RETIREMENT TIMES



Happy Holidays from HHM Wealth Advisors!

On behalf of everyone at HHM Wealth Advisors, we want to wish you joy and happiness during this special season. Thank you for choosing us to be your dedicated retirement plan advisor. This year we certainly saw plenty of activity in the retirement plan landscape — the end of the DOL's proposed Fiduciary Rule, and a new ruling on hardship distributions. We look forward to 2019 and continuing to keep you abreast of current events within the industry. We are extremely proud to be your retirement plan advisor, protecting you as a fiduciary and helping your plan participants prepare for a meaningful retirement.

As we do each December, this month's Retirement Times highlights excerpts from issues published this year. Please contact us with any questions or feedback; we look forward to serving you in 2019 and beyond!

Warmest Regards,

HHM Wealth Advisors, LLC

Weather or Not, Stay Invested

Issued February 2018

2017 was one of the strongest years on record for hurricanes in the Atlantic region of the United States and among the costliest of seasons on record, with preliminary estimates totaling over $200 billion. This is the second largest season in damages since 1900, with 2005 having a slightly higher total (Hurricane Katrina).[1] For those not directly affected by the hurricanes or other extreme weather events, some often wonder how it might affect them indirectly, via their investments. Article upon article is quickly spewed out, some with catchy titles that contain minimal factual content (example: "Investors Brace for Hurricane Irma"). While these articles succeed at garnering clicks, they can also lead investors to act irrationally, thinking they can time the markets or shift investments due to pending storm damages.

Thankfully, some helpful studies exist that show how markets react to these extreme weather events. The first, from Ishuwar Seetharam at Stanford University, shows that natural disasters do have a small effect on companies who are directly exposed.[2] He looked at over 30 years of data, spanning the top 122 natural disasters. From a timing perspective, the largest effect occurs five days preceding the event to 20 days following. Though this may seem like a no-brainer, other variables can surface which help drive this effect in either direction. For example, if a company has different business lines, or is spread around multiple geographies (to name a few), this can add to or mitigate potential losses.

Diving deeper into the markets by industry, Dubravko Lakos-Bujas, from JP Morgan's U.S. Equity strategy team, claims that distributors and construction materials are the top beneficiaries from hurricanes, while energy and insurance companies fare the worst.[3] He arrived at these conclusions by looking at all of the major hurricane landfalls since 1995. As for the overall market, the losses from hurricane damage tend to revert back to normal levels due to ensuing increases in public and private spending.

Despite a lack of strong evidence from the two studies above, there is another idea that comes from no closer than that of left field, albeit from a highly respected individual. Robert Bruner, dean emeritus and current professor of the University of Virginia's Darden School of Business, believes that Hurricane Katrina (2005) triggered the 2008-2009 financial crisis.[4] Like a domino effect, Katrina caused significant damage to housing in the Gulf Coast states, which then triggered credit card delinquencies, and then sub-prime mortgages fell after that. He also claims that other market downturns were triggered by natural disasters, notably referencing the Mississippi flood of 1927 eventually triggering the Great Depression.

One major lesson learned in investing is that you cannot immediately discredit an idea, no matter how unusual it might be. Professor Bruner's claim might sound strange, but perhaps the overarching claim pertains to vulnerability. Some companies, countries and geographic regions are prepared and built to withstand a natural disaster, either physically, financially or some combination of the two. Both studies above show that certain companies and industries can immediately be affected (via-the stock market) if they are not prepared. Also, keep in mind that a particular company's preparedness (or lack thereof) can already be priced into the market. The long-term effects, though intriguing, are very difficult to assess because they seem tangential (i.e. hindsight is 20/20).

If conducting the research on affected companies and industries while also factoring in investor sentiment seems daunting, we believe it is best to remain diversified and hold for the long-term.

1. *http://time.com/4952628/hurricane-season-harvey-irma-jose-maria/*

2. *https://web.stanford.edu/~ishuwar/Disasters_Stocks_Current.pdf*

3. *https://www.marketwatch.com/story/what-history-says-about-hurricane-irma-and-the-stock-market-2017-09-08*

4. *http://www.cityam.com/277606/floods-hurricanes-and-earthquakes-triggers-financial-crises*

Collective Investment Trusts
The Fastest Growing Investment Vehicle Within 401(k) Plans

Issued August 2018

For almost a century, collective investment trusts (CITs) have played an important role in the markets. They were originally introduced in 1927. A 2016 study showed that they are the fastest growing investment vehicle within 401(k) plans, with 62% of asset managers believing their clients will shift from mutual funds to CITs.[1]

For the vast majority of their existence, CITs were available only in defined benefit (DB) plans. In 1936, CIT use expanded in DB plans when Congress amended the Internal Revenue Code to provide tax-exempt (deferred) status to CITs. CITs then gained widespread adoption in the 1950s when the Federal Reserve authorized banks to pool together funds from pensions, corporate profit-sharing plans and stock bonus plans. The IRS also granted these plans tax-exempt status.

In the 1980s, 401(k) plans became primary retirement plans and mutual funds became the primary investment vehicle, due to daily valuation. In the 2000s, CITs gained significant traction in defined contribution (DC) plans due to increased ease of use, daily valuation and availability. During this time CITs were also named as a type of investment that qualifies as a qualified default investment alternative (QDIA) under the Pension Protection Act of 2006.

THE HISTORY OF COLLECTIVE INVESTMENT TRUSTS

1927	1929	1936	1950s	1980s	2000s	Current
First Collective Investment Trust	CITs seen as a contributor to market crash	CITs restricted to DB plans	CITs gain widespread adoption in DB plans	CITs in Defined Contribution plans mainly stable value funds	NSCC trading of CITs; uncommitted 401(k) funds go to QDIAs (TDFs)	CIT adoption in DC plans
	Stock Market Crash	Congress amends IRS Code	Federal Reserve authorizes banks to pool funds from penions, corporate profit-sharing plans, and stock bonus plans	Advent of 401 (k) plans	**2000**- NSCC adds CITs to mutual fund trading platform **2006**- Pension Protection Act triggers DOL to set QDIA as defualt	**2016**- DOL release fiduciary rule resulting in fee pressure

From 2009 to 2014, the use of target-date CITs nearly doubled as a percentage of target-date assets, from 29% to 55%.[2]

The advantages of CITs are plentiful:

- Lower operational and marketing expenses
- A more controlled trading structure compared to mutual funds
- They're exempt from registration with SEC, thereby avoiding costly registration fees
- On the other hand, CITs are only available to qualified retirement plans and they may have higher minimum investment requirements

While CITs have traditionally only been available to large and mega-sized plans, continued fee litigation – as well as increased CIT transparency, reporting capabilities and enhanced awareness – has amplified the allure of CITs to plan sponsors across all plan sizes. However, CITs haven't been widely available to all plans — until now.

Through our strategic partnership with RPAG, a national alliance of advisors with over 35,000 plans and $350 billion in retirement plan assets collectively, HHM Wealth Advisors can provide our clients with exclusive access to actively managed, passively managed and target date CITs, featuring top-tier asset managers at a substantially reduced cost.

The Five-Year Clock for Roth Withdrawals

Issued July 2018

For most investors, it's important to know that there is a five-year waiting period for tax free withdrawals of earnings, and it is applied differently, depending on if you made Roth IRA contributions, converted a traditional IRA to a Roth, rolled over Roth 401(k) assets or inherited the Roth account.

The five-year clock starts with your first contribution to any Roth IRA—not necessarily the one from which you are withdrawing funds. The clock rule also applies to conversions from a traditional IRA to a Roth IRA. (Rollovers from one Roth IRA to another do not reset the five year clock.) Once you satisfy the five-year requirement for a single Roth IRA, you're done. Any subsequent Roth IRA is considered held for five years.

If you have a Roth 401(k), those have their own clock (Treasury Regulation 1.402A-1, Q&A4(b)). If you open a new 401(k) with a new employer, that Roth 401(k) has its own clock. If you move an older 401(k) to a newer 401(k) with a new employer, the old clock is the one that counts. In other words, I would keep the Roth money from a 401(k) plan separate from other Roth IRAs to avoid issues over whether the five-year clock has expired

What Happens When You Deposit Employee Deferrals Late?

Issued April 2018

In our research, late deposit of contributions is a frequent error made by plan sponsors and is a key priority of the Department of Labor (DOL). In every plan audit conducted by the DOL, the investigator looks to see if contributions have been deposited in a timely manner.

A number of years ago, the DOL revised the instructions to Form 5500 requiring plan auditors to review and confirm that contributions are made in a timely manner. For this reason, it is unlikely that late deposit of contributions will go undetected in the case of plans subject to the audit requirement.

The essence of the requirement to deposit deferrals quickly is that once these amounts are withheld from employee paychecks, they become plan assets and therefore must be held in trust. It is a prohibited transaction for a sponsor to continue to hold these amounts after they have become plan assets.

DEADLINES FOR DEPOSITING CONTRIBUTIONS

ERISA requires plan sponsors to deposit these amounts in the plan trust as of the earliest date they can "reasonably be segregated" from the sponsor's general assets. Although this timeframe is somewhat subjective, there is also an outer limit which is the 15th day of the following month.

This period is sometimes interpreted as a safe harbor, in the sense that the rule has been complied with so long as the deposits are made by the 15th day of the following month. However, the DOL has made clear on many occasions that this is not the case. There is rarely a situation where a sponsor can wait this long to make deposits.

In determining whether contributions have been made in a timely fashion, investigators look at how long it usually takes the sponsor to make deposits as the standard. For example, if contributions are generally deposited within two to three days after being withheld from employee paychecks, two to three days is seen as the standard. If a deposit for another pay period is delayed for a month, it would be considered late.

Small plans (less than 100 participants), although not subject to the plan audit requirement, must still comply with the timeframe for depositing deferrals. However, the ERISA regulations allow a seven day safe harbor period for small plans. As such, deposits made by small plans will be deemed timely if made within seven business days following the date withheld from employee paychecks.

WHAT STEPS ARE REQUIRED WHEN DEPOSITS ARE LATE

When it is detected that deferrals have not been deposited in a timely manner, the sponsor should follow four steps of action:

1. Deposit these amounts as quickly as possible;
2. Calculate and deposit the lost earnings on these contributions to compensate participants for loss of investment opportunity due to the delay;
3. Report the late contributions on Form 5500 for the year in question; and
4. Pay the excise tax on the prohibited transaction.

There are two approaches to correcting late contributions – filing under the DOL's Voluntary Fiduciary Compliance Program (VFCP) or self-correction. Most sponsors elect self-correction, rather than undertake the expense and effort involved in completing a filing under the VFCP.

When a sponsor elects self-correction, lost earnings can be calculated using the interest rate imposed by the Internal Revenue Service on the underpayment of taxes, essentially the same rate as the DOL's online calculator.

However, the plan's actual investment return must be used if this is greater. The interest on underpayment of taxes can be in the range of 4% to 6%. The excise tax on the prohibited transaction must be paid. The return used to file and pay this tax is Form 5330.

Although this form is six pages in length, it is relatively simple to complete. The tax is 15%. This tax is assessed only on the lost earnings and not the late contributions themselves, so the amount of the tax is generally small.

If a sponsor elects to do a filing under the VFCP, it must still complete the first three steps above. The main disadvantage of this approach is the added step of applying to the DOL, which will require the employer to describe in detail why deposits were not made within the required time frame and the method of correction, and they will have to do so under penalty of perjury.

However, there are three distinct advantages to filing under the VFCP. First, the DOL will not recommend a plan for audit where the late contributions are revealed through a VFCP filing.

The second is that the online calculator may be used to calculate lost earnings regardless of the plan's actual investment return. As mentioned above, the rate for the online calculator is in the range of 4% to 6%, far below typical investment returns in recent years.

The third advantage is excise tax relief. This relief is available if three conditions are met:

1. Late deposits were made to the plan within 180 calendar days of the date these amounts were withheld from employees' paycheck;

2. The applicant has not filed under VFCP in the three years prior to the submission date;

3. If the amount of the excise tax exceeds

$100.00, a notice of the filing is provided to plan participants affected by the delinquent deposits within 60 days of the date of the submission.

SUMMARY

Don't get into a bind with the DOL by depositing employee deferrals late. If deferrals are late, be sure to follow the action steps to rectify the situation.

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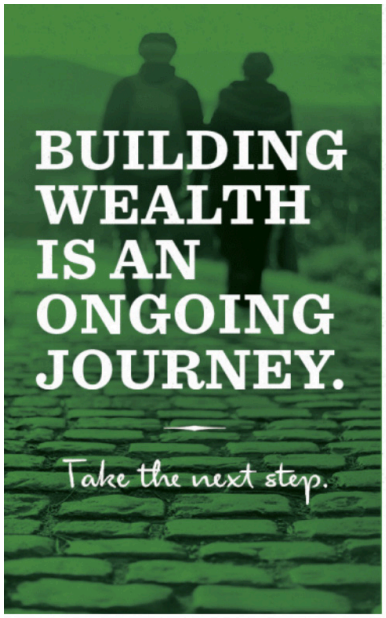

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Every step of the way.

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