

Money *and your* retirement



Written and updated with the help of Jonathan Hefner, M.A., L.P.
Mr. Hefner specializes in financial and legal counseling and is the
Manager of Legal and Financial Services at Ceridian Corporation.

© 2000, 2006 Ceridian Corporation. All rights reserved.

Contents

- 3 Introduction
- 5 What kind of retirement do you want?
- 9 What you will have and what you will need in retirement
- 17 Saving for retirement
- 27 Getting help from a financial planner
- 30 Tax-incentive savings plans
- 36 Investing your retirement savings
- 44 Other ways to improve your financial situation in retirement
- 49 Benefits available to you when you retire
- 56 When to start drawing on retirement savings and pensions
- 58 Conclusion

Introduction

This booklet has been developed to help you think through the financial side of your retirement plans. It will tell you about steps you can take now to boost your retirement savings, as well as about some of the more complicated—but very important and beneficial—ways of investing for retirement. It also contains information about programs and benefits that will be available to you in retirement, such as Social Security, Medicare, and Medicaid, so you can keep them in mind as you plan for the future.

Retirement once meant an abrupt end to work and career and the beginning of a life of relaxation at age 65 (or “early retirement” at age 62). Today, for many people, retirement is a more flexible transition. Many people continue working after “retirement”—at a different job, a part-time position, or in their own business—and, as a result, may retire more than once. Other people remain active and productive through volunteer activities. And some people retire early, with or without the prodding of an early retirement offer.

In this booklet we’ll look at retirement as a time in your life when you leave or cut back on the work that has been your primary career and adjust to a different set of income and expenses. You may have less income from some sources but more from others. You may be eligible for retirement benefits—from the government, from your employer, or from your own retirement savings accounts. You may need to spend less money for some things, but more for others.

All this may seem like a big change, but it really may not be that different from other changes you've already adjusted to in your life. If you've ever purchased a car, bought a home, raised children, or moved to a higher- or lower-paying job, you know what it's like to adjust your budget—and your lifestyle—to a new set of expenses or to a different income.

Above all, this booklet will show you how to plan for and improve your financial situation in retirement. It will help you understand how much money you're likely to have in retirement, what you can do now to increase that nest egg, and what you can do after you retire to make it last.

What kind of retirement do you want?

Before you get into the details of the money, it's a good idea to step back and think about how you want to live in retirement. That way you'll have a better sense of how to plan your finances.

Most of us share these basic goals:

- *To remain independent*—not to become a burden to our children or dependent on the government
- *To be able to afford whatever health care we need*—to avoid suffering poor health because we don't have enough money or enough insurance

Other aspects of your retirement will also determine how much money you'll need:

- *Where do you want to live?* Do you want to live in a different place—for a better climate, to be nearer to children and grandchildren, to start a new career, or just to have a change? Do you want to stay in the same area but live in a different house or apartment—somewhere bigger, smaller, nearer to downtown, or farther from town; somewhere easier to maintain or with room for visitors?
- *What do you want to do?* Work part time? Study? Take it easy? Travel? Write? Garden?
- *How expensively do you want to live?* Do you want a more comfortable lifestyle than you've had so far? Do you want to live more simply?
- *Are there some expensive things you've been waiting to do or to have?* A visit to relatives in another country? A better kitchen? A boat? A college education?

- *Do you want to leave money to your children or grandchildren, or to a charity or other organization?*
- *Do you want to give financial help to your children, grandchildren, or aging parents? Do you want to help pay for your grandchildren's education? Do you want to build an addition to your home for your parents? Do you expect to pay for your parents' health care or for nursing-home care? Is it important to you to do these things even if it means forgoing your own wants and needs?*

Why planning for retirement is more complicated today

There's one crucial question for planning that no one can answer: How long will you and your spouse live after you retire? You'll have to make an informed guess, based on:

- the age at which you intend to retire
- your life expectancy and your spouse's life expectancy

With average life spans of 80 for men at age 65 and 84 for women at age 65, there's a lot more retirement time to plan for than there used to be. People have more healthy years to plan for in retirement, as well as more years of less active old age. It can help to think about your retirement in stages.

These stages will depend on your particular circumstances. For example, there will likely be a stage when you are still healthy and vigorous, interested in travel and sports. Later, you may seek care, comfort, and convenience. Or there may be a stage in which you want to be near grandchildren while they are growing up, while at a later stage they will have moved away and you, too, might want to live somewhere different. There may also be a stage of taking care of your own elderly parents.

What about retiring early on your own initiative? That greatly affects how much money you'll need. To retire early, you need to build up a bigger nest egg in less time. It has to be ready sooner and last longer. And, depending on exactly when you choose to retire, you'll probably need enough of a nest egg to do without Social Security, your pension, and other such sources of money until you reach full retirement age. (Or be able to live on reduced benefits if you start collecting those benefits early.) Sometimes a few more years of working can make a big difference in how long your retirement savings will last and in the size of your Social Security and pension benefits throughout retirement. This is a good thing to talk over with a financial planner, because it takes careful planning, not guesswork.

There's no question that retirement planning is more complicated than it used to be. Some of the reasons are encouraging ones:

- Most people live longer and stay healthy longer.
- There are many more savings and investment options open to people who aren't rich or interested in spending time to learn about the intricacies of financial markets.
- There are many more opportunities for retired people to become involved in new activities—to travel, learn, or start new careers.
- Many people are not waiting until a traditional retirement age to begin to live their dreams.

There are also some less encouraging reasons why retirement planning has become more complicated:

- Families are less likely to stay together in the same home or the same town.
- Medical care can become increasingly expensive as we age.
- Pensions and Social Security weren't designed for retirements that last several decades.
- The increasing number of savings and investment choices makes it harder to understand and choose from them.

So instead of planning for a few quiet years after you stop working—years when your family might be nearby and helping to take care of you—you now need to plan for a retirement that may last several decades and possibly with little or no family help.

It's a serious task, and it's clearly worth taking the time to plan thoughtfully. One writer observed that many people put more effort into planning a two-week vacation than they put into planning for 20 years of retirement.

How a financial planner can help

Much of retirement planning is so straightforward that you may want to do it yourself. But retirement planning can also get complicated, with technical issues about tax implications and the risks and returns of different investment options. It's important to know that you don't have to do it all on your own. For example, it may be a great idea for you to put some money into an IRA or into your 401(k) account. But what if you're

uncomfortable trying to decide the kind of IRA to invest in, what choices to make in your 401(k), or how much you should be saving? What if you've changed jobs and don't know what to do with the retirement savings you've built up in the 401(k) plan offered by your former employer? A financial planner can help you with these and many other financial planning questions. We'll talk more about financial planners later on.

What you will have and what you will need in retirement

Will I have enough money when I'm retired to live the way I would like to live?

You've begun to answer this question by thinking about the way you want to live when you're retired. The next step is to figure out how much money it will take to live that way, and how you might grow your current savings and investments to reach that goal.

Estimating what your expenses will be

One common rule of thumb is that the average retired person needs 70 to 80 percent of the income she had at the time just before she retired in order to keep up her pre-retirement lifestyle. Why would it cost less to keep living the same life? One reason is the cost of working. While you earn money by going to work, you also spend money by going to work—on transportation, work clothes, and meals, and by paying Social Security tax and paying into retirement funds and other set-asides. Another reason is that many people have paid off their home mortgage by the time they retire.

Remember, the 70 to 80 percent calculation is based on what you'll be making the day you retire, not what you're making right now. How can you guess what you'll be making years from now? One way is to assume that your salary will rise with the inflation rate. If you expect your salary to increase by more than the inflation rate, due to promotions at work or other factors, then you should factor that into your estimate.

But the 70 to 80 percent rule is only a rule of thumb. It's important to look at your own situation—and at your own goals for life in retirement. You can use the chart on the opposite page to estimate what your expenses in retirement might be.

As you fill in this chart, remember to estimate what you think your costs will be, which may be quite different from what they are now. You may plan to eat out more often, or less often, when you retire than you do now. You may expect to use less gas for the car if you're not commuting to work—or more if you're planning to use the car to travel. You may cut down to one car once you're not working, or buy a different kind of vehicle for your life in retirement. You may plan to move to a smaller home to reduce your housing expenses.

Beyond your regular expenses, it's important to include those occasional expenses you may not plan for but which are actually predictable: the cost of maintaining your home, for example, including the costs of occasional major repairs such as a new roof or new furnace. You can't plan for them, but a solid financial plan will also account for those expenses you can only guess at: an extended stay in an assisted-living facility, for example, or in a nursing home.

Inflation is an important factor in projecting expenses, but it's also hard to predict. With the help of a financial planner, or by putting the numbers from the worksheet in a retirement planning program online, you can make a reasonable estimate. Without taking inflation into account, your estimate of what you'll need for expenses in retirement could be far too low and could undermine your plans.

In this worksheet and in those that follow, don't get hung up on details. You can always go back and make changes later as you learn more or get a clearer picture of what you want to do.

ESTIMATING RETIREMENT EXPENSES	
Regular expenses	
Mortgage (paid off in year:) or rent	
Utilities	
Telephone	
Car/truck insurance	
Health insurance (medical, dental)	
Memberships (gym, civic organizations, etc.)	
Food (groceries)	
Entertainment (eating out, movies, video rentals, etc.)	
Clothing	
Fuel for car/truck	
Home insurance	
Magazine/newspaper subscriptions	
Other	
TOTAL	
Irregular expenses	
Birthday and holiday gifts	
Vehicle maintenance and repairs	
Eyeglasses	
Medical/dental co-payments	
Vacation/travel/family visits	
Home maintenance and repairs	
Taxes	
Other	
TOTAL	
TOTAL ESTIMATED ANNUAL EXPENSES	
Large one-time expenses (second home, major home improvements, etc.)	

TOTAL	

Where will the money come from?

These calculations should give you at least a rough idea of how much money you'll need for the retirement you want. The next step is to determine where your retirement income will come from and if it will be enough.

Some of your retirement income will probably come from Social Security, the federal program designed to ensure that older people and people with disabilities receive at least a basic level of income when they no longer work. Some of it may also come from employer pensions.

Estimating future Social Security benefits

The Social Security Administration mails an annual *Social Security Statement* to workers ages 25 and older who are not receiving Social Security benefits. The statement shows your Social Security earnings history and how much you have already paid in Social Security taxes. It also estimates your benefits at retirement based on past and projected earnings.

You may also request a copy of this statement by calling Social Security's toll-free number at 800-772-1213 (TTY/TDD: 800-325-0778), or online at www.ssa.gov/mystatement. It's a good idea to look at the statement every year, both to get a sense of your future Social Security benefits and to check for errors. The statement is sent with instructions for correcting any mistakes you may find in your salary history.

Estimating future pension benefits

Some employers offer pension plans, and each plan can be unique. If you are eligible for a pension through your employer, you may request a "Summary Plan Description" (SPD) from your employer and a statement of estimated benefits. Be sure you understand:

- *Eligibility and vesting.* How soon after you start working are you eligible for the pension plan? How soon are you vested—that is, how long must you work at the company before you have a right to any

of the money that's been building up? For example, you may be eligible for a pension plan after one year of employment but not be vested until five years. In that case, if you leave after ten months, you have no claim to pension benefits. If you leave after three years, your pension money has accumulated for two years, but you won't be able to collect any pension. (If you've been contributing to a 401(k) plan—which is not a pension—your contribution is yours under any circumstance.)

- *When you will receive benefits.* Can you retire early? At age 55? At 62? At 65? Can you keep building up benefits until age 70?
- *How the benefits are calculated.* This includes how they might be reduced if you retire early, or increased if you work beyond normal retirement age.
- *How you will receive your benefits.* You will have some choices about how you receive pension payments. Depending on your plan, you will be offered a lump-sum payment or payments over time. Some of your options may depend on whether you are married or single. Talk to a financial planner to learn which option would be best for you.
- *What happens if there are gaps in your employment?* What happens if you are transferred, are laid off, take a leave of absence, or are disabled?

Once you have become eligible for a company pension, keep an eye on its health. Pensions do fail sometimes. Ask your employee benefits administrator for a copy of Form 5500, the Summary Annual Report, which the employer files annually with the U.S. Department of Labor. You can also get this form directly from the Department of Labor by sending a written request for the Summary Annual Report with your employer's name and identification number, and the plan number if you have it, to the Public Disclosure Facility, U.S. Department of Labor/EBSA, 200 Constitution Ave. N.W., Washington, DC 20210. Form 5500 includes an actuary's report on the back. If the actuary is not confident of the plan's financial health, you shouldn't be either. Things change over time, so it's a good idea to check Form 5500 every few years to read the actuary's report.

If your Social Security and projected pension benefits are more than enough to cover the retirement expenses you estimated on the previous worksheet, consider yourself lucky. For most of us, it won't be enough to support the retirement we hope to have.

Estimated monthly benefits	
Social Security	
Pension (current employer)	
Pension (former employer)	
TOTAL ESTIMATED MONTHLY BENEFITS	

Understanding and using your assets

Where will the rest of the money come from? The answer begins with how much money you have now. If you don't have enough now to retire comfortably at your planned retirement age, you will need to add to and possibly re-invest your current nest egg until you do have enough.

What you have now falls into some general categories:

- *Liquid assets.* These are the assets you have quick access to when you need to spend money. They include cash, checking accounts, savings accounts, money market funds, and bank certificates of deposit (CDs). The value of liquid assets does not change substantially with market ups and downs. They are generally lower in risk than other investments. In fact, the major risk of liquid assets is that they will not keep up with or appreciate with inflation. If you have too much of your savings in liquid assets, you risk getting poorer over time as inflation erodes the value of your savings.
- *Investment assets.* This is money that you may have invested in stocks, bonds, and mutual funds. These investments, over the long term, have historically produced higher returns than liquid assets have, and are generally considered to be better protection against inflation than more conservative savings instruments such as certificates of deposit

(CDs) and money market accounts. Many investors, especially younger investors, fail to plan for inflation by placing enough in investment assets.

- *Use assets.* These are things of value that you use, such as your home, your car, furniture, or a boat. These assets usually decrease in value with time and use. Your home may be the exception, as real estate has historically grown in value over time. Use assets can be turned into money by selling them. Your home can also be turned into money if you obtain a home equity loan or a reverse mortgage. It can generate income if you rent it or take in a boarder. Your home has another special feature as a financial asset: if you have lived in it for at least two years, when you sell it, the first \$500,000 (if you are married and filing taxes jointly) or \$250,000 (if you are single) in capital gains on the sale (the difference between what you paid for the house and what you sold it for) is not taxed.

Your strategy, as you plan for retirement, is to use whatever assets you have now to make even more money available for your retirement.

It's important to have a clear picture of your assets as you plan for your future, because it indicates how much money you can start using to make more money for your retirement. As a first step, make a list of your assets in each of the three asset categories (liquid, investment, and use assets). The total of these assets minus any loans you owe (your "liabilities") is called your "net worth." This is simply the value of everything you own that could be sold and turned into cash. Because investment assets are likely to generate the highest return over time, any liquid assets you can comfortably shift to investment assets—assuming you have time to weather the risk of a market downturn—may bring you more money to spend in your retirement. You can use a worksheet like the one on the following page to calculate your net worth and to look at how your assets are divided into the three basic categories.

CALCULATING YOUR NET WORTH	
Liquid assets	
Cash	
Checking account	
Savings account	
Money market account/certificates of deposit	
Cash value of insurance policies	
TOTAL LIQUID ASSETS	
Investment assets	
Stocks, bonds, mutual funds (current value)	
Stock options (if exercised today)	
IRA	
401(k) or 403(b)	
Pension (estimated current value)	
Collectibles (e.g., coins, artwork)	
TOTAL INVESTMENT ASSETS	
Use assets	
Home	
Car/truck/RV	
Furniture, home electronics, clothes, etc.	
TOTAL USE ASSETS	
TOTAL ASSETS	
Liabilities	
Mortgage debt	
Car loan	
College loan	
Credit card balances	
Home improvement loan	
Other loans	
TOTAL LIABILITIES	
NET WORTH (Total Assets – Total Liabilities)	

Saving for retirement

You may look at your net worth and feel that it simply isn't enough—no matter how it's invested, it can't grow into enough money for your retirement needs. But your net worth today is only the starting point. You can increase it through savings. And there are many tools available to help you save more for retirement.

How to save

Saving is the foundation of retirement planning. And for most people, “forced saving” is the most effective way to save. Forced saving means having money transferred straight from your paycheck into a savings or investment account. The harder that account is to get at—the more severe the penalties for early withdrawal—the better you're likely to do at leaving it alone and letting it grow.

Without a forced saving plan, many of us may be able to save for a few weeks or even a few months. But then one month we might use the money to pay a mounting pile of bills or to buy something we've “always wanted.” Most of us do much better if the money is set aside before it ever gets to our checking account. We get used to living on what we actually get. And the biggest surprise is that, in almost all cases, we never miss the money that's being withheld. We adjust our spending to what we're being paid, while money begins to accumulate in our retirement account.

How much should you set aside? As much as you can afford. Pick a percentage of your total pay that you think you can do without. Try it out for a while. Then increase the percentage when you feel you're ready. Whatever amount you choose, even if it's only 2 percent of your earnings, it's money you'll have in retirement that you wouldn't have otherwise.

Where to save: tax-deferred plans

Where should you put the money you've saved? For many reasons, a regular bank or credit union savings account is probably not the best choice. The interest rate will be relatively low, the interest is taxed as you earn it, and—worst of all—it's too easy for you to get at the money and spend it.

Where then? Tax-deferred savings plans are probably your best option. You may not recognize that term, but you've probably heard of 401(k) plans, 403(b) plans (for nonprofit organizations), or IRAs. We will discuss the various kinds of tax-deferred investment plans later in this booklet. Right now, the important point is that these plans were created by the government specifically to encourage people to save for retirement. These are excellent retirement savings vehicles for a few key reasons:

- *Money goes into the account before taxes are taken out.* When you put \$100 from your pay into a retirement account, you save and start earning interest on the whole \$100, not just the \$60 or \$75 that would be left after taxes were deducted.
- *Money grows without being taxed.* Not only do you start out with the full pre-tax contribution, but all interest and dividends accumulate without being taxed. This entire untaxed amount earns interest and grows—making full use of the power of compounding—until you retire.
- *The money is hard to get at.* Steep tax penalties for withdrawing and spending the money before you reach retirement age keep you from drawing on the money before you need it for retirement.
- *The plans are sometimes offered with an employer match,* which means that your employer may match a certain part of your contribution up to a specified percentage of your salary.

- *The plans generally offer an array of investment choices, including different stock and bond mutual funds that allow you to earn the high rates of long-term returns that the stock and bond markets (especially the stock market) have historically offered, while allowing you to spread your risk over a wide range of investments.*

When to start saving

The time to start saving is right now. Immediately. By starting now—with whatever you can afford—you'll be taking advantage of the power of compounding. Because of compounding, your money makes more money the longer it sits there. The sooner you start to pay in regularly, the bigger your pile will be at the end.

Every month and every year you wait to start saving can mean a dramatic cut in your savings at retirement. That's why paying even a small percentage from every paycheck, starting now, will do much more good than waiting until you can afford some larger percentage. An example can help show just how powerful compounding can be, and why you want to harness that power by saving now.

Two friends, both 22 years old, start work in the same field at the same salary. One of the two saves 10 percent of his pay in a retirement account. The other decides to wait a little longer before he starts his retirement planning. After six years, the first friend gets married, buys a house, and stops saving for retirement—but he leaves his retirement savings in an investment account that has been earning, and continues to earn, a return of 15 percent a year. The same year his friend decides to start saving for retirement. He, too, invests 10 percent of his pay, and he, too, invests in a retirement account that earns a 15 percent return. For 37 years, until he retires at age 65, he continues to set aside 10 percent of his pay. And for 37 years, the first friend leaves his retirement account untouched. He never saves another penny.

At age 65, they compare notes at their joint retirement party. The friend who had saved diligently for 37 years was proud to report that his retirement account was worth over \$1 million, which surprised the friend who'd stopped saving after six years. "That's odd," he replied. "That's exactly what my retirement account is worth."

That's the power of compounding at work. Saving early for six years created a nest egg equal to one that took 37 years to build, starting just six years later. There is no guarantee that you'll earn a 15 percent return on your investments, but you probably get the idea from this example of just how powerful compounding can be.

The main points of saving for retirement

- Forced saving is, for most people, the most effective way to save
- Tax-deferred investment plans (such as the 401(k), 403(b), and IRA) are the best places to save for retirement
- Now is the best time to start saving for retirement. Starting sooner will produce dramatically better results than starting later

Spending less

You may need to reduce your everyday living expenses as a way to set aside more money for retirement—or because your income during retirement won't support the lifestyle you kept up while you were working. You may choose to reduce your living expenses as part of an effort to live more simply, or to use your money differently. Whatever your reason, there are many, many ways to lower your expenses in large and small ways.

One of the best ways to reduce your spending is to understand just what your expenses are. Track your spending for two weeks or a month, keeping exact records of all your expenses. Keep a record of

how you spend your cash, what kinds of expenses you charge to your credit cards, what you pay to keep your car running, and so on. It may seem like a nuisance at first, but you'll quickly find it a fascinating way to spot your "money leaks." Then look at your bills over the past year to see what some of your bigger expenses look like over time. You probably don't have to pay for car repairs every week or every month, but you almost certainly have those expenses at some time during the year. And your heating bills and credit card spending may go up or down at different times of year. A record of your daily or weekly spending, combined with an understanding of your major periodic expenses, will help you understand just where your money is going.

If you're like most people, you'll probably discover one or two big money leaks. Owning and driving a car is usually one of the biggest. When you add up what you spend on gas, insurance, taxes, maintenance, repairs, parking, and car payments, you'll probably be shocked at what it really costs you to drive. You may decide you can get by with less expensive transportation. The extra money this frees up may make it well worth the occasional inconvenience.

The cost of eating out is often another big surprise. It's fun, it's easy, and it can break up the routine of life. But a restaurant meal is several times more expensive than a meal made at home. Once you see what you spend on meals out—from coffee and a donut or bagel in the morning to lunch at work or dinner and drinks in the evening—you might want to make an effort to cut back and use that money another way.

There may be another big expense that's unique to you, and that could be an opportunity for scaling back on spending to free money up for savings and investment. However you do it, trimming expenses now can have a big impact on your finances in retirement.

There are many books, articles, and Web sites that describe ways to spend less on practically everything, from homeowner's insurance to toilet paper, from fresh vegetables to the ink for your printer. You

can go overboard, but if you're really trying to tighten your belt—especially if you need to set aside more cash to reach your retirement goals—you might check out these resources and take the suggestions that make sense to you.

Earning more

Obviously, one way to build up more money for retirement is to earn more. Not only will a bigger paycheck give you more room for saving, it will also increase the amount you will receive in Social Security payments when you retire.

Assuming you're already working full time, here are some things to look into:

- *What are your present skills worth?* Do you have skills you're not using in your current job that might make you more valuable in a different position?
- *What can you do to be worth more?* Would a degree, a professional certificate, or some training make you eligible for a higher-paying position? Many people with technical skills find they can earn more money if they're willing to take on management responsibilities.
- *Are you in the right business?* Are you in a company or industry that's growing? Or is it declining?
- *Could you earn extra money on the side?* Some people do repairs or small carpentry jobs. Some teach at local colleges or adult education centers. A man who likes going to yard sales and buying old books found he could make some extra money by reselling certain books to specialized collectors.
- *Do you want to take a second job, work overtime, or rent out a room?* The possibilities can be limitless.

Working longer

You may want (or need) to keep working at your present job just to accumulate more money in your nest egg. Working longer also delays the date that you need to start drawing on your savings for retirement living expenses. Every year you work is one less year you have to pay for out of your savings and investments.

Keeping debt from eating up your retirement

Among most people's regular expenses is a certain amount of debt repayment: mortgage or car payments, school loans, or accumulated credit card debt. Try to pay down or pay off as many of these debts as possible before you retire. Paying off a credit card that charges 21 percent interest may be better than investing in a stock fund that earns 15 percent interest. A financial planner can help you develop a plan for reducing your debt while increasing your investments. Not only will it feel good to have fewer bills when you're no longer receiving that paycheck, but the more debt you pay off, the more quickly you'll get to the point where your money works for you rather than you having to work for it!

The money you could be making through investments, if you weren't using it to pay off debts, is one of those invisible losses that people don't often think about. Try to pay a little extra on your various debts each month—especially on those that charge high interest, such as credit card debts. Pay more than the minimum payment required on your credit card bill. If you only make the minimum monthly payments required, it may take you years to pay off the balance, even if the balance is rather small.

If you're already paying off your credit card balance each month, add \$10 or \$20 to your mortgage payment. Think of that extra debt repayment as money that will later be in the bank—the interest you won't have to pay in the future. When your debt is finally paid off, keep making the same payments into your own retirement savings.

Credit cards

Credit cards can be one of your biggest enemies when it comes to retirement planning. Maybe you're one of the few who use your credit card only when you have to rent a car or reserve a hotel room over the phone. But credit cards entice millions of Americans to buy things they don't really need. Although that spending may seem painless at the time, without careful control it can mean you will have much less financial independence during retirement. That's a big price to pay.

It's no joke that one of the best forms of retirement planning would be to

- get rid of all but one credit card
- leave that credit card at home
- pay off the balance in full each month when you do use it

Use that one credit card if you really do have to pay for something important that you don't have the cash for—to get your car running or to replace a broken water heater. But if you're just going shopping, leave the credit card at home and take your checkbook. Even using a debit card, which pulls money out of your bank account as you use it, tends to restrain us from spending what we don't have. (But be careful of relying on “credit reserve” or overdraft privileges to turn a checking account into another way to borrow at high interest rates.)

One writer suggests putting your credit card in a dish of water and keeping it in the freezer. If you really need it, you can always thaw it out, but you can't just grab it and take it with you on the spur of the moment.

A general rule of thumb is that a credit card will only work in your favor if you pay it off in full each month within the grace period. Otherwise it can add an extra 10 to 25 percent to your spending. By cutting back on credit card use, you'll start to spend your money, not your future. To put it another way, you'll be spending what you have in your bank account, not your retirement.

Reduce debt and save instead

At times when interest rates are low, you may be able to refinance your mortgage at a lower rate—as long as the savings are big enough to offset any closing costs on the new loan. But if you refinance, don't think of it as having more money to spend. Think of it as having more money to save! Step up your contribution rate to your retirement account at the same time so you don't simply slip into higher spending habits. Or use the extra money to pay down other high-interest debt. You managed to live with that old mortgage rate, so you should be able to use the rate reduction to increase your savings or reduce your debt. As with any savings step, you'll be putting the extra money to work—to increase the length or comfort of your retirement.

The same strategy works with car payments. Today's cars are manufactured with attention to quality and durability. With proper maintenance, your car should last quite a few years longer than your payment plan. When your car loan is paid off, start making extra payments into your retirement savings—or into a savings account to put toward your next car. Whether you increase your retirement savings now or decrease the payments on your next car, you'll be using those years of extra payments to build an even bigger nest egg for your retirement.

If you do need to borrow money for a large expense, and have built up enough equity in your home, you might consider taking out a home equity loan or home equity line of credit rather than using a credit card. Because such loans are secured by a home, they may have lower interest rates. Of course, home equity loans have a down side, and shouldn't be looked at as a source of easy cash. When you pay off credit card debt with a home equity loan, for example, you are replacing an unsecured loan with a secured loan. The lender now has a legal right to take your house if you fail to make the payments. You still owe the same amount of money—you're just making smaller payments over a longer stretch of time. And because these loans generally have long repayment periods, you may actually pay

more money over the life of the loan. Also, because your monthly payments are smaller, you may feel an artificial kind of relief. Most people who take out home equity loans to consolidate consumer debt find themselves back in credit card debt before long, with the home equity loan as an added burden. You should be especially careful of loans that allow you to mortgage the full value or even more than the full value of your home's worth.

It's a good idea to check with a financial counselor as you weigh the pros and cons of a home equity loan. If you approach a home equity loan with a good understanding of the benefits and risk, and if you are confident in your ability to make the loan payments, this kind of loan may be an economical way to borrow.

Getting help from a financial planner

Before we discuss some of the more complicated investment choices, such as stocks, bonds, and mutual funds, let's step back with a reminder that you don't have to master all of the details of these choices yourself. You can hire a financial planner to help you.

A competent financial planner is someone who can help you make decisions about how to manage your money now in order to achieve your financial goals in the future—including paying for college, buying a house, retiring, or other goals. A financial planner can be helpful even if you have limited assets, limited time, or limited tolerance for risk.

Anyone can call himself a financial planner, so be careful whom you choose. Several types of professionals offer financial planning:

- *True financial planners* look at your whole financial situation and your goals and help you develop a comprehensive financial plan in order to reach them. This plan may be modified through the years as your situation and goals change or as the financial world changes. Certified financial planners (those with a CFP certification) have been trained and passed extensive exams in the major areas of financial planning. They must also meet challenging continuing education requirements, sign an ethics statement, and follow guidelines set by the CFP Board of Standards.
- *Financial advisers* often work at service firms such as brokerages, mutual funds, and insurers. These advisers may specialize in selling specific investment or insurance products. Because of their affiliation and incentives they may or may not have the objectivity to develop a comprehensive financial plan for you.

- *Certified Public Accountants (CPAs)* have had their major training in accounting and taxes (both federal and state taxes). They can be very helpful if you have tax questions, need a tax preparer, or have your own business.
- *Wealth (or money or investment) managers* manage your money directly (rather than simply advising you what to do), typically in exchange for a certain percentage of the assets they manage.

It's important to be careful about choosing a financial planner, just as you would be careful about choosing a pediatrician or a lawyer. Interview several people before you choose, and compare factors such as

- experience, education, and credentials
- references the financial planners give you
- references you get from people you know
- fees and commissions

This last point is key in choosing a financial planner. How the planner earns her money may affect the advice she gives you. An adviser who charges only a set or hourly fee (a “fee-only” arrangement) and accepts no commissions may be more likely to give unbiased advice. An adviser who earns money from selling certain types of investments or insurance, or from commissions on stock trades, may be biased toward certain types of investments or perhaps toward frequent changes in your investment portfolio—investments or activity that may not be in your best interest. You need to look carefully at how your financial planner earns her money. What you pay her may be only part of the story. She may also be earning commissions for financial products she sells.

If you are inexperienced in financial matters, if you strongly dislike dealing with financial matters, or if you have a particularly complicated financial situation, then hiring a good financial planner is likely to be a sound investment in your future.

Safe steps to choosing and hiring a financial planner

- **Deal only with certified planners.** Certified financial planners (CFPs) are trained to look at individual and family goals, to do a thorough analysis of a client's financial situation, and to help develop a plan to meet those goals.
- **Ask to see regulatory and disclosure records.** Part I of the planner's ADV form, which is used to register with the Security and Exchange Commission, discloses any run-ins the planner has had with regulators and any disciplinary history. Part II discloses the terms of compensation, including all commissions and payments from sponsors of financial products that the adviser recommends.
- **Interview several candidates.** Most will give you a free initial session. In any case, it's reasonable to spend some money in the process of choosing your planner. Ask several planners how they would approach a particular problem you need to solve, to see what their different approaches are. Ask each one what her typical clients are like, how she works up a financial plan, and what her investment philosophy and areas of special expertise are. Ask, too, how you will be charged and what you will receive in return. Come prepared with specific information about your financial situation.
- **Ask for references.** Call the references and ask how well their plans succeeded. Find out if they had problems with fees or with getting access to the planner.

Tax-incentive savings plans

Now let's go back to the question of where to save. First, we'll look at tax-incentive savings plans—a set of financial tools specifically designed to help you retire with enough money to live the way you want to live.

The government runs on taxes, but a number of special programs have been created in the tax code to encourage saving and investing for retirement. Most of these are variations on the tax-deferred retirement savings account—an account that lets you set aside income before it is taxed, in a special account where it can grow, again without being taxed, until you are ready to use the money in retirement. The money is taxed as income only when you withdraw it.

Tax-deferred savings accounts allow you to set aside and invest some of the money you earn—plus the portion of that money the government would have taken in taxes—in an account where its growth is sheltered from the shrinking effect of taxes on interest, dividends, and capital gains. What makes these accounts so attractive is the boost you get from setting aside a larger initial pot of money (\$1 pre-tax compared to 60 or 75 cents after taxes have been taken out), combined with the extra growth allowed year after year in a tax-free account. By the time you retire, you will have more money saved than you would if you had saved after-tax earnings in accounts that were taxed every year as they grew.

The main tax-deferred savings plans offered through employers are:

- 401(k) and 403(b) plans
- Simplified Employee Pension (SEP) plan (for self-employed and for small companies)

- SIMPLE (Savings Incentive Match Plan for Employees)
- Keogh plan (for sole-proprietor and partnership organizations)

The two tax-incentive savings plans available to individuals are:

- Individual Retirement Account (IRA)
- Roth IRA

We know this list can be confusing. Even the names of the different plans can be intimidating. But the choices and decisions for you are really fairly straightforward. You generally won't be choosing from the different plans—an employer usually offers only one. Your job is to decide whether to contribute to the plan and whether to supplement your retirement savings at work with additional contributions (if you're eligible) to an IRA. If you're self-employed, you'll be choosing from a Keogh plan, a SEP plan, and an IRA.

One of the best features of all these plans is the one that may make you nervous at first—the penalty for early withdrawal. But since the point of a tax-deferred savings plan is to save for retirement, anything that keeps you from spending the money earlier is actually a feature, not a drawback. You want a plan that gives you an incentive to keep the money invested and growing until you really need it in retirement. Some plans do allow early withdrawal without penalties in very specific situations, but in general the money is considered to be for retirement use only.

Tax-deferred savings plans available through employers

401(k) and 403(b)

The popular 401(k) plan allows your employer to deduct money from your paycheck and put it directly into an investment account in your name. In most plans, you have a choice of several investment options. Usually these are mutual funds with a range of risks and returns. Some employers match a portion of your contribution,

adding 25 cents, 50 cents, or more of the company's money to your account for every dollar you invest. Some employers offer an additional matching contribution as a form of year-end profit sharing. If your employer does this, you should make every effort to earn as much matching money as possible. It's essentially free money, and it will grow into even more money over time in your tax-protected account.

Even without this matching feature, a 401(k) is a very attractive retirement savings vehicle. The money is deducted from your paycheck, so it requires no discipline on your part to save. And the tax benefits give you a huge boost as you grow your retirement savings. If your company has a 401(k) plan and you're not participating in it, you're almost certainly making a big mistake.

The 403(b) plan is very similar to the 401(k) in most respects, but is offered by nonprofit employers.

[Simplified Employee Pension \(SEP\) Plan and Savings Incentive Match Plan for Employees \(SIMPLE\)](#)

SEP plans and SIMPLE accounts are available only to self-employed individuals and smaller companies that don't have the staff, technical expertise, or earnings to administer a full-scale 401(k) plan. Unlike an IRA, these plans don't have an annual contribution limit.

[Keogh Plan](#)

Only sole proprietors and partnerships can set up a Keogh plan. For an employee, the Keogh is similar to an IRA in that earnings in the plan are tax deferred until money is withdrawn. Unlike an IRA, a Keogh plan doesn't have an annual contribution limit.

All of these plans come in different flavors and the differences can be very important. See your company representative for further explanation of your plan, including the vesting requirements (how long you must work before becoming eligible), or visit with a certified financial planner.

Tax-incentive savings plans available to individuals

Individual Retirement Account (IRA)

A traditional IRA is a tax-deferred investment account into which you make your own contributions and for which you decide the investment choices. IRAs are offered by banks, credit unions, and other financial institutions. To be eligible to open an IRA, you need to have earned income (that is, your income can't come solely from dividends, interest, and capital gains) or alimony. You can save up to \$4,000 each year in your IRA, and some or all of your contribution may be tax deductible. Whether it's tax deductible, and how much is tax deductible, depend on several factors, including whether you or your spouse are covered by other retirement plans, and the size of your total income.

In many cases, both spouses can open IRA accounts. And a working spouse can open one for a non-working spouse. If you leave your job before retirement age, you can roll your pension over into an IRA (within a certain amount of time) and keep growing your savings tax free until you actually retire. And there are various ways to move money from one IRA to another if you want to take advantage of new investment opportunities with different IRA sponsors.

Even if your contributions to an IRA aren't tax deductible, the fact that the investment grows without the growth being taxed may still make this an attractive retirement savings option. IRAs can be complicated, and the laws governing them have changed several times, so it may be a good idea to get advice from a financial planner.

Roth IRA

The Roth IRA differs from the traditional IRA in some very important ways. You contribute to a Roth IRA from income that has already been taxed (rather than from pre-tax income, as with a traditional IRA). After that, all the growth is tax free, and you are not taxed when you withdraw the money during retirement (subject to certain restrictions).

Whether this works out to your advantage depends on your particular situation, and specifically on the difference between your current tax rate and what your tax rate will be in retirement. If you believe that tax rates in general will be lower when you retire, and that your tax rate will be significantly lower, then a Roth IRA may not be a good choice. But for many people, the Roth IRA may be very advantageous. Because the intricacies of a Roth IRA are somewhat complicated, it's a good idea to discuss this with a financial planner before you decide.

Retirement account withdrawals and pension payouts before retirement

Americans are changing employers more and more frequently, and that means they're moving their retirement savings from place to place. The most important thing for you to do if you're transferring a retirement account or pension fund balance is—don't have it sent directly to you! If you do, and you don't put it in another retirement savings account within the required time limits, you'll have to pay income tax as though the entire amount were part of your annual earnings. You will also lose out on what your money could have earned had you rolled it back into an IRA or some other tax-sheltered investment plan, where it would have had the opportunity to grow. And if you spend any of the money while you're holding it, you may have to pay a 10 percent penalty for early withdrawal.

If you're faced with a decision to move pension money before retirement, discuss your options with your benefits administrator and with your financial planner if you have one. (Even if you don't have a financial planner you might want to consult one in this situation.)

There are other plans and variations that you can discuss with a financial planner. But here are the key points you should understand and remember:

- Tax-deferred investment plans are one of the best ways to save and invest for retirement
- While there are many different plan types, only one is likely to be available to you through your employer, and that option will be determined by the type of organization you work for
- The plan available to you is likely to offer a range of investment options, with varying levels of risk and expected return
- When deciding among investment choices within a plan, or when deciding whether to invest in an IRA or Roth IRA, it can be helpful to consult a financial planner

Investing your retirement savings

Whether you invest in a tax-deferred savings plan or make after-tax investments for your future, your choices will generally be to invest in stocks, bonds, or interest-bearing instruments such as money market funds. Mutual funds offer a way for individual investors to put money into any of these investment vehicles in a way that spreads their risk over a large number of investment choices.

Stocks

When you invest in stocks (sometimes referred to as equities), you own a piece of the company you invest in. As the company grows, and especially as its profits grow, your piece as a shareholder (what owners of stock are called) also grows. But it's not a direct relationship. The value of the stock depends on many factors, from other investors' confidence in the market as a whole or in a particular industry or business sector, to expectations that the company's earnings and profits will continue to grow. A company's stock price is a measure of investor confidence in its financial future.

Because earnings and profits in any company vary from quarter to quarter and year to year, and because investor confidence can go up and down based on any number of factors, stock prices can rise and fall in unpredictable ways. Some companies make the value of ownership a little more predictable by paying dividends to shareholders. This is usually sent as a check every quarter to shareholders. If you own stock through a retirement plan or a mutual fund, the dividends are usually reinvested in additional stock and contribute to the growth of your retirement savings.

While stock prices—and the value of your investment in stocks—go up and down on a regular basis, sometimes in dramatic swings, the trend over time has always been up. Over any 10- or 15-year period, history shows stocks to be an investment with a strong record of growth—even through major market drops such as the 1929 stock market crash. Investing in stocks is a way to invest in innovation and in the long-term growth of the economy. But if you choose to invest in stocks, you must also be prepared to see your investments lose value at times.

Whether you invest in individual stocks or invest in groups of stocks through a mutual fund, you'll need to decide what kind of return you are looking for and what kind of risk you're willing to bear. The size of the company, the industry in which it operates, and its strategy for growth all contribute to a stock's expected rate of return (how quickly it is likely to grow) and to its level of risk (the chance that it will lose value and how much value it could lose). Here are some of the key categories of stocks:

- *Growth stocks* have the potential to grow faster than the stock market as a whole, but may also be at greater risk of losing value.
- *Blue-chip stocks* are the leaders in their markets. These are the companies whose names you know, whether you buy anything from them or not, such as IBM, GM, Microsoft, GE, Coca-Cola, or Xerox.
- *Income stocks* pay out a greater portion of their profits as dividends, making them more reliable sources of income. Utilities are the classic example.
- *Small-company stocks* (“small caps”) are riskier as individual investments than large-company stocks but have historically increased in value more quickly. A very successful small company can double in size every year or two, something a huge company can't do. But small companies also fail more frequently than large companies do.

- *Value stocks* are seen by market analysts as being undervalued, yet their financial fundamentals look good, so they are expected to increase in value.
- *Foreign stocks* may perform better or worse than U.S. stocks due to changes in currency exchange rates and the different rates of growth of local economies.

Consider stocks as a long-term investment—an investment you plan to hold for eight or ten years or longer. Be prepared to see the value of your investment go up and down in the short term. And find ways to spread the risk of a single stock's price swings by investing in the stock of many companies.

Your own company stock

Many companies make it easy for their employees to acquire company stock through stock purchase plans or by offering company stock as an investment option through a 401(k) plan. These plans often offer stock at a discount, which makes them attractive as part of an investment portfolio. But be careful that your retirement plan doesn't rely too heavily on your company's stock. If your employer suffers a setback, your job may be at risk. You don't want your retirement savings to be at risk at the same time. One of the keys to investing in stocks is to spread the risk over a large number of companies' stocks. It's never wise to bet your retirement on a single company's fortunes.

Bonds

When you invest in bonds, you are lending money to companies or governments. In general, bonds are a lower-return, lower-risk investment than stocks. They are sold with a fixed interest rate and a set maturity date (the date at which the bond will be repaid). Interest is paid to the bond holder at regular intervals (often twice a year). At the maturity date, the end of the bond's term, the original investment is repaid.

A bond can be held for its full term, which could be a year or less (for a short-term bond) or 30 years or more (for a long-term bond). Or it can be sold to another investor before that. Because the value of a bond changes with fluctuations in the rate of inflation and in the interest rates offered by other bonds, investors can make or lose money by buying and selling bonds, in addition to the interest they earn by holding them. Bonds tend to rise in value when interest rates and inflation are going down and to lose value when interest rates and inflation are going up.

An example can show how this works. Let's say you buy a 10-year \$1,000 bond with an interest rate of 8 percent. Every year, you'll be paid \$80 in interest (8 percent of \$1,000). After five years, you decide to sell the bond because you need the money for living expenses in retirement. If inflation has dropped over those five years, and new bonds are now being issued with interest rates of only 6 percent, your bond will be worth more than the \$1,000 you paid for it. But if interest rates on new bonds have risen, and investors can now earn 10 percent interest on a similar bond, your bond will be worth less than the \$1,000 you paid for it.

A bond can also lose value if the company or government that issued it gets into financial trouble and looks like it may not be able to repay the bond.

You can buy bonds through a bond mutual fund or through a broker. Government bonds can also be bought directly from the government.

Money market funds

Money market funds invest in short-term corporate and government debt, and they generally pay interest at a higher rate than that offered by banks on savings accounts. Most money market funds let investors write checks to draw on the money.

Money market funds offer a low-risk way to earn interest. The risk is somewhat greater than putting money in a bank or credit union savings account, because the balance is not insured as it is in a bank. But the return is also higher. The interest rates on money market accounts vary with the interest rates in the market. The rate of return is low when inflation and interest rates are low, and high when inflation and interest rates are high.

Mutual funds

Mutual funds allow investors to put money in a portfolio of stocks, bonds, or money market accounts. An investment in a single mutual fund is, in effect, an investment in a large number of individual investment vehicles. And by investing in a large number of vehicles through a mutual fund, you are reducing the risk of dramatic drops (or increases) in value that sometimes accompany surprising news about an individual company's or municipality's outlook. In a mutual fund that invests in dozens or even hundreds of individual vehicles, some of these ups and downs tend to offset each other. So the effect on stock values of bad news at one company might be offset by the effect of good news at another.

Thousands of mutual funds are available to investors, each with its own investment focus. One fund, for example, might concentrate on international stocks, while another might focus on small company stocks and another on municipal bonds. Depending on the focus of the mutual fund you choose, your investment might still be at risk from drops in value in an entire sector of the market, from currency fluctuations, or from other broad market changes. But your risk from the fluctuations in value of individual stocks or bonds will be reduced by the fact that your investment is spread over so many different vehicles.

When you invest in a mutual fund, you are also putting your faith in the judgment of the people managing the fund. You can evaluate

their performance by looking at how the fund has done in the past compared to funds with similar strategies. Morningstar and other rating services, whose publications are available at many public libraries, evaluate mutual funds and rate them according to their risk, historic performance, and other factors.

By putting different portions of your retirement savings into several different kinds of mutual funds, you can build a diversified portfolio that matches your financial needs. If you are young, and have many years to go before you'll need the money in retirement, you might put a larger proportion of your money into mutual funds with a more aggressive growth strategy. You have time to weather a market downturn as you keep building your nest egg over time. If you're very close to retirement and need to be sure the money you've saved is there to spend in just a few years, you might put a larger proportion in a money market fund, a bond fund, or a mutual fund that invests in income stocks. (But even if you're nearing retirement age, remember the time horizon of your retirement. While you'll need some of the money soon, you will want to leave some of your money invested for another 15 or 20 years.)

When investing in mutual funds through your employer's tax-deferred retirement savings plan, you'll probably have a limited selection of mutual funds to choose from. But those funds should offer a range of investment strategies—giving you a range of risk and return potentials. Read the literature about each fund carefully before you make your choices. It may be a good idea, too, to sit down with a financial planner and get some advice on how these choices fit with your overall financial plan for retirement.

When buying or selling stocks or bonds, you pay a commission to a broker. When buying or selling mutual funds, you may pay a commission in the form of a "load." "No load" mutual funds charge no commission on the purchase or sale of fund shares. They generally make their money through annual management fees charged to the fund. When a load is charged, your initial investment

is immediately reduced by the 2 or 3 percent load, and it may take several weeks or months for your investment to grow back to what you put in. When comparing expected rates of return on different mutual funds, be sure to pay attention to this load factor as well as the management fees.

Managing risk through dollar-cost averaging

When you invest in a retirement savings plan through regular deductions from your paycheck, you are actually using a highly successful investment strategy called dollar-cost averaging. By making regular investments of the same amount in the same stock or mutual fund, you turn market fluctuations from a worry into a force for growth. When stock prices are high, you buy fewer shares with your regular, fixed investment—but your overall investment has grown. When stock prices are low, you buy more shares with your regular, fixed investment—and when the market recovers, your larger holdings accelerate your growth.

By forcing you to make the same small investment every month or with every paycheck, retirement savings plans keep you from making investment mistakes that are driven by emotion. They keep you in the market through all of its ups and downs, which turns out to be the smartest investment strategy. When you keep buying stock through a market downturn, you're able to leverage your money and buy more, at a time when many people are leaving the market for emotional reasons. Because you know you're getting a bargain on the shares you buy, you tend to be more comfortable sticking with your plan. And on the other side of a market swing, when prices are high, you stick with the same investment schedule rather than over-investing at a market peak.

For both mathematical and psychological reasons, dollar-cost averaging can be a very effective investment strategy. And it's built right into your employer's retirement savings plan.

Dollar-cost averaging (an example)

Let's say you've decided to set aside \$100 from your paycheck and invest it in a stock mutual fund. The first month, the fund is selling at \$10 a share, and you buy 10 shares ($10 \times \$10 = \100). The next month, the stock price has dropped dramatically, to \$5 a share. Your original investment is worth half what you put in, but you stick with the plan and invest another \$100, which now buys 20 shares ($20 \times \$5 = \100). The next month, the price has recovered part way and is up to \$7.50 a share. Again you invest your \$100, this time buying $13\frac{1}{3}$ shares ($13\frac{1}{3} \times \$7.50 = \100).

At the end of three months, you've invested \$300 and the stock price is down from \$10 to \$7.50 a share. Things look pretty bad. But it turns out you're not in bad shape at all. You own $43\frac{1}{3}$ shares, and they're worth \$325. By buying more shares when the market was low—instead of panicking and bailing out—you turned a market downturn into an opportunity for growth. That's the power of dollar-cost averaging.

Other ways to improve your financial situation in retirement

We've looked at ways to save for retirement through tax-deferred savings plans and at ways to invest your retirement savings. There are other things you can do in the years before retirement that will put you in a better financial situation after you retire.

Economize on health insurance

With two spouses working, you may be paying for duplicate coverage. Examine both policies carefully to see if the cost of dropping one—paying out-of-pocket for certain services—would be worth the paycheck increase. However, be sure to find out what it would take to rejoin the policy you dropped, should you lose the one you kept. If your policy, or policies, allow you to choose from a menu of benefits, be sure you're not paying for services you won't need. You may be able to choose different services from each spouse's menu, so that you don't pay twice for the same coverage.

A plan with a higher deductible might also save you money. You'll pay a lower premium, and you can put the money you are saving on premiums into a health savings account. Any money you don't spend in the health savings account during the year can be carried forward to the next year.

Look into long-term care insurance

Long-term care refers to

- medical care that is needed over a long period for a chronic illness or condition or for a serious injury
- the help with everyday living that people may need when they are unable to care for themselves

Long-term care varies from having someone come to the house to help you dress and bathe, to having a visiting nurse help you with your medication, to living in an assisted-living facility or a nursing home.

Long-term care can be a huge expense. Nursing home care and some forms of in-home care are covered by Medicaid for those who fall below the program's asset and income requirements. But to qualify, you and your spouse will have to have spent most of your assets and be living on a modest income. These forms of care are generally not covered by Medicare, pension plans, or ordinary health insurance. An option for some people is long-term care insurance. A long-term care insurance policy tends to be less expensive the younger and healthier you are when you buy it, so it's worth looking into early on.

Prepare for a career after "retirement"

For more and more people today, retirement doesn't mean the end of a working life. It offers a chance to start a second (or third, or fourth) career. You may want to work in a field for which you have a special passion, or you may need to work because you can't afford to retire without an income. Whatever your reasons, you may need to plan ahead by developing the knowledge, skills, and contacts that will enable you to make money when the time comes. If you plan to work in retirement because you need the money, it's probably not a good idea to plan for income from a risky business venture in a field you haven't worked in—such as opening a restaurant or a bookstore.

You might think instead of work in which you have some real expertise or that you could do with a smaller investment—such as restoring furniture, operating a small after-school program in your home for neighborhood children, or consulting to other businesses in an area of special expertise.

To prepare for post-retirement work,

- *Gain experience in the kind of work you hope to be doing*, through volunteering, moonlighting, or apprenticeship. While you're learning how to do the work, you'll learn whether you enjoy doing it and how much talent you have for it.
- *Learn all you can about the work you hope to do*, by reading, subscribing to journals, going to meetings and conventions, and talking to people in that field.
- *Learn the skills you'll need*, both specific to that work (for example, how to make food efficiently in volume) and common to any business (such as the basics of accounting or marketing).
- *Start learning about the market for the products or services you intend to offer*. Talk to people who have succeeded in similar enterprises. Is there a need in the market for what you plan to offer? Who would be interested? How much would they be willing to pay? What's the best way to make them aware of your service or products?
- *Save up the money you'll need to get the new venture going*. This should be part of your overall retirement plan.

Keep an eye on your retirement plan

Retirement planning, like any kind of long-range planning, is based on a certain number of guesses about the future. It's important to check periodically to see if your guesses need to be changed in light of the following:

- *Changes in your financial situation*. Your salary goes up or down. You have another child. You inherit a large sum.

- *Changes in your goals.* You want a different career. You want to retire earlier than you thought. You have children and you want to leave an inheritance.
- *Changes in the economy.* Different segments of the economy are doing well or poorly. New investment options have become popular.
- *Inflation.* All your projections have to be looked at through the lens of inflation. So inflation trends that look like they're going to go on for years could have a big effect on how ready you are for retirement when it comes.

You need to keep an eye on your retirement savings account or company pension to be sure you're still headed toward your retirement goals. And you need to be aware of changes in government benefits, such as Social Security and Medicare, which might affect what you think you'll need to save on your own.

Divorce or the death of a money-earning spouse can seriously reduce what you thought would be your assets and income in retirement. Either of these events calls for a thorough reassessment of your retirement plan. In case of such a setback, review your retirement plans with your lawyer and a financial adviser, so you don't make poor decisions under stress that will jeopardize your future.

Early retirement offers

Retirement doesn't have to start at 65. Part of retirement planning is deciding when you want to retire and then doing what you need to do to make that possible. But sometimes an unplanned option arises in the form of an early retirement offer from your company.

When weighing an early retirement offer, ask yourself these questions:

- *Do I want to go?* If you've been wishing you could retire and take up some other activity, but thought you couldn't afford it, this may be your chance. Even if the package would be a financial loss compared to staying on until you're 65, it might be worth it just to have a more satisfying life.

- *How much choice do I really have?* If everyone in a large company gets the same offer, and as far as you know your boss is happy with your work, you probably don't need to worry. The company is trying to slim down, but hasn't targeted you. But if the offers were made to your group in particular, or if your boss isn't all that happy with you, you may be wise to take a good offer before it's replaced by a worse one or before you're let go without any package.
- *Can I afford to go?* This depends on the specifics of the package. Does it offer a bridge until you can collect Social Security? What will your pension benefit be and when will you start collecting it? Can you hold on to any of your medical benefits until you are 65, and at what cost? Talk to a financial planner if you have any doubt.

Be cautious. This is an important decision. But if the deal looks good, don't be afraid to take advantage of what may be a lucky break.

Benefits available to you when you retire

Now we'll look at the benefits available to you to supplement your retirement savings and investments. These may become available to you when you retire or when you reach "retirement age" (whether you stop working then, keep working, or have already stopped working).

Social Security

The Social Security program is the nation's income "safety net" for people whose earnings have either stopped or been reduced in retirement or through disability. The program is administered by the Social Security Administration, a federal agency, and is financed through taxes paid by employers and workers. The vast majority of retired people are eligible for Social Security retirement benefits. In fact, nine out of every 10 Americans who are 65 or older receive Social Security benefits. (The program is designed to help people who have not reached retirement age, too. One out of every three Social Security beneficiaries is not a retiree.)

Credits determine whether you are eligible for these Social Security benefits. The amount of money needed to earn one credit is adjusted each year for inflation. In 2005, a worker earned one credit for each \$920 of earnings—up to a maximum of four credits a year.

To qualify for Social Security retirement benefits, you or your spouse must be over 62 and have earned sufficient credits by working at a job covered by Social Security. To qualify for retirement benefits, most people need 40 credits, which is usually 10 years' worth of work.

The amount of money you receive in Social Security benefits is determined by your lifetime earnings, not by the number of credits earned. In general, the more you pay in Social Security taxes during your working years, the higher your benefits. Social Security payments will not replace all of your earnings when you retire. People who rely solely on their Social Security income usually find it quite difficult to live on the money they receive each month.

The eligibility age for full benefits is increasing gradually over the next 20 years, from 65 for those born before 1938 to 67 for those born after 1959. Reduced benefits become available at age 62. The age at which you will be eligible for full retirement benefits is shown below:

Year of birth	Year of 62nd birthday	Age for full benefits
1937 or earlier	1999 or earlier	65 years
1938	2000	65 years, 2 months
1939	2001	65 years, 4 months
1940	2002	65 years, 6 months
1941	2003	65 years, 8 months
1942	2004	65 years, 10 months
1943-1954	2005-2016	66 years
1955	2017	66 years, 2 months
1956	2018	66 years, 4 months
1957	2019	66 years, 6 months
1958	2020	66 years, 8 months
1959	2021	66 years, 10 months
1960 or later	2022 or later	67 years

Early or delayed retirement

If you retire at 62, you will be eligible for Social Security benefits, but you will be paid at a lower rate than you would be if you waited until full retirement age to apply for benefits, and you will be paid at that lower rate throughout your retirement. The amount is permanently reduced by $\frac{5}{9}$ of 1 percent for each month you receive benefits before your full retirement age. For example, if you were born in 1938 and begin receiving benefits at age 62—38 months before your full retirement age of 65 years, 2 months—you will receive 78.9 percent of your full benefits.

Because the age for full retirement varies for people born after 1937 (as described in the chart above), the percentage by which benefits are reduced for retirement at age 62 will also vary by your year of birth. This is simply because the number of months between your 62nd birthday and your full retirement age will be higher or lower depending on the year in which you were born.

Benefits are increased for each month you delay retirement after your full retirement age.

Benefits for family members and spouses

When you begin collecting Social Security retirement or disability benefits, other members of your family may also be eligible for payments based on your earnings. Benefits might be paid to your spouse (if your spouse is 62 or older, or caring for your dependent children), your children (if under age 18 and unmarried, under age 19 and in school, or any age and disabled), and your ex-spouse (if he or she was married to you for at least 10 years and is not eligible for equal or higher benefits based on his or her own work record or anyone else's). An ex-spouse's benefits do not affect your own benefits or those of your current spouse or of anyone else in your family. Your ex-spouse can begin receiving benefits when you become eligible, even if you are not yet receiving benefits.

If you are a widowed spouse of an insured worker, you are eligible for the spouse's benefits if you are 60 or older, or at least 50 years old and disabled. If you are a widowed spouse and have children at home, you may be able to receive benefits for the children. If you are an ex-spouse of an insured worker who dies, you may also be eligible for survivor's benefits if you fit the criteria listed above for a current spouse and are unmarried. Dependent parents may also be eligible if they relied on the insured person for at least half their support.

Finding out about eligibility

If you or anyone in your family have questions about eligibility, call Social Security at 800-772-1213 (TTY/TDD: 800-325-0778) to schedule an appointment with your local Social Security office. It is important to call, visit, or write your local office so that you get accurate answers to your questions about benefits, Medicare, and other programs. You may want to request some of the booklets and pamphlets the agency publishes that explain Social Security benefits and eligibility requirements in detail. You can also get in-depth information on the Social Security Administration's Web site at www.ssa.gov.

Check with your local Social Security office about how to apply for benefits. You may need to go into the office, or you may be able to schedule a telephone interview. It's a good idea to apply about three months before you reach the age of eligibility, as it can take that long for the benefits to start.

Medicare

Medicare is the federal health insurance program available to older Americans and to many adults with disabilities. In most cases, you become eligible for Medicare at 65 or if you have a disability, regardless of your income. If you are eligible for Social Security

retirement benefits but do not take them at age 65, or if you are working after age 65, you can still receive Medicare benefits.

Medicare is divided into two parts, Part A and Part B. They cover different services and have different costs. If you are eligible for Medicare, there is no premium for Medicare Part A coverage.

Medicare Part A covers inpatient hospital, skilled nursing facility, home health, and hospice services. You pay a monthly premium for Medicare Part B. Medicare Part B covers almost all reasonable and necessary medical services, including physicians' services, outpatient hospital care, durable medical equipment, laboratory tests, X-rays, therapy, mental health, and ambulance services.

Medicare covers most reasonable and necessary health care. However, it does not cover most preventive care, dental services, custodial or long-term nursing home care, or experimental procedures.

Medicare Part D, starting in 2006, offers Medicare users the chance to sign up for a privately operated prescription drug coverage plan.

If you already get Social Security or railroad retirement benefits, your Medicare enrollment is automatic. However, you should contact the Social Security office at 800-722-1213 (TTY/TDD: 800-325-0778) to make sure your coverage is in place. If you do not already get Social Security or railroad retirement benefits, enroll three months before your birthday to make sure your Medicare coverage starts as soon as you turn 65. If you are covered under a group health plan through work or through your spouse's work and if the employer has 20 or more employees, you have the option of keeping the company health plan as your primary insurer. (It pays first.) Medicare is then your secondary insurer and may pay any remaining costs. Medicare becomes your primary insurer only if you drop your company health plan or retire.

Medicaid

Many people confuse Medicaid and Medicare. The programs are very different and meet different needs. Medicaid is a federally funded program that is administered by the states. In some states, Medicaid is referred to by different names—MediCal in California, Medical Assistance in other states. The basic difference between Medicare and Medicaid lies in who qualifies for coverage. Medicare is available to almost everyone 65 years of age or older, regardless of financial need, while Medicaid is available only to those who are financially needy. A person can be eligible for Medicaid because his income is low or because his medical expenses are so high that he cannot afford them.

Because the Medicaid program is administered differently by each state, the definition of “financially needy” varies from state to state. Many states have, or are currently considering, laws that will protect a spouse from becoming impoverished while paying for the care of a husband or wife. In other states, husbands and wives, and sometimes children, are financially responsible for the care of their ill spouse or parent—and only qualify for Medicaid support when they have spent the bulk of their assets.

One of Medicaid’s most important functions is to help older people pay for long-term custodial care in nursing homes. In fact, Medicaid pays for nearly half of all nursing home costs today. But because Medicaid usually reimburses nursing homes at rates significantly less than what they charge residents who can pay for care themselves, many nursing homes will not accept Medicaid patients while others limit the number of Medicaid patients they accept.

Medicare supplemental (“Medigap”) insurance

Medicare doesn’t cover everything. For some medical services and equipment it requires you to make a 20 percent co-payment. And there are important expenses it doesn’t cover at all, such as hearing aids and eyeglasses. Private supplemental insurance is available to fill the gaps in Medicare coverage. To make it easier for consumers to compare coverage and prices, the federal government requires these policies to fall into 10 standard packages. All companies offering one of the 10 packages are required to offer exactly the same array of coverage details.

Other benefits

You may be eligible for a number of other benefits when you turn 65 (or 62 or even 55). These might include

- *Veteran’s pensions and other pensions.* Keep yourself informed about all pensions for which you are eligible through military service or previous employment. Know what choices you have and what the consequences of your choices will be.
- *Tax breaks.* Some communities assess real estate and other taxes at lower rates for older residents.
- *Reverse mortgages.* When you are 62, you are eligible to apply for a reverse mortgage on your home. With a reverse mortgage, the lending institution (such as a bank) makes monthly payments to you—in effect, buying back your house. You (or your spouse) keep ownership as long as you (or your spouse) are alive and living there.
- *Senior discounts.* If travel is a big part of your retirement plans, senior discounts can make a big difference. Keep your eye out for discounts on public transportation, movies, restaurants, hotels, car rentals, and much more. Membership in such organizations as the American Association of Retired Persons (AARP) can entitle you to additional discounts on travel, insurance, and other expenses.

When to start drawing on retirement savings and pensions

You need to be careful about when you start to draw on your retirement account or pension. In some cases, you may be able to draw funds before retirement age, but with a reduction in your benefits. Estimating your income in retirement from these plans will be important to your decision about when to retire and when to start receiving retirement income. And that estimate will be different for the two main types of retirement plans.

Defined-benefit pensions pay a fixed amount per month once you retire. The company bears the risk of providing the promised benefit. The money paid into defined-benefit pension funds does not come directly out of your paycheck. The payment you receive depends mainly on how long you worked for the company and what your salary was. When you are near retirement, discuss your pension with your company's employee benefits administrator. There may be options for continuing payments to your spouse after you die. These can be decided when you're ready to retire; you don't need to decide in advance.

Defined-contribution retirement plans, such as 401(k) plans, generally allow you to set aside a percentage of your salary, sometimes supplemented with employer contributions or profit-sharing payments. You make the decisions about how to invest your retirement savings. And that places the risk of making poor investment choices on you. Because the size of your retirement savings will depend on how much you set aside and how well you manage your investments, you won't know with any certainty how much you'll have in your account until you're ready to retire. In fact, the balance will keep varying even after you retire unless you move it into very stable investments.

With the exception of the Roth IRA, money you withdraw or are paid from a retirement account or pension is treated as taxable income. The more you take out of your savings in any given year, the higher your taxable income will be. A tax professional or CFP (certified financial planner) can help you avoid costly mistakes.

Post-retirement saving

We've talked about saving for retirement, but you don't have to stop saving when you retire. If you can afford to keep putting money into your investments,

then do so. That makes you less vulnerable to running out of money, either because you live for a very long time or have very high medical expenses.

Conclusion

Let's take one last look at the main points of this booklet:

- The purpose of retirement planning is to ensure that you have enough money to live the way you want to live once you retire.
- Retirement planning requires a clear picture of what kind of life you want to have in retirement and a reasonable estimate of what that life will cost. If you change your mind about your goals along the way, take the time to revise your estimates and your plan.
- Certain public benefits become available when you retire, or reach a particular age (usually 65), such as Social Security and Medicare. But without additional income from retirement savings or a pension, these programs will not usually provide enough money to allow you to live comfortably.
- The most effective way to build up the money you'll need when you retire is to save regularly and invest your savings, so that the balance compounds itself for growth over the years.
- For most people, the most effective way to save for retirement is through forced saving—or regular payroll deductions. Tax-deferred investment plans offer a vehicle for forced saving with some attractive and important tax advantages.
- Compounding works its power more completely the sooner you start saving and investing. Setting aside even a little bit now is better than waiting until you can invest more.

- The investment likely to give the best results over a long period (at least 15 years) is the stock market. For most people, the best way to invest in the stock market is by investing in mutual funds (which are generally among the investment choices in company 401(k) plans).
- You don't need to be an expert to grow a significant retirement nest egg. If you have questions about complicated investment choices or the tax implications of a decision, you can consult a financial planner. Consulting a carefully chosen financial planner is generally well worth the expense.

We'd like to hear any suggestions or ideas you have on this topic. Please write to us at publications@ceridian.com. Be sure to include the title of the booklet in your message. Thank you.

