Don't Run With Your Retirement Money

Understanding Your Resources and How Best to Use Them

A joint project of The Actuarial Foundation and
WISER, the Women's Institute for a Secure Retirement

WISER

The Women's Institute for a Secure Retirement

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Finding money to set aside for retirement can be a big challenge. Once you have money put away, you want to learn how to make the most of it. This booklet is intended to help you understand the things you need to consider, and how to avoid pitfalls as you transition to retirement status, however you define it.

The Actuarial Foundation®

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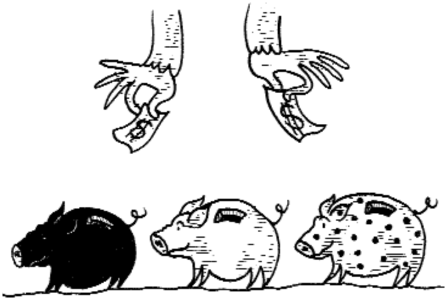
Introduction

As a worker today, you have a lot of responsibility for retirement planning. The growing availability of retirement savings programs, like 401(k) plans and IRAs, offers important opportunities to build savings, but they also require knowledge and attention. At the same time, traditional pensions that don't require a lot of knowledge and attention from workers are becoming less common, making 401(k) plans not just nice-to-have, but critical to financial security in retirement. In the midst of these changes, Social Security faces challenges of its own, leaving in question what the benefits will be and when they will be available to you and the rest of the nation's future retirees.

Just as important as building your retirement savings, however, is figuring out how to manage the money available to you when you do retire. Unfortunately, not enough attention has been paid to this part of the retirement planning process. This guide intends to help fill the gap, giving you information to help you make wiser choices as you transition to retirement status. (Although "retirement" can have many meanings, we'll simply consider it to be the point in your life when you move from building up retirement funds to drawing them down.)



We've divided the guide into three sections: taking stock of what's available to you, understanding what your needs will be during your retirement, and determining how best to meet them.

So read on to help understand the choices you will have and the options available to you as you plan for that time known as retirement, however you choose to define it.

PITFALL: KEEP AN EYE OUT FOR POSSIBLE "PITFALLS" THAT ARE IDENTIFIED BY THIS ICON.

What Are Your Sources of Retirement Income?

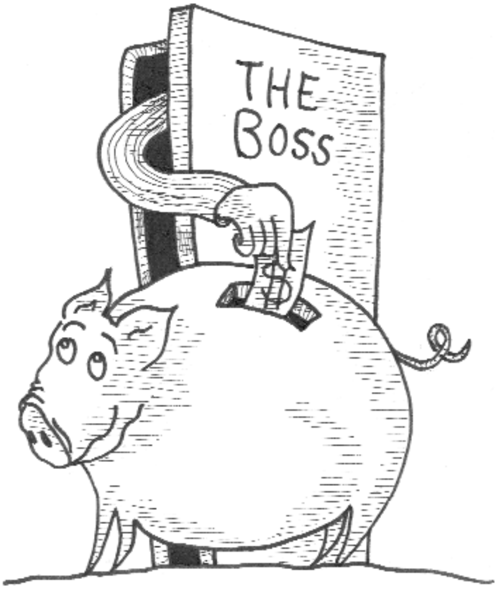
American workers can build resources for income in retirement through Social Security, employer-sponsored pension and retirement savings plans, and personal savings. This section briefly describes these sources and how you can find out what income may be available to you.

Social Security

Social Security covers the vast majority of American workers and their spouses, paying basic retirement income for life. Social Security payments increase each year to keep pace with inflation. The Social Security Administration sends annual estimates of benefits to current and former workers aged 25 or older, but you can request a statement at any time. For a copy of your statement, contact the Social Security Administration at: 1-800-772-1213, or online at www.ssa.gov.

Social Security gives you no choice about *how* to receive your benefit (a monthly payment for life), but you can decide *when* to begin receiving your benefit. This is an important consideration, because the longer you put off applying for your benefits, up to age 70, the higher your monthly payment will be, and the higher the potential survivor benefit for your spouse will be. Your statement will show you how the payments change based on when you elect to begin receiving them. Make sure to review your statement carefully when you get it—for accuracy in your earnings history, as well as for what your benefit amount will likely be.

PITFALL: MAKE SURE YOU READ YOUR ANNUAL SOCIAL SECURITY STATEMENT CAREFULLY TO MAKE SURE YOUR EARNINGS HISTORY IS CORRECT.



Your decision on when to begin receiving your Social Security benefits should take into account your and your spouse's overall financial situation, tax picture, and expected longevity. We'll talk more about this in the next section, which explains how to use several "tax-preferred" retirement savings arrangements that get favorable tax treatment from the IRS.

Defined Benefit Pension

Defined benefit pension plans are generally provided by long-established public or private employers. The traditional pension benefit provides monthly retirement payments for life, although some plans offer a single lump sum payment upon retirement. The amount is based generally on the number of years you worked for the employer and your average pay.

You can find out if your employer offers a traditional pension by contacting your human resources department, or if available, looking it up on your company's internal website.

If you do work for an employer that offers a traditional pension, it's important to find out what benefits you have earned. Each private pension plan is required to provide plan participants with written material describing the plan provisions. It is usually supplied in a booklet format, and is known as the *Summary Plan Description*. This booklet (which may be online or in hard copy) will tell you the requirements for becoming a plan member, the conditions for receiving benefits (such as normal retirement, early retirement, disability retirement and death benefits), the formulas used to determine them, and the different options for you to receive your benefits.

Defined Contribution Plans

Defined contribution retirement savings plans offer eligible employees the opportunity to save for retirement, typically through payroll deductions. Such plans are commonly known as 401(k) plans in the private sector and 403(b) or 457 plans in the public sector. Many employers match some portion of the employee contribution, and contributions and earnings grow tax-free until the participant receives the benefits in retirement.

Your account balance under a defined contribution plan reflects all the contributions made by you and your employer together with any investment gains and losses. When you leave the employer, you usually have the option of taking your money out in a lump sum, but short-service employees who are not fully vested may lose any employer contributions.

Note that you may also be eligible to receive benefits from an employer-paid stock ownership plan, money purchase plan, or profit sharing plan, under which the employer usually pays the full cost.

PITFALL: YOU MAY HAVE ACCESS TO YOUR RETIREMENT SAVINGS DURING YOUR WORKING YEARS THROUGH A LOAN, HARDSHIP WITHDRAWAL, OR CHANGE OF JOBS. IT IS IMPORTANT FOR YOU TO TRY TO AVOID USING THE MONEY BEFORE RETIREMENT. NOT ONLY WILL YOU HAVE LESS MONEY WHEN YOU RETIRE, BUT YOU WILL PAY INCOME TAX AND PENALTIES. BEING FINANCIALLY PREPARED FOR RETIREMENT IS HARD ENOUGH WITHOUT SPENDING DOWN MONEY YOU'VE ALREADY SAVED BEFOREHAND.

Personal Savings

Individual Retirement Accounts (IRAs)

IRAs are savings accounts that you can use to save part of your pay for retirement outside of an employment-based retirement savings plan. IRAs get favorable tax treatment which depends on the type of IRA. Contributions to a traditional IRA are tax-deductible in most cases, while the money you take out later is taxable as income. Contributions to a Roth IRA are not deductible, but the money you take out later usually is tax-free. Many workers use IRAs to receive rollovers of 401(k) assets when changing jobs or retiring. IRAs are an important way to accumulate more retirement savings because of the tax treatment.

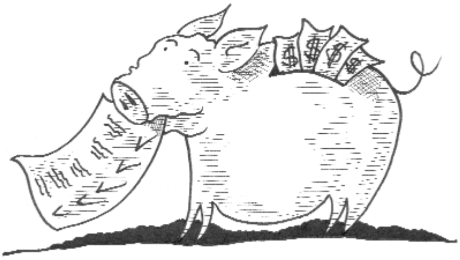
Non-Tax-Preferred Savings and Other Assets

Other possible retirement income-producing assets include money you have saved outside of the tax-preferred retirement savings system, such as savings accounts, the value of life insurance policies, or inheritances. For many working Americans, their home is their most valuable asset and can be viewed as an income resource in retirement. For example, you could:

- Move to a less expensive home, a rental property, or an assisted-care facility, using the assets from your home sale to help finance your retirement.
- Rent part of your home to generate income.
- Use a reverse mortgage, which uses the equity in your home to pay you monthly income for life. This arrangement is not used widely, but could become increasingly popular.

What Are Your Needs?

Now that you have a good idea of what your sources of income will be, this section focuses on how you can tell what you will need to lead a financially comfortable life in retirement.



Retirement planning involves developing a long-term goal and considering numerous factors, such as inflation, taxes, your likelihood of living many years, the types of income you expect to receive in retirement, how you plan to invest and spend your available assets, and whether you want to leave anything to your heirs. You will need to consider your spending needs for both basic living expenses and special interests. You will also have to consider your needs for medical care and long-term or extended care as you get older.

Get Good Advice

Seeking advice early in the retirement planning process helps ensure that you are on the right path to financial security. These are some of the questions you need to consider:

- When will you be financially ready to stop working?
- When should you apply for Social Security?
- When should you take money out of your IRA investments?
- What mix of investments is right for you?
- How much income will you need for spending each year?
- How should you handle estate planning?
- Should you buy long-term care insurance?
- Should you put some of your assets into an income annuity?

PITFALL: DON'T WAIT TOO LONG TO SEEK ADVICE. YOU SHOULD GET ADVICE EARLY ON, BUT AT LEAST THREE TO FIVE YEARS BEFORE YOUR SCHEDULED RETIREMENT DATE. ALSO SEEK ADVICE WHENEVER AN EVENT IN YOUR LIFE OCCURS THAT CHANGES YOUR FINANCIAL SITUATION.

Consider How Long Retirement May Last

How long can people retiring now expect to live? According to the Social Security Administration, the average lifetime of retirees will continue to increase.

For Americans reaching age 65 in the year 2005, the average future life expectancy is 17 years for men and nearly 20 years for women. Here are the percentages of men and women aged 65 that are expected to survive to the ages shown.

Table 1: Chances of Survival to a Later Age for Men and Women Who Reach Age 65

Age	Men	Women
70	89%	93%
75	76%	83%
80	59%	69%
85	39%	52%
90	19%	31%
95	6%	13%
100	1%	3%

So, if you are a 65 year old woman, you stand a 52 percent chance of living until at least age 85. The catch here is that life expectancy is only an average. About half of seniors will live longer. Using these averages as a guide may work for people who don't live past their life expectancy, but what about those who do? A safer bet is to assume your retirement will last to age 90 or even 100.

Think About Medical Costs

Medical care ranks high among retirees' needs and expenses, so medical insurance should be an important part of your financial plan. The federal Medicare program covers almost all Americans who are over age 65 or severely disabled, but it falls well short of covering all of a retiree's health care expenses. To supplement Medicare, you may want to buy private insurance, unless you're lucky enough to be among a minority of retirees with an employer-paid plan. Retirees under age 65 are usually not eligible for Medicare, and so their medical insurance can be very expensive. It's difficult for retirees to plan far ahead for medical insurance costs because health care costs are rising fast, and the Medicare program is likely to change. Here are some issues to consider when thinking through your medical costs in retirement:

- How will your (and your spouse's) medical bills be paid?
- Are you eligible for Medicare at age 65?
- If you're under 65, what temporary health coverage is available?
- Will you have retiree health coverage or supplemental coverage on top of Medicare? If so, what are the premiums, and how are they likely to change?

Calculate Your Needs

You can't know for sure how much of your savings you can afford to spend each year without ever running out of money. This is because it's impossible to predict how long you'll live, what will happen with inflation and your investment performance, and what unexpected costs you may have. Computer models based on economic experience can be very helpful, but some are more reliable than others, and none of them can predict the future.

Many financial planners counsel retirees to plan on spending a certain percent of assets the first year, and then raise the dollar amount a little each year to allow for inflation. For example, retirees today can start out spending four or five percent of their assets each year, with plans to adjust spending later if conditions call for it.

PITFALL: MANAGING A WITHDRAWAL PROGRAM CAN BE TRICKY. YOUR STRATEGY MAY LOOK FINE ON PAPER, BUT REAL LIFE IS FULL OF SURPRISES. PLAN TO BE CONSERVATIVE ABOUT HOW MUCH YOU WITHDRAW, AND REVISIT YOUR PLAN AT LEAST EVERY FEW YEARS. YOU DON'T WANT TO RUN OUT OF MONEY BY OVER-SPENDING, NOR DO YOU WANT TO UNDER-SPEND AND LIVE BELOW A LEVEL YOU COULD COMFORTABLY AFFORD.

Other Considerations

You'll have a lot of issues to think about when figuring out how much money you may need for your retirement years, in addition to the issues we've already touched on.

- How will you cover your normal living expenses including taxes?
- What are the needs of your spouse and other dependent family members? Remember that your spouse may outlive you.
- How will you cope with ongoing inflation? Living costs are likely to rise year by year, and the effect over time can be very big. For example, at a three percent annual rate of inflation, a dollar today will be worth about 70 cents in 12 years.
- How can you handle potential emergencies, such as home or car repairs, unexpected medical bills, or family emergencies? Can your funds cover these?
- What if you'll need long-term care, assistance at home, or special housing? Costs for these needs may keep going up. Long-term care insurance could cover part of these costs.
- Do you plan to provide an inheritance to your heirs, or contribute to charity? How will you make sure you can do this?
- Can you fulfill your retirement dreams? For example, some people like to travel extensively early in retirement and may choose to withdraw large amounts early to do that.

What's Your Best Way to Take Money Out?

Making your money last a lifetime is no simple undertaking. But with the proper organization and professional help, you can make it work.

This section is focused primarily on the choices you have available to receive your assets from a retirement account after you become eligible to receive them without tax penalty (at age $59\frac{1}{2}$ in most cases). During your working life when you are building your assets, there will be opportunities to take the money out, such as at a job change when you have the option to cash out your assets, roll them into a new employer's plan, or roll them into an IRA. You may also have access to hardship withdrawals or loans from your defined contribution plans, and you can take out IRA assets before retirement. Failing to hold onto your retirement assets in your working years can have two major consequences: first, you are making it harder on yourself to afford to retire, and second, you are going to pay income taxes and penalties. These consequences can be so significant that we urge you to keep your retirement assets for retirement, and from here on in, the information you read in this booklet presumes you will.

So what are your options for receiving your retirement money? Aside from Social Security, for which your only decision is when to receive a monthly payment for life, your other retirement assets typically come with decisions on when and how to receive them. You can lock in a regular monthly payment for life, or take a lump sum to manage on your own, or use some combination of these two methods. Table 2 highlights the distribution options based on the type of retirement plan you have.

Guaranteed Payments for Life

You will receive regular payments for life from Social Security, and you could receive a similar type of benefit from other plans. A stream of regular monthly payments for life comes from a product known as an annuity. Depending on the type of annuity, your spouse could continue to receive payments following your death, at least for a certain period of time.

Table 2: Ways to Take Your Money Out of Tax-Deferred Retirement Plans

Defined Benefit Pension	Defined Contribution Plan (401(k)-type plans)	IRA
1. Receive guaranteed benefits for life.	1. Leave your money in the plan and withdraw funds over time.	1. Leave the money in until you need to withdraw some for expenses, and then take systematic withdrawals.
2. Receive a lump sum distribution, if available, then invest and manage the money yourself.	2. Take a lump sum distribution, invest it, and withdraw funds over time.	2. Buy an annuity with all or part of your money.
3. Rollover the money to an IRA	3. Buy an annuity with all (or part, if the plan allows) to provide guaranteed income for life.	3. Cash out some or all of the IRA, and spend and/or manage it yourself.
	4. Roll over the money to an IRA and then make choices about buying an annuity, investing, or spending some or all of the money.	

Types of Annuities

Insurance companies sell several kinds of annuities, and the terminology can be confusing. We will focus only on the kind of annuities that are designed for retirees to receive income. These are sometimes called immediate annuities, life annuities, or income annuities. These are purchased with a lump sum of money at the time you want to begin receiving a guaranteed stream of lifetime income. (In contrast, "deferred" annuities are used to accumulate assets before you retire and won't be discussed here.) Here are the kinds of annuities on the market today that are designed for retirees to receive income:

- A *life annuity* usually pays you the same benefit each month for as long as you live. If the annuity pays you $500 a month when you retire, for example, then it will continue to pay you $500 a month for the rest of your life. A few insurers sell annuities that have automatic annual increases based on a formula or the rate of inflation.

- A *joint and survivor annuity* is payable to you for life, and a percentage of the annuity payment is continued to your surviving spouse or beneficiary for the rest of his or her life. Under this option, you will receive a lower benefit because the annuity has to allow for continued benefits to your survivor.

- A *life annuity with payments guaranteed* for a fixed period of time provides you with income for the rest of your life; however, if you die before receiving payments for a specified period of time, say five or ten years, benefits will continue to be paid to your beneficiaries or your estate for the rest of that period of time.

- A *"pop-up" joint and survivor annuity*, while not common, is available from some insurers and from some pension plans. With this type of annuity, the employee's benefit payment would be restored to the monthly amount of the life annuity after the spouse dies. In this case the plan would pay a smaller initial monthly benefit than under the typical joint and survivor annuity because it gives the employee the added benefit of a "pop-up" to a higher monthly payment upon the spouse's death.

Example of a Joint and Survivor Annuity

Janet can retire at age 65. Under a life annuity, she would receive $1,000 a month that would end when she dies. Janet's husband John is 67. She chooses to provide him with 50 percent of her benefit after she dies. In this case, her plan will pay her $900 a month during her lifetime. After her death, John will receive $450 a month for the rest of his life. This is typically known as a 50 percent joint and survivor annuity.

Example of a Life Annuity With Payments Guaranteed for Five Years

Alan is planning to retire at age 67. His standard benefit is $2,000 a month payable in the form of a life annuity with payments guaranteed for five years. If Alan dies after two years, at age 69, his wife Jackie will continue to receive benefit payments for another three years. However, if Alan lives beyond the guaranteed five years—to age 72 in this case, Jackie will not receive further benefit payments when Alan dies.

Benefits from Defined Benefit Pension Plans

Defined benefit pensions are typically paid in monthly installments. Each plan offers standard and optional ways for you to receive your benefits. (As discussed in the first section, you can find this information in your plan's *Summary Plan Description*.)

Purchasing Income Annuities on Your Own

You can buy an annuity with funds you receive from a defined contribution retirement plan, an IRA, savings, or any other source. The amount of income you will receive from an annuity is based on the amount you pay the insurance company, the income option you choose, current interest rates, your gender, and your age at the time you purchase it.

Some advisors suggest that you buy an annuity after you retire, between about ages 70 and 80, if your prospects for a long life are still good. As you get older, the rates will be more attractive and there will be less risk to you of future inflation. Another option is to buy multiple annuities at different times, to allow you to spread out both interest rate risk and the payment of income taxes.

A New Annuity Protects Against Outliving Your Savings

Insurance companies have begun offering a new type of annuity that is often referred to as "longevity insurance." With this product, you pay a single sum upfront, and benefits begin at an advanced age, such as 85. With longevity insurance, retirees can be less concerned about spending through their savings if they live far beyond what they expected. But it must fit into a retiree's total financial picture, so it should be considered carefully.

The Pros and Cons of Income Annuities

As with all aspects of retirement planning, the decision to purchase an annuity involves many considerations. Here are some of the pros and cons for you to think about:

The Pros

- It guarantees income for life. The insurance company you buy an annuity from (or your employer, as the case may be with a defined benefit pension) takes on the investment risk, as well as the risk of guaranteeing payments for life even if you live past 100. The insurance company estimates how many people will live to age 80, 90, 100, etc., and calculates the premium based on their estimates.
- It gives you a form of security that traditional investments can't. Managing your own retirement savings without an annuity is uncertain and requires substantial knowledge and attention.
- If you apply for Medicaid or other means-tested benefits, annuity benefits (including those from defined benefit pension plans) may not count as income in determining your eligibility. This varies by state.
- It is a good option if you are a retiree who is older, in good health, and ready to transfer to an insurer the job of managing part of your assets.
- If you buy an annuity using IRA or 401(k) funds, it has the advantage of satisfying IRS rules for required distributions after reaching age 70 1/2 (more on this later).

The Cons

- With most annuities, your choice is final—you can't decide to change your mind once payments have begun. You give up control of your money and lose the flexibility to take advantage of an upswing in the stock market or to use the money for other purposes.
- The price includes the insurer's profit, marketing and administrative costs.
- If you are not in good health with at least a normal life expectancy, the annuity will probably not end up providing you with a good return for the cost.
- It doesn't allow you to leave any of the money you pay for the annuity to your heirs unless you pay an extra price so that the annuity contract provides for additional payments after your death.
- Most annuities pay a fixed income that will lose purchasing power with inflation, although a few annuities pay income that increases over time to help cover rising prices.

You normally shouldn't convert all your retirement funds to an annuity, but should keep some money available for unexpected expenses. If you decide an annuity is right for you, take a look at some shopping tips in the Appendix.

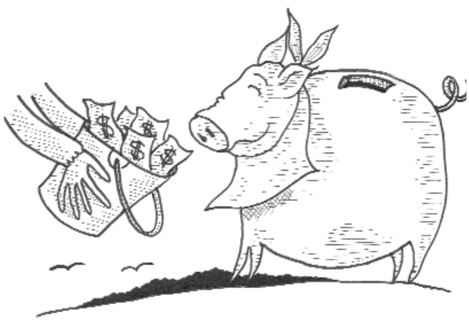
For more information on buying an annuity, see *Making Your Money Last for a Lifetime: What You Need to Know about Annuities*, available online at www.wiserwomen.org.

A Note about Social Security Benefits

As we stated earlier, you will receive your Social Security benefits in the form of a monthly payment for life. However, you do have a decision to make on when to begin receiving your benefits.

Financial advisors have typically suggested a conventional strategy of applying for Social Security benefits as soon as you retire. This strategy did not focus on the value of survivor benefits and was a mistake for many people. Also, Social Security benefit formulas now give bigger increases than in the past to workers who wait to apply for benefits after normal retirement age. Today, some advisors suggest that married workers wait a few years after retirement to apply for Social Security, and first draw on their retirement savings from a defined contribution plan or IRA for income during those years. This has two possible advantages. First, by spending down retirement savings more rapidly, the couple may be able to reduce income taxes payable on Social Security benefits later. Second, by waiting to collect Social Security, the worker will get a substantial benefit increase for each year payment is deferred before age 70, and this will increase the potential survivor benefit payable to the worker's spouse. Thus, a non-working spouse who outlives the working spouse can gain substantial Social Security survivor protection. Before adopting this strategy, couples should carefully review advantages and disadvantages, taking into account their total finances, tax picture, and anticipated longevity.

PITFALL: CONSIDER THE IMPACT ON SURVIVOR BENEFITS WHEN APPLYING FOR SOCIAL SECURITY. DEFERRING YOUR BENEFITS FOR A FEW YEARS CAN RESULT IN SUBSTANTIAL PROTECTION FOR YOUR SURVIVING SPOUSE.



Managing the Money Yourself

Rather than taking your pension plan money in the form of a steady income stream in retirement—a stream that usually isn't intended to keep pace with inflation, you could choose to take a single lump sum, if the option is available from your plan. In this case, you probably would roll over the lump sum to an IRA, using a direct rollover as explained on page 22. Before you seriously consider taking your benefit in this form, ask yourself how confident you feel that you can manage the money yourself. Remember that your retirement assets are intended to provide you (and possibly your survivors) with a source of income for life.

Lump Sums from Defined Benefit Pensions

You may be able to receive your defined benefit pension as a single lump-sum payment. In such cases, you can direct your plan administrator to roll the lump sum over to an IRA so you don't pay current tax on the distribution. Or you can use the money immediately, in which case it will be subject to federal tax and possibly state and local tax.

When you take your benefit as a lump sum from a defined benefit pension, the plan will calculate the present value of your benefits and pay you that amount. Be aware that a private pension plan must abide by government rules and formulas in calculating your lump sum, and must offer the same amounts to men and women. In contrast, an insurance company is competing with other insurers and is free to set its annuity rates as it wishes. Insurers know that people who buy an income annuity usually expect to live a long time, and that women tend to live longer than men. You can look into this by comparing the amount of annuity that the lump sum could purchase from an insurance company against the annuity amount available to you from the plan. There are several annuity calculators available on the Internet; one that we find useful is www.immediateannuities.com.

The amount of the lump sum payment from a defined benefit pension is based in part on the expected longevity of a person of your age and gender (see Table 1 on p.7). If you have health issues that may reduce your life expectancy, consider taking the lump sum, rolling it into an IRA, and investing it, or taking a form of annuity that will protect your spouse.

PITFALL: IF YOU ARE THE SPOUSE OF AN EMPLOYEE WHO WANTS TO RECEIVE A LUMP SUM FROM HIS DEFINED BENEFIT PLAN, CONSIDER THAT YOU ARE WAIVING YOUR RIGHT TO PENSION PAYMENTS IN THE EVENT OF HIS DEATH. THINK THROUGH YOUR OTHER RETIREMENT INCOME SOURCES FIRST.

PITFALL: SOME EMPLOYERS THAT PROVIDE RETIREES HEALTH CARE AND OTHER BENEFITS DO NOT PROVIDE THEM TO EMPLOYEES WHO TAKE LUMP SUM DISTRIBU- TIONS. FIND OUT THE FACTS BEFORE TAKING ACTION.

Another reason to consider taking a lump sum from your defined benefit pension plan is if you are concerned that the plan may not be able to pay your full benefits in the future. A federal government agency, the Pension Benefit Guaranty Corporation, insures defined benefit pension plans. However, the highest earners may be affected by the agency's limit on what it will pay. For a pension plan that terminates in 2008, the maximum benefit from the agency for a life annuity is $4,312.50 a month, and $3,881.25 for a joint and 50 percent survivor annuity. These limits are reduced if the pension begins before age 65.

It pays to understand how taking a lump sum from your defined benefit pension can affect other post-retirement benefits. Some employers provide their retirees health insurance or other valuable benefits that are only available to current retirees and their spouses collecting monthly benefits *and not to* former employees who have taken a lump sum. These plan provisions vary among employers, so make sure you find out the facts. Understand, though, that an employer's non-pension benefits are not necessarily guaranteed forever. Employers can generally change health insurance or similar retiree benefits.

Lump Sums from Defined Contribution Plans

If you choose to receive a lump sum distribution from your defined contribution plan, you can roll the money into an IRA. From there, you could manage the investment of funds yourself, use an investment manager or mutual fund, purchase an immediate annuity, or use a combination of these options. You can make several purchases of annuities at different times to spread out interest rate risk and tax payments.

You can also take a lump sum distribution from your defined contribution plan instead of rolling over the money. You will generally have to pay taxes on the full amount of the distribution. After that, you can spend the funds whenever and however you wish, including setting some or all of your money aside to buy an annuity later.

An option in some defined contribution plans is to leave your money in the plan and receive the funds over time. This allows you to withdraw invested funds on a planned basis, for example at four or five percent a year, or periodically as needed. You also can withdraw a large amount at one time if needed.

Investing Your Savings

As a retiree, your investment mix should be somewhat conservative, emphasizing fixed-income securities such as bonds. But you could still include a significant commitment to the stock market if you have a solid base of ongoing income and you can afford to accept the risks along with the rewards. Be sure to think about your total retirement resources as an integrated portfolio when you plan your investments. To protect against large losses, diversify your assets by using various types of investments whose values don't all rise or fall together. It's especially dangerous to invest heavily in your employer's stock, risking the loss of both your job and your nest egg, as some unfortunate individuals learned the hard way in recent years.

When investing in the stock market, you should spread your total investments among different kinds of holdings, including small businesses and overseas corporations, for example, to protect against times when one sector may perform poorly. You'll need to review and rebalance your investments at least every few years, recognizing that your financial picture and investment markets will change over time.

PITFALL: MANY PEOPLE ASSUME FIXED-INCOME INVESTMENTS ARE RISK-FREE. THEY AREN'T—HERE ARE SOME RISKS WORTH KNOWING:

- **INTEREST RATE RISK**: WHEN INTEREST RATES GO UP, THE VALUES OF BONDS THAT YOU OWN GO DOWN.
- **CREDIT RISK**: CORPORATE BONDS ARE AT RISK WHEN AN UNPROFITABLE COMPANY IS UNABLE TO PAY BACK ITS BOND HOLDERS.
- **INFLATION RISK**: THE INCOME YOU GET FROM ANY FIXED INCOME INVESTMENT WILL TEND TO BUY LESS EACH YEAR.

Also, pay attention to the expenses associated with your investments. For more information on this, see WISER's fact sheet on Mutual Fund Expenses at www.wiserwomen.org.

Fixed Income Investments
When managing your own retirement funds, avoid using only short-term investments like certificates of deposit, Treasury bills and money market funds. While these investments are unlikely to lose money and will pay interest, they won't likely keep up with inflation. Instead, consider investing in longer-term investments that pay higher interest rates. For example, you can buy shares of low-cost mutual funds that give you convenient access to practically any kind of fixed-income security. Mutual fund investments are spread across many securities, allowing you to absorb losses if some perform poorly.

Tax-free municipal bonds can be a good investment if you're in a high tax bracket. But avoid holding these in an IRA because you'll earn less interest than you could get from other investments and you'll pay unnecessary taxes when you take the money out.

Stock Investments
You have several options on how to invest in stocks. You can own individual stocks or mutual funds. If you hold individual stocks, you will need to keep close track of your holdings and the stock market.

Mutual funds can use fund managers who try to pick stocks that will outperform the market, or they can use index funds, which are set up to mirror a diversified basket of securities (such as the S&P 500 Stock Index). Index funds have grown in popularity because of their low expenses and good investment performance. Investing in index funds is a "cruise control" method that doesn't require any skill in selecting securities or timing the ups and downs of the market. Different kinds of index funds now are available to let typical savers invest in various kinds of stocks or bonds.

Your Home as an Income Source
If you own your home, you can consider renting out part of it. Or you can consider selling, moving to less expensive housing, and investing the proceeds to help meet future expenses. You can also consider a reverse mortgage to provide income and extra assets while staying in your current home. A reverse mortgage is basically a reverse of the normal

mortgage payment stream. Rather than making monthly payments *to* a lender, you as the borrower receive monthly payments *from* the lender. The amount of income from this kind of a product depends on the equity in your home, its appraised value, the terms of the loan, and your age and marital status. You need to be careful because reverse mortgages sometimes have high closing costs and expense charges.

Accounting for Taxes

As painful as it can be to think about taxes, it pays to know how you can reduce them on the money from your tax-deferred retirement plans. If you do it right, you will have that much more retirement income to work with. But don't forget to figure income taxes into your post-retirement budget.

Taxation of Defined Benefit and Defined Contribution Plan Payments

Payments to you from a pension plan or a defined contribution plan are taxed as ordinary income if 1) you didn't contribute to the plan, or, 2) you did contribute but your contributions were made pre-tax (that is, you didn't pay income tax on the amounts that were set aside from your gross pay). If you made after-tax contributions, part of your payments will be tax-free because the amounts will be treated as a return of contributions that have already been taxed.

PITFALL: WHEN MOVING MONEY FROM A DEFINED PENSION OR DEFINED CONTRIBUTION PLAN TO AN IRA, MAKE SURE YOU USE DIRECT ROLLOVER. IF YOU DO NOT, YOU'LL PAY A 20% WITHHOLDING TAX, WHICH YOU CAN GET BACK, BUT IT'S NOT EASY.

Receiving employer stock from a defined contribution plan gets a special tax break if you meet certain rules. You will owe ordinary income tax on the original value of the shares when you receive them. If you hold the shares for at least 12 months after you receive them, however, you will owe capital gains tax on the investment earnings above the original amount you paid for the stock when you sell it. Since the capital gains tax is often lower than ordinary income tax, holding onto the stock for a year after you receive it can reduce the tax you pay.

If you take your retirement money as a lump sum from your defined benefit or defined contribution plan, you can defer taxes by making a direct rollover to an IRA. Making a direct rollover is important. If you take a lump sum instead of having the trustees make a direct rollover, then the trustees must withhold 20 percent from the full amount, even if you immediately put that lump sum into a rollover IRA.

To preserve the tax-deferred status without a direct rollover, you would have to deposit the full amount of the distribution into an IRA within 60 days, including an additional amount equal to the 20 percent that was withheld. You would then receive the 20 percent tax withholding as part of your tax refund, if you're entitled to one, for the year of the distribution.

Taxation of IRA Distributions

All the money you take out of a traditional IRA to which you have made tax-deductible contributions is taxed as ordinary income. If you have a Roth IRA or other kind of non-deductible after-tax IRA, then distributions, including investment returns, usually are not taxable.

Distributions from an IRA you inherited can be paid out over your lifetime. Tax treatment of an inherited IRA follows special rules that can be important to you and other heirs. You may want to get help from a tax advisor when receiving funds from an IRA that you inherit or when filling out the form to name a beneficiary for your own IRA.

Social Security Taxes

In some cases, depending on your income, part of your Social Security benefit will be taxable. A single person will not pay taxes on Social Security benefits if her income—including one half of her Social Security benefits and income from any tax-free municipal bonds—is under $25,000. The same applies generally to couples filing jointly to the extent their income does not exceed $32,000. For more information, see IRS Publication 915, "Social Security and Equivalent Railroad Retirement Benefits," available online at www.irs.gov.

Taxation of Stocks and Bonds

Investment income on savings outside of retirement plans or IRAs is taxable each year. Although tax law is always subject to change, currently the income tax rates on dividends and capital gains from stocks you hold are typically lower than the rates on ordinary income. If you invest in both stocks and bonds, you may consider holding stocks outside of your retirement plan or IRA for the tax benefit.

Taxation of Other Savings

Because investment income on regular, non-tax-preferred savings is usually taxable each year, financial advisors often suggest that you take retirement income from regular savings first and let IRA or 401(k)-type plan funds grow tax-preferred as long as possible.

Penalty Tax for Not Taking Your Money After Age 70$^1/_2$

If you hold onto your retirement plan assets too long in the eyes of the IRS, you will pay a heavy tax penalty. The "minimum required distribution" rule requires you to begin annual withdrawals from a defined contribution plan or a traditional IRA no later than the year in which you reach age 70$^1/_2$. (For the year in which you attain age 70$^1/_2$, you can actually defer distributions until April 15 of the following year.) The minimum amount is calculated from an IRS table. The IRS charges a 50 percent tax on any shortfall between what you have taken out of the plan and the minimum required for a calendar year. Financial institutions or plan administrators usually will make the necessary information available to you to avoid running afoul of these rules.

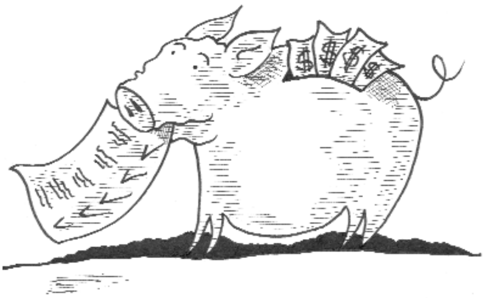
PITFALL: PAY ATTENTION TO THE TAX RULES THAT REQUIRE YOU TO BEGIN TAKING OUT A CERTAIN PERCENTAGE OF YOUR RETIREMENT ASSETS WHEN YOU REACH AGE 70$^1/_2$. IF YOU RUN AFOUL OF THE RULES, THE TAX PENALTY IS SIGNIFICANT.

State and Local Tax

State and local income tax rates vary greatly, with some states having no income tax and others having substantial tax breaks for retirement income. You may even want to consider moving to a place with favorable tax treatment of retirement income.

Conclusion

It's no secret that finding money to set aside to save for retirement can be a big challenge. But once you do have money put away, you want to learn how to make the most of it. This booklet is intended to help you understand what you will need to consider, and what the implications of various decisions could be.



You are among the first wave of American workers to assume primary responsibility for your retirement income. Social Security will be around, but the form, timing of payments, and benefit amounts may change. Most future retirees will not have lifetime income from traditional pension plans. Individual saving, through 401(k)-type plans and IRAs, has taken on monumental importance. The many decisions working savers face are significant, but so are the opportunities to build enough assets to afford a comfortable standard of living in retirement.

Be prepared by understanding your sources of retirement income and the rules that apply to them, preserving your savings for retirement rather than tapping into them earlier, staying aware of how tax law changes might affect you, and keeping an eye out for new products that may help you secure your income in retirement.

Retirement planning, from building enough assets to taking them out in the best way possible for you, involves knowledge and action. You're doing the right thing by reading this and other publications that can help you build the knowledge so you can take the appropriate actions to ensure financial security during your retirement.

Appendix

Checklist for Managing Your Savings in Retirement

- ❑ Invest for income security and try to allow for your income to rise with inflation.
- ❑ Provide enough annual income to pay your bills, while preserving a rainy-day fund adequate to handle unusual or unexpected items.
- ❑ Adjust your living standards if your after-tax income will not be able to meet your expenses.
- ❑ Plan how to manage all your financial resources together—Social Security, pensions, and savings. If you have a solid base of ongoing income, you can invest your savings more aggressively.
- ❑ Consider your home and other fixed assets as possible sources of income to meet your living needs.
- ❑ Stay informed about tax issues affecting retirees.
- ❑ Be sure to take minimum required distributions after age $70^{1}/2$ from an IRA or 401(k) account.
- ❑ Consider how to cope with risks such as longevity, inflation, and lifestyle changes using available insurance and investment products.
- ❑ In the event of divorce, make sure you file for a qualified domestic relations order to govern the division of pension assets, to avoid risking unfavorable treatment under state law.
- ❑ Keep track of how your investments are doing, your changing needs for income, how financial markets and products are changing, and how income annuities might help you achieve your goals.
- ❑ Understand how to choose and use investment brokers and financial planners.

Annuity Shopping Tips

If you decide that purchasing an income annuity is right for you, here are some tips when shopping for one:

- **Compare options.** Compare different options if you need both lifetime retirement income and income for survivors or heirs, such as a joint and survivor annuity, or an annuity that is guaranteed to make payments for a minimum of five or 10 years.

- **Use a financially healthy insurer**. You want a life insurance company with a strong financial rating because an annuity is a long-term arrangement. Several insurance company rating services measure financial strength, and the Internet or your public library can help you check rating information.

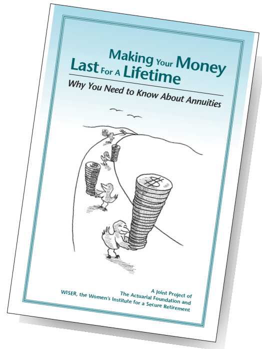
- **Compare rates.** Comparing rates among different insurers requires little paperwork and no physical exam. The Internet has made shopping for an annuity much easier. You want to get the annuity with the best price from the strongest insurer, or come as close to this ideal as you can.

- **Know about state protection**. Your state insurance department may help clear up problems you might have with a specific company or representative. Each state also has a guaranty fund to protect individuals if an insurer becomes unable to pay benefits in full. Find out how this fund would cover your annuity contract, including any dollar limits that apply.

Other joint projects of The Actuarial Foundation and WISER, the Women's Institute for a Secure Retirement

Making Your Money Last For A Lifetime

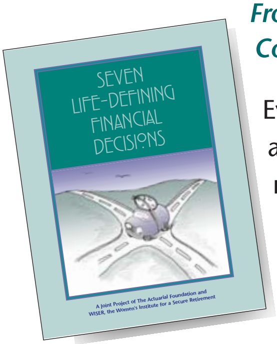
Why You Need to Know About Annuities



This booklet provides information and guidelines for people on how to make their savings last. It helps explain the important role that immediate annuities can play in stretching an individual's money to last as long as that person lives.

Seven Life-Defining Financial Decisions

Making the Most of Life's Key Decisions —



From Careers and Marriage to Savings and Retirement, Consumer GuideBook Offers Tips for Making the Right Choices.

Everyone faces key financial decisions that will dramatically affect the resources they have to enjoy their lives in retirement. A new guidebook, "Seven Life-Defining Decisions," provides an easy-to-follow roadmap for avoiding life's ditches and detours and safely navigating to a financially secure retirement.

To order either of the above or for a list of WISER's publications, please visit our website at **www.wiserwomen.org**, or call us at 202-393-5452.

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