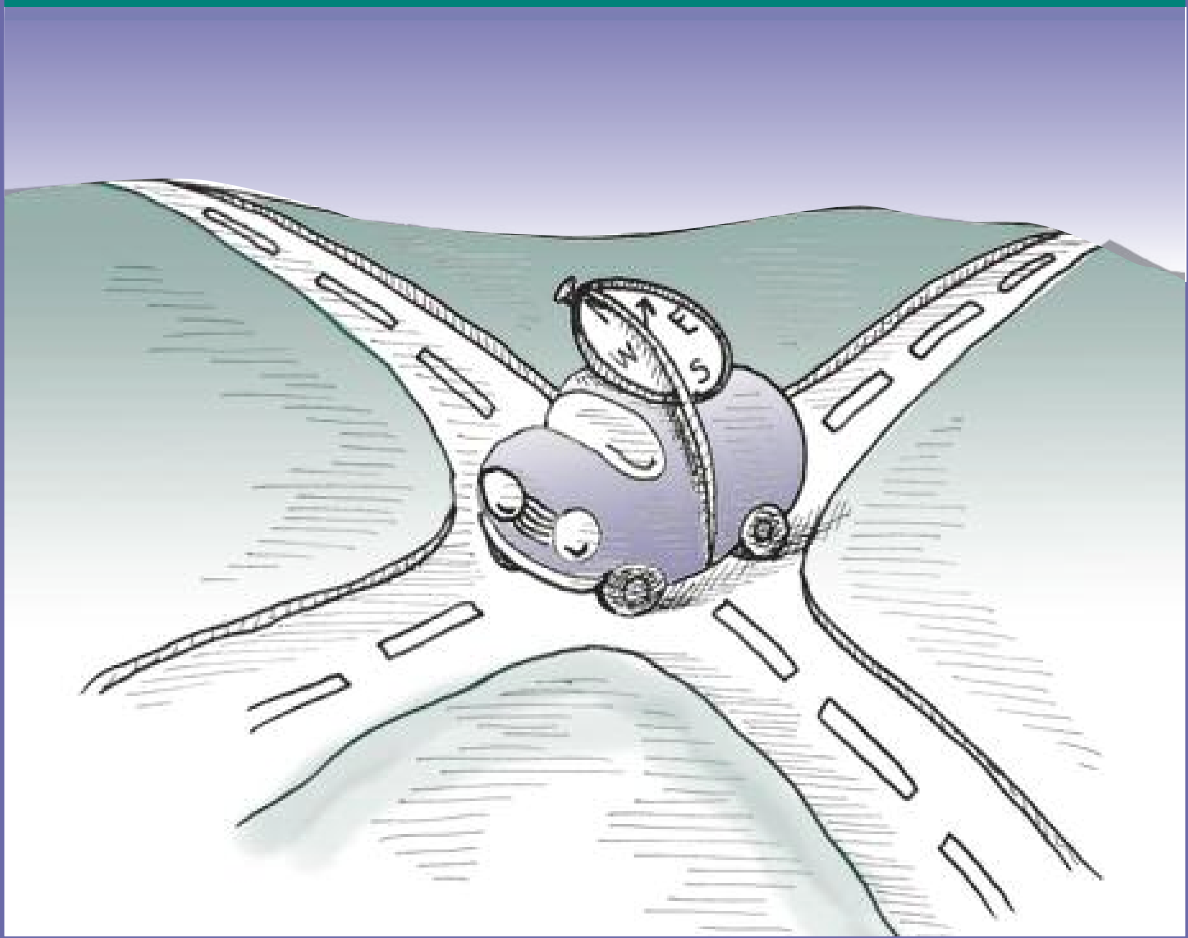
# SEVEN LIFE-DEFINING FINANCIAL DECISIONS




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


## *Acknowledgements*

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## Dedication

Gertrude Guckenheimer immigrated from Nazi Germany to America, where she lived a thrifty lifestyle and focused her saving on a good retirement and a helping hand for friends and family members. A much admired model for family, co-workers and the students she taught, she helped others improve their lives by teaching how planting the seeds of savings truly can change lives for the better.

## A Joint Project of The Actuarial Foundation and WISER, the Women's Institute for a Secure Retirement

The Actuarial Foundation, a 501(c)(3) organization, was established in 1994 to help facilitate and broaden the profession's contribution to society. The Foundation explores innovative ways to apply actuarial skills in the public interest and brings together broad partnerships of individuals and organizations to address social problems in creative ways.

WISER is a 501(c)(3) organization, established in 1996 by the Heinz Family Philanthropies to improve the opportunities for women to secure retirement income.





THE ACTUARIAL FOUNDATION®

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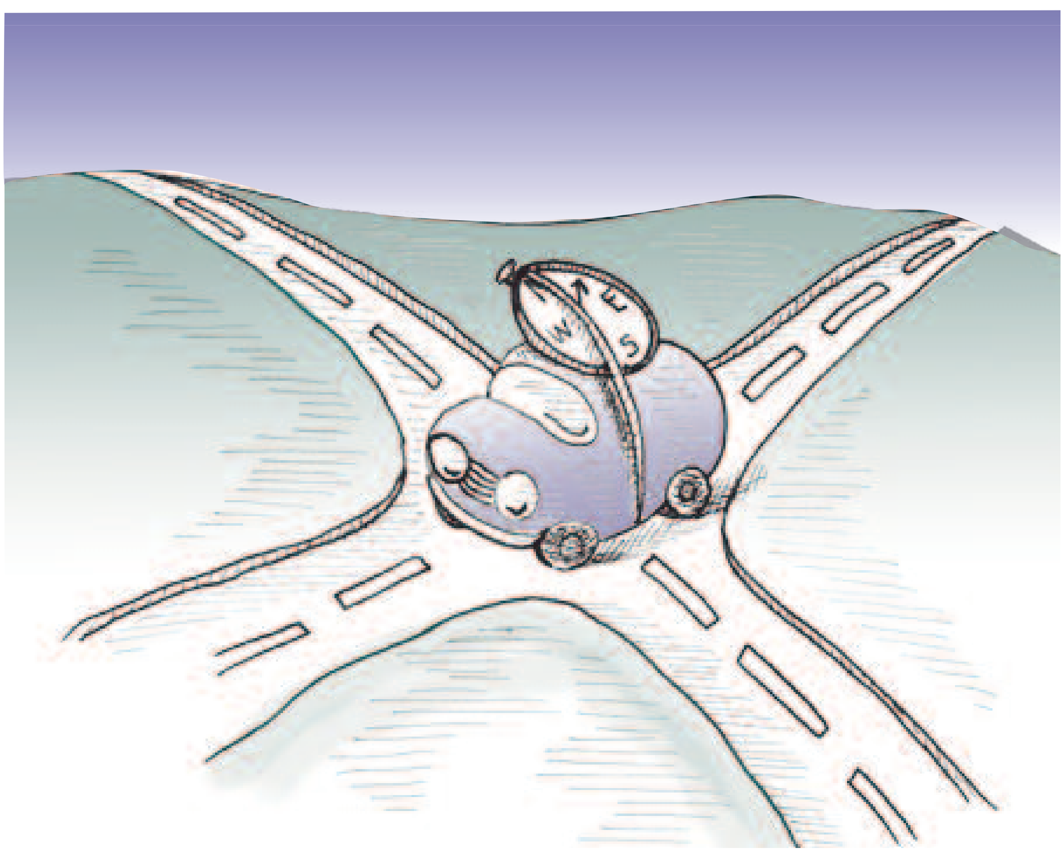
# 1

# START PLANNING

**Decisions you make throughout your lifetime — choosing a career, getting married, having children, buying a home, starting to save and invest — have a big impact on your future financial security, including retirement.**

**At many different points in your life, you can take steps to ensure a smoother journey and a more secure financial future.**



## This is your road map for making wiser financial decisions.

Knowing and understanding the rules of the road can help you avoid life's financial potholes and dead ends. The more you know at the beginning of the journey, the smoother your ride will be.

Here are some key tips for your life-defining financial decisions:

1. Start planning early for long-term goals, such as buying a home, paying for your children's education, and ensuring a comfortable retirement.

2. Pursue a job with good benefits and make the most of them.

3. Keep actively involved in the financial decisions when you marry or live with someone. Understand the financial consequences of divorce and carefully protect your interests if you should leave a marriage.

4. Avoid accumulating credit-card debt and keep your credit record in the best possible shape to qualify for the lowest interest rates on your car and home loans.

5. Study and carefully select your options, from IRAs to 401(k) plans, for saving for retirement.

6. Learn the investment rules of the road and make a financial plan to ensure your life savings will get you to your savings goals and last you through retirement.

7. Explore the options for protecting yourself and your family by having adequate disability, life, health, and long-term care insurance.

Last, but not least, don't be afraid to ask for directions along the way!

If you don't find all you need here, we have more information on our websites: www.wiserwomen.org and www.actuarialfoundation.org.

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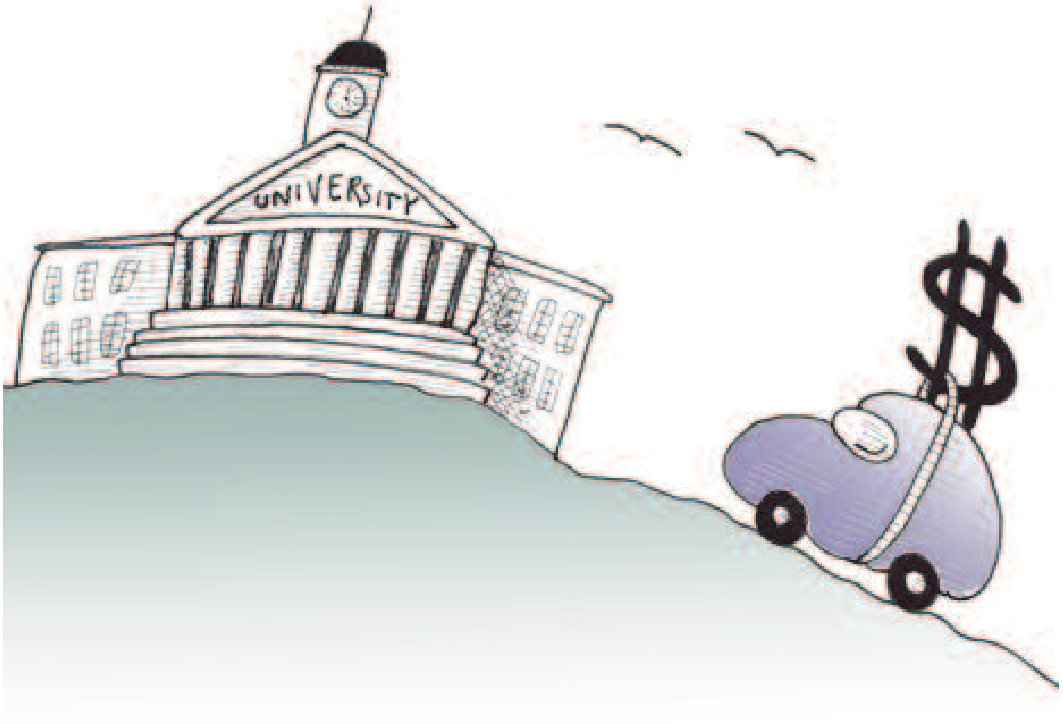
# JOBS AND CAREERS

**When starting or changing jobs, most of us know to ask about the pay. Some jobs offer benefits that are worth a good deal of money, such as health insurance, pensions, and retirement savings plans.**

**While not everyone can get a job with good benefits, it is important to know that they are out there and to include a job with benefits in your goals.**




# TAKING A JOB

**Early career decisions and later job changes can make a big difference in your finances and options down the road.**

## Rules of the road

When you are job hunting or considering a job offer, ask about the benefits. In a larger company, you can call the Human Resources Department and ask — you don't have to tell them who you are or that you are considering working there.

While this chapter focuses on retirement benefits, you should also ask about health insurance, life insurance, and disability insurance. There is additional information about these benefits in Section 7.

## Pension Detour/Roadside Assistance

Pension plans often seem complicated or dull, but they can provide very valuable benefits.

There are two basic kinds of employer-sponsored pension plans:

1. defined benefit (DB) and
2. defined contribution (DC) plans.

Some employers have both types of plans for their employees.

1. Under a defined benefit (DB) pension plan, the employer invests money and pays you a benefit at retirement.

- In private company DB plans, the employer often funds the plan and makes the investment decisions.
- The retirement benefit is usually based on the employee's years of service and highest average pay level. This plan is most valuable to employees who stay a long time with one employer.
- You must stay long enough, often five years, to be vested. This means that you can receive a pension benefit at retirement even if you are no longer working for that employer. If you leave sooner, before you are vested, you will not receive a benefit.

2. Under a defined contribution (DC) pension plan, such as 401(k), 403(b), and 457 plans, it is generally up to you to decide to have money taken out of your paycheck to invest in a retirement savings account.

- Some employers also contribute or match a portion of your contribution. For example, an employer may contribute $.25 or $.50 for every $1.00 you put in, up to a certain amount. Find out how much you have to contribute to get all the matching contributions that are available.
- You, the employee, choose from investment options and bear the risk of choosing good investments.
- The amount is taken out of your pay before income taxes are deducted, so your contribution can cost you less than the dollar amount you choose. The amount in your account grows tax-deferred — you do not pay taxes until you take the money out.
- You generally have to stay three years in order to vest in the employer's contributions. Your own contributions are always yours to take with you when you leave a job.

## Back on the road

The value of the pension to you now and at retirement depends on several things. In a defined benefit plan, your pension benefits depend on:

- Your salary plus how long you stay at that job. You can ask the pension plan administrator to explain in writing how much you would receive from your pension if you stayed a certain number of years.

In a defined contribution plan, the value of your account depends on:

- How much you contribute, how much the employer contributes, how long you have to stay to vest in or keep the employer match, and the success of your investment choices.

## Decisions

If your job has no pension benefits, you should save on your own in an Individual Retirement Account (IRA). Saving in an IRA is a good idea even if you have a pension through your employer.

If your job has a pension, make sure you understand how it works. Don't worry about looking foolish by asking a lot of questions. It's a bigger mistake to miss out because you didn't understand how it worked.

Be aware that the employer can change the pension plan at any time. You cannot lose benefits you have already earned, but future benefits that you counted on may be drastically different.

If your employer has a defined contribution plan, like a 401(k), make sure you understand the plan, then decide how much to contribute to it, and how to invest it. It's a good idea to get started, even with a small amount until you get used to how it works, especially if there is an employer match. Get your contribution up to the level that gives you the full amount of employer match available. Employer matching contributions are essentially free money that you don't want to leave on the table.

# LEAVING A JOB

**Changing jobs, even for higher pay, can cost you a bundle in lost benefits and retirement income.**

## Rules of the road

Sometimes when you leave a job, you have some say over when and how you leave. Other times you don't. Either way, it is important to understand the long-term financial consequences.

When you leave a job, you need to consider what will happen to your retirement benefits:

- If you are in a defined benefit pension plan, you usually become vested in 5 years or less. Once you are vested, you can collect a benefit from that employer when you reach retirement age. Generally, the longer you stay, the more valuable the benefit will be. Some government pension plans have longer vesting periods.
- In a defined contribution pension plan, there is a similar requirement — you must stay a certain number of years (often between 3 and 6 years) or lose the money the employer contributed to your account.
- If an employer provides retiree health insurance, it will usually be only for retirees who worked for the employer until retirement age and receive a monthly defined benefit pension over the remainder of their lives.

When you leave a job, if you are not immediately going to another job with health insurance coverage, you can often elect to continue coverage under the previous employer's group health insurance policy, but you pay all of the premiums. You have 60 days to decide if you want to elect this coverage under a federal law referred to as COBRA.

## Decisions

If you are covered by a pension in a job, make sure you understand what will happen to your pension when you leave. If possible, wait until you are vested in the defined benefit pension or vested in your employer's contributions to your 401(k) or other defined contribution plan before you leave.

When considering another job offer, compare the value of any benefits you have at your current job to those at the new job opportunity. The longer you work, the more

!

Barbara B. knew she was going to leave her job, but she was determined to stay just long enough (to the exact hour) to meet the 5-year vesting requirement for the company's defined benefit pension plan. The money in her defined benefit plan was too much to walk away from, even though she was confident she would find a job that paid more. And, because she talked about it, the whole office became aware of the 5-year vesting requirement.

you may have to lose in the way of retirement, seniority, and other benefits. If you switch jobs, even a substantial pay increase may not offset the value of pension growth you'll lose.

If you are leaving a job with a defined benefit pension plan, your employer can tell you what you will receive as a monthly pension benefit when you reach retirement age, if you should leave now or at a later point. For example, ask for calculations of what your benefit would be if you left the job now, in a few years, and if you stayed for most of your career. If it's an option, consider staying another year or two if it would dramatically increase your benefit.

In a defined contribution plan, when you change jobs, you will have some choices. You can leave your retirement savings in the same account or roll it over into an Individual Retirement Account (IRA). You also have the opportunity to take the money out, but you should resist the urge to spend it. Keep it invested so that it continues to grow until you retire. Plus you'll avoid the IRS penalty for taking it out early.

## STAYING HOME FULL-TIME

**There are many reasons to stay home to care for children or other family members, but it is important to think through the family finances, including retirement planning.**

### Rules of the road

You know the upside, so we'll make sure you've thought about the potholes you might hit down this road.

Staying home, you will lose compensation and benefits; you may also lose job skills and contacts. For some, there may also be a loss of tenure and its benefits, such as promotional opportunities, job security, or more vacation days. If you are leaving behind a pension plan, you will lose years of service toward vesting or increased benefits and/or account contributions that build up while you work.

## Decisions

Before you leave your job, sit down with your spouse and budget your expenses and how you will cover them with one income.

Do some worst-case planning and consider what might happen if your spouse should become disabled or die, or if you should get divorced. Find out what health, disability, and life insurance coverage you have, and what it would cost if you decided to buy additional coverage on your own.

Stay-at-home spouses should consider putting money into a Spousal Individual Retirement Account (IRA). If you are a spouse with no earned income, you can contribute $5,500 a year to a Spousal IRA, or $6,500 if you are 50 or older. These amounts will be increasing over the next few years and, of course, you can always put in less. You can deduct the amount of your contribution when you file your income taxes if your joint adjusted gross income is below $150,000. You get a partial deduction if your income is under $160,000. There is more information on IRAs in Section 5.

If you start your own business or do some consulting while at home, you could also start a small business pension plan, like a SEP, a Simplified Employee Pension. A SEP is easy to set up and will let you contribute more than an IRA. If you hire others into your business, you can include them in the plan.

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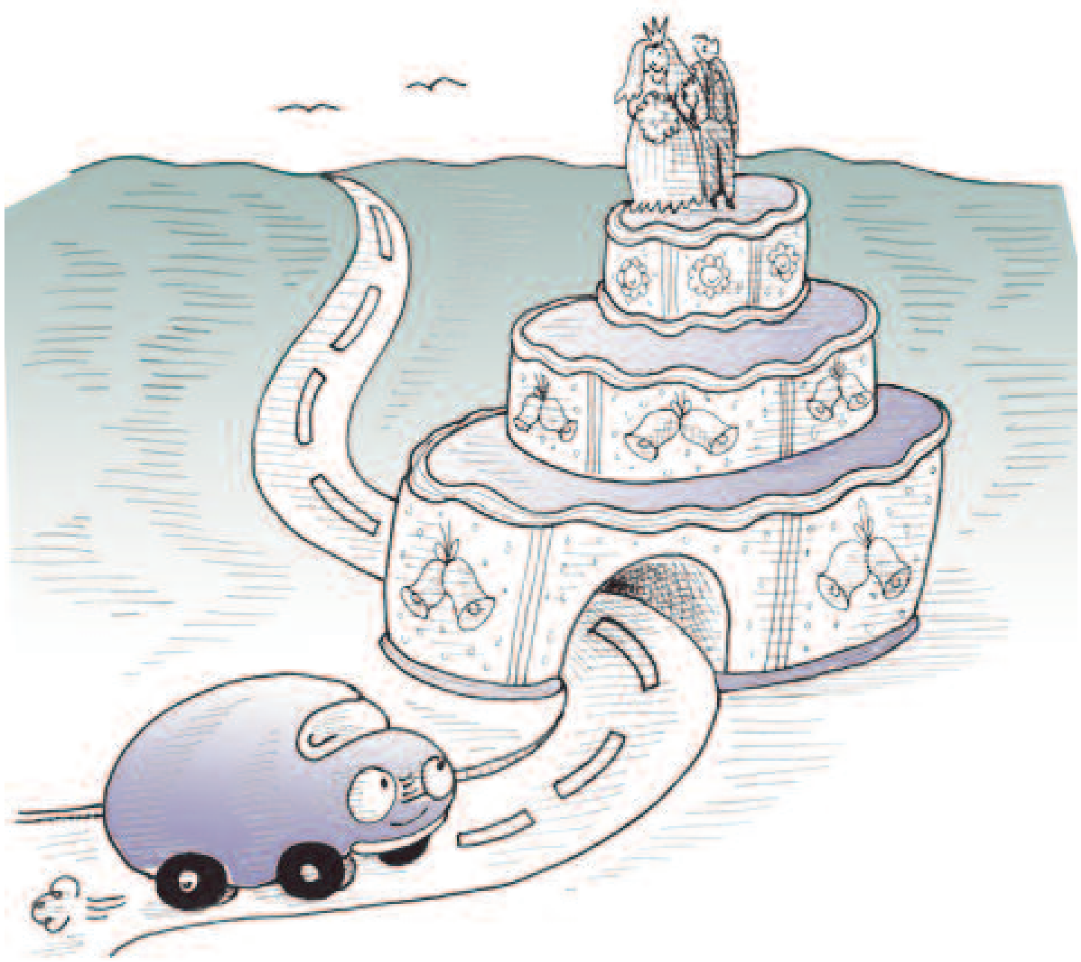
# MARRIAGE AND FAMILY

**Getting married, living together, getting divorced, and raising children all require financial decisions that will make a big difference in the assets and income you'll have before and after retirement.**



# Getting Married

**Both of you need to stay involved in financial decisions because they affect the family's future economic well-being.**

## Rules of the road

When you get married, most property or income that you or your spouse acquire or earn during the marriage will belong to both of you. Individual property that you owned before the marriage may often stay separate.

You may both be responsible for debts that either of you incur during the marriage. It will depend on the type of debt, whether you both signed for the debt, and whether you live in a community property state.

When others are depending on you for financial support, you need to consider life, disability, and health insurance. In addition, you need to review survivorship provisions, that is, find out whether either of you can receive benefits from your spouse's pension, IRA, and other retirement plans and accounts.

Both spouses need to be aware of the financial security arrangements that are in place, and both should participate in any significant changes.

## Decisions

Property ownership changes with marriage. If you want to maintain property you bring into marriage as individual property, you will need to state that in a legal document.

If you live in a community property state — Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin — you should understand how those rules affect property ownership. For example, in community property states, all earnings during marriage are generally considered to be owned equally by each spouse.

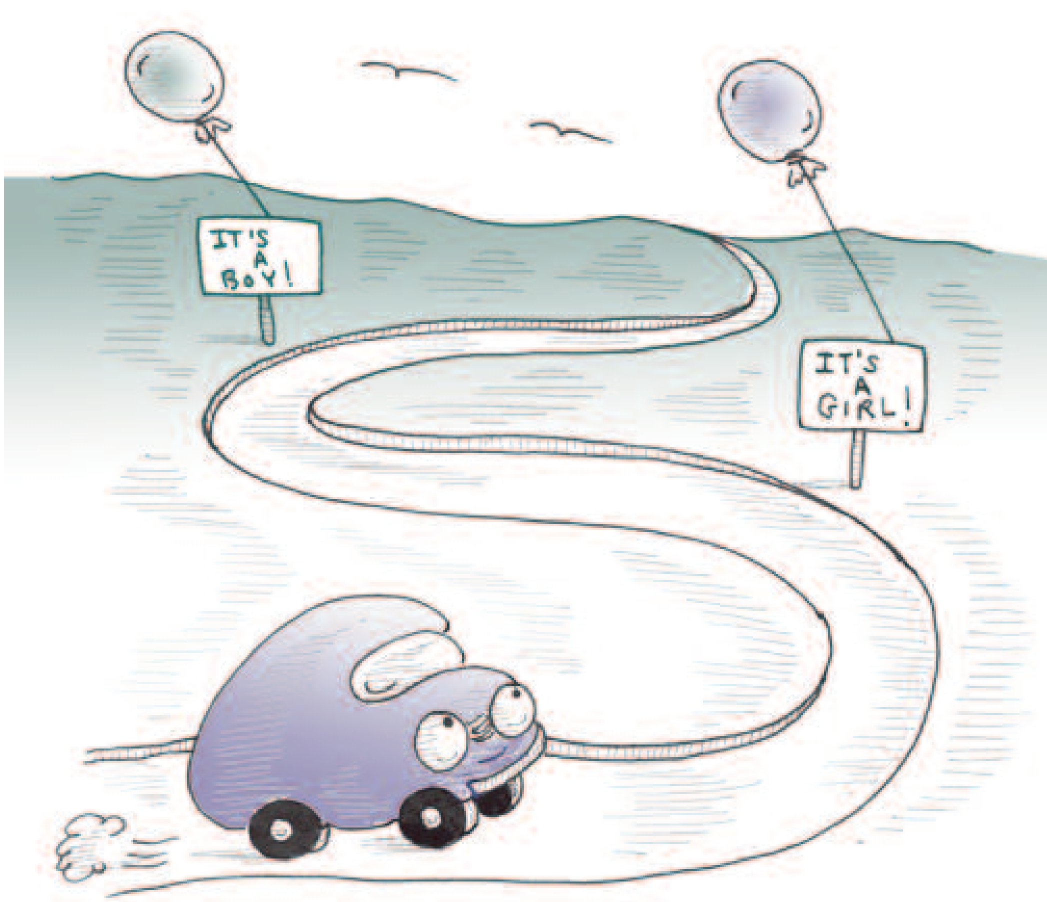
Exchange credit reports with your prospective spouse before you get married. Stay aware of your spouse's debts, because they may become yours some day — if you should divorce or become widowed.

With your spouse, work through what would happen to each of you and your finances if either spouse should outlive the other. Make sure you have each designated your spouse as a beneficiary for life insurance, any Individual Retirement Accounts you have, 401(k)s, or other pension plans, and consider writing a will and a power of attorney for health care decisions.

Remarriage may also affect access to benefits and to the other spouse's current and future income, as well as property ownership rights. A previous divorce may bring with it financial obligations for children or for an ex-spouse. In addition, the timing of getting married a second time may affect your ability to collect Social Security or pension benefits based on your first spouse's benefits or work record.

## CHILDREN

**Raising children requires time and money (among other things), often requiring trade-offs with other obligations.**



## Rules of the road

As parents, you and your spouse may find yourselves making changes in your careers and the number of hours you work. If either of you stops working or cuts back to part-time, you will have less income and lower potential retirement benefits. You may find it difficult to return to work when your children are older.

You may find that paying for your children's expenses and saving for their education are now competing with what you want to save for retirement.

Finally, you need to protect your family against the possibility that one parent may die or become disabled and unable to work or care for your children.

!

Susan D. left a full-time job after having a baby, opting for a consulting job to earn more money and work fewer hours. She left the old job and a benefits package for more flexibility. After all, she was young, what could happen? A freak medical problem left her without the ability to work or take care of her child. Without disability benefits, her family became financially disabled as well.

## Decisions

Some types of savings accounts are designed to be tax-deferred and also allow you to withdraw money without penalty for child-related expenses. These include Education IRAs, Medical Expense Accounts, and U.S. savings bonds. Read up on available savings options for education including their tax implications and how they affect potential grants and loans.

Keep in mind that college savings should not come at the expense of your own financial security or saving for retirement. Consider asking your children to help pay for their education themselves, with earnings from summer and part-time jobs, student loans, and outside sources of financing.

Review the life and disability insurance coverage that you and your spouse have through your employers or which you purchase independently, and consider purchasing additional coverage if you think it is needed.

# DIVORCE

**When dividing property and assets during a divorce, pensions and retirement plans may be the most valuable items on the table.**

## Rules of the road

Divorce can change your whole financial road map. During a divorce, the married couple has to make decisions about dividing the property that was acquired during the marriage. In addition, they may need to address whether either one will provide child and/or spousal support and how much.

State law governs divorce and each state has different laws that determine how property is divided at the time of divorce. However, if you or your spouse earned a pension during your marriage, it may be divided along with other property acquired during the marriage, such as your home. Federal pension law known as ERISA permits the division of pension benefits earned while working for a private company and includes requirements about how it is divided. Federal, state, and local government employee plans have different requirements.

If you are covered by your spouse's health insurance, you are likely to lose that coverage. However, you are eligible to continue coverage under a federal law called COBRA, although you will have to pay the premiums and an administrative fee. Additional information about health insurance is in Section 7.

If you were married for 10 years or more, and are unmarried when you apply to collect Social Security benefits, you can apply to receive benefits based on your ex-spouse's work record. While your ex-spouse is living, you can receive a benefit equal to half of that benefit. If your ex-spouse should die before you, you can receive a benefit equal to the full benefit. The Social Security Administration can calculate your benefits based on both your work record and your ex-spouse's and you can receive the larger of the two — but you cannot receive both. See chart on page 51.

## Decisions

During a divorce, it is important to get good legal advice and specialized professional help to deal with the financial issues. Although this can be expensive, going without such help can be even more costly in the long run.

The pension or retirement plan earned during the marriage can be the most valuable property to be divided at divorce. Be sure to consider all pensions from current and previous jobs and consider hiring an expert to determine the value of the pension or retirement plan.

# LIVING TOGETHER

**If you and your partner are living together but are not married, you can take steps to protect your relationship and your finances.**

## Rules of the road

Couples who are living together but are not legally married do not usually receive the same legal protection or have access to benefits that legally married couples have. Non-married couples should look for other ways to provide the financial protections that they believe are important and then decide how they would pay for them. For example, couples can draw up legal documents to show who owns what property or to set down plans for household expenses or other financial matters.

Some employers extend health insurance and other benefits to domestic partners. Some pension plans will allow the employee to designate someone other than a spouse for a survivor benefit, but not all do.

Social Security provides spousal or survivor benefits to individuals in common-law marriages that are recognized under state law, just as the agency provides benefits to married couples, described in Appendix B. However, Social Security provides nothing for couples living together in non-common-law states or for same-sex domestic partners.

## Decisions

Some states recognize common-law marriages. In those states that do, if you and your partner should split up, you need to determine if the state views you as married. If so, you will be required to go through a legal divorce to end the marriage and divide marital property.

If your relationship is not a common-law marriage, consider whether you want to formalize any property ownership or financial obligations. With your partner, investigate your options for protecting each against the death or disability of the other. Looking down the road, consider provisions for making health and financial decisions for the other, as well as financial plans to provide for each other to compensate for the lack of Social Security or pension survivor benefits.

# CARING FOR PARENTS

**When your parents need assistance, whether in their home or in another setting, look into all of the resources that are out there for you and them.**

## Rules of the road

It is important to talk with your parents to understand their wishes and their plans. You should ask whether they have long-term care insurance. If they are willing, talk to them about what income they have and how they plan to make ends meet throughout their retirement. If they are thinking about moving or selling their home, make sure they have thought through the expenses involved. You may also want to discuss and review any medical and legal documents to be sure they are up-to-date and properly written.

If you need to find some help for your parents, contact the Eldercare Locator and investigate other resources listed in Appendix C.

!

Alice Turner, who had emphysema, was meticulous about her health insurance planning. But her daughters, who lived at the other end of the country, never realized that she had purchased a long-term care insurance policy and assumed she only had Medicare coverage. As a result, when she had a health crisis, she went to the hospital's Intensive Care Unit, was discharged to a nursing home for 20 days, and then was sent home. This sequence was repeated with each medical crisis. If her family or doctors had known about her long-term care insurance, she could have received the ongoing home care or nursing home care she needed.

## Decisions

- Talk to your parents and help them decide where they would live if their physical abilities should decline. Look into alternative living arrangement options if your parents have not already.
- Ask whether they have a power of attorney for finances and health care, or a living will.
- Check on your parents' health insurance coverage and whether it will continue into their later years.
- Talk to your siblings to see if they would be willing to pitch in, either by spending time caring for your parents or compensating you for your time.

## Wills, Directives, and Powers of Attorney Detour/ Roadside Assistance

Almost everyone should have a will, regardless of the amount of your assets. A will is the only effective means of directing how your property will pass after your death.

A healthcare directive or living will states what medical care you do or do not wish to receive if you should ever become incapacitated and unable to communicate directly with the doctor. If you want to designate a person to supervise your care, you can do so through a document called a durable power of attorney for healthcare. In a few states, the healthcare directive and durable power of attorney can be combined in a document called an advance directive.

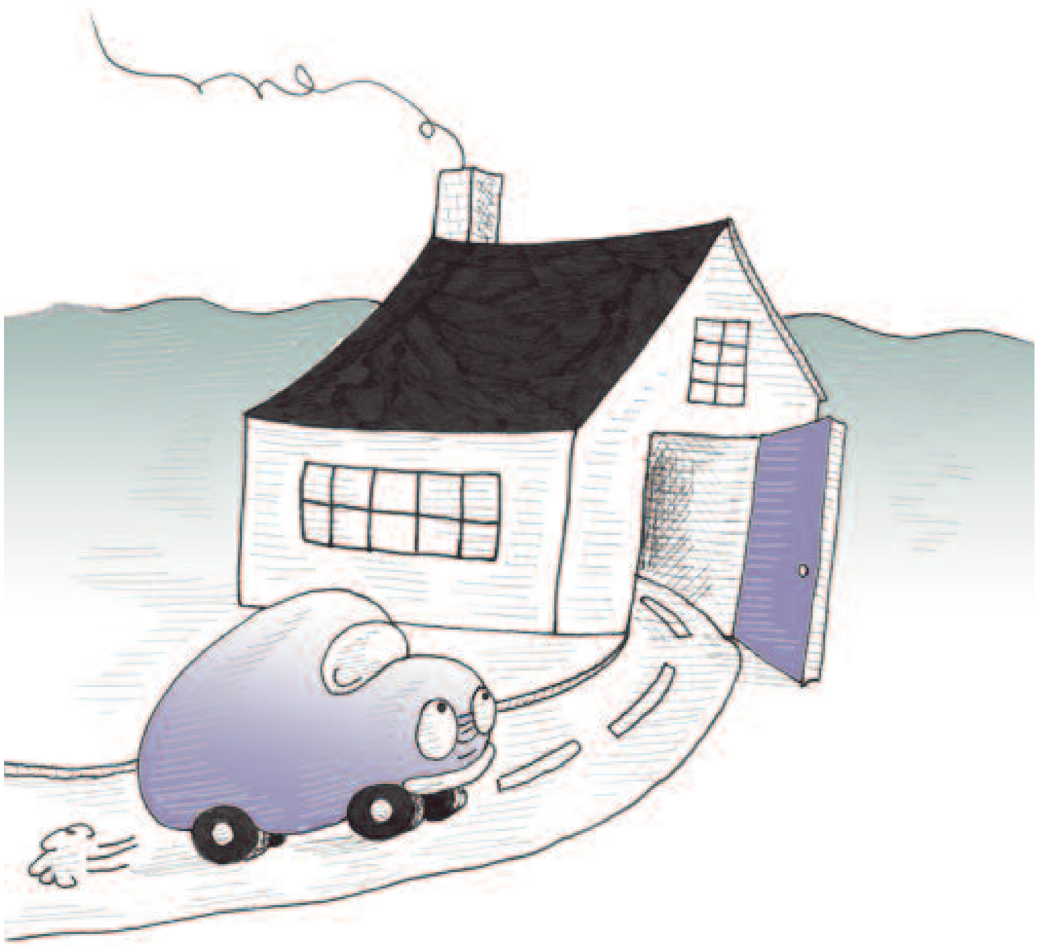
You can use a durable power of attorney for finances to designate one person to oversee your finances if you become unable to do so.

You can contact the American Bar Association for names of local organizations that can assist you in preparing these documents.

# 4

# HOME OWNERSHIP, DEBT, AND CREDIT

**Buying a home is one of the largest financial transactions most of us will ever make, so it pays to understand the process. Your credit record will influence the terms under which you buy a home and make other purchases, both large and small, if you buy them on credit.**



# BUYING AND OWNING A HOME

**Owning a home is part of the American Dream, but it is also a very expensive purchase and investment.**

## Rules of the road

Keep in mind that your home differs from other investments because:

- The value of your home can't easily be converted to cash.
- Transaction costs for selling or buying a home (closing costs, moving, etc.) are relatively high.
- You have ongoing costs for maintenance, utilities, real-estate taxes, and mortgage payments.

On the plus side, taxpayers who itemize deductions can usually deduct home mortgage interest and real-estate taxes. You may be able to use your home as a source of income in the future by trading down to a less-expensive home, perhaps by moving to a lower-cost area, or by tapping into your home equity through a loan or a reverse mortgage.

## Decisions

Don't buy a house just to get the tax deduction. The decision to rent or buy your home depends on a lot of factors, including how settled you are in your job, your marital status, and the geographic area where you live. Home ownership takes time, money, and sometimes a lot of work. You will have to pay closing costs to sell one home and buy another, and those costs can be high.

# MORTGAGE LOANS

**Most people who buy a home use a mortgage loan. You need to have saved enough money to make the down payment and a bank or other lender puts up the rest of the money.**

## Rules of the road

Once you take out a mortgage, you will make monthly payments to the mortgage company. Part of your monthly payment is for interest on the amount that you owe (the principal) and the rest is to pay off some of the principal. The amount of the principal you owe gradually gets smaller, so that each month a little less of your payment is for interest and a little more is for the principal. The monthly payments are figured out so that the amount of principal you owe is zero at the end of the mortgage term.

It's useful to know some of the rules when you take out a mortgage.

- Your credit rating will determine the interest rate that the mortgage company offers you. A bigger down payment may also cut the interest rate.
- Investigate interest rates available through different mortgage companies. You can get a general idea of the range of interest rates available from your local newspaper.
- You can choose between a 15-year or 30-year mortgage and a fixed or variable-rate mortgage. Variable mortgages usually start out cheaper, but cost more later if interest rates rise. However, if interest rates fall, they can stay cheaper.
- Some loans include points — these can help lower the interest rate that you get, but are an additional up-front expense.
- Closing costs may include sales commissions, loan initiation fees, appraisal, survey, title examination, private mortgage insurance, and lawyer fees. Find out the amounts you must pay before you get to the closing — they can add up to a substantial amount of money.

If you don't make your monthly mortgage payments, you may lose your home. If you are married, both you and your spouse are liable for the amount owed on the mortgage.

Your mortgage is usually the largest debt that you owe. Many people try to pay off their mortgage before retirement, anticipating that their retirement income may be lower and a tax deduction for mortgage interest might be less valuable.

## Decisions

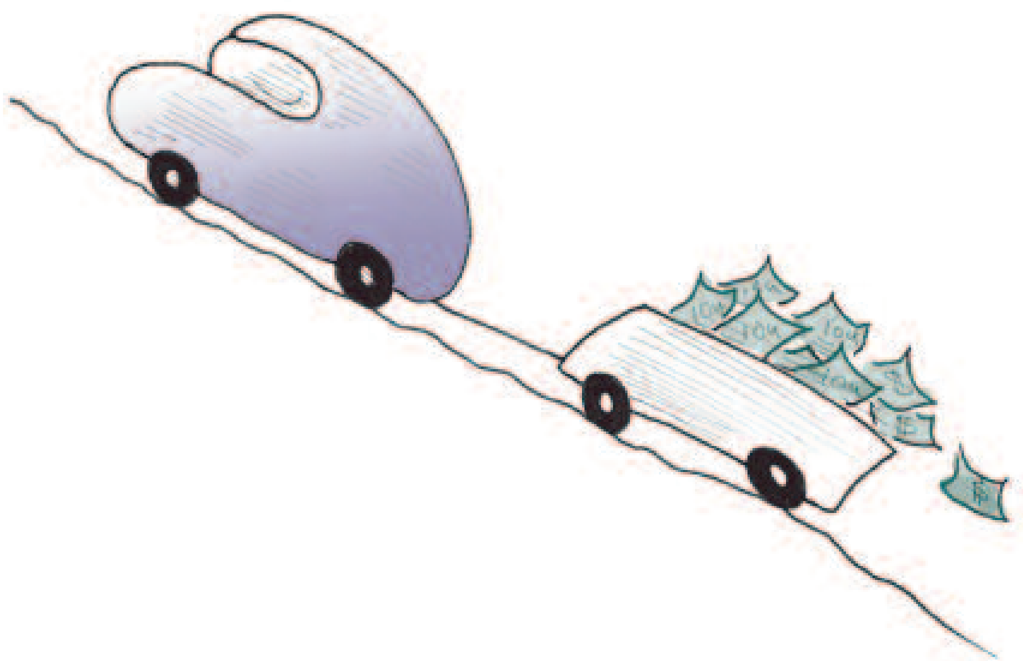
If interest rates fall substantially, consider refinancing your mortgage. You'll have to pay additional closing costs to get a new mortgage. It makes sense to refinance if you will save enough in mortgage payments to make up the closing costs in a reasonably short time.

You can send in an extra payment to go towards the principal, to help pay off the mortgage sooner. You generally do not need to go through a service to do this, but you should send a note with the payment specifying that it be applied to the principal.

When you are older, if your house is paid off and you need more money for living expenses, look into a reverse mortgage. A reverse mortgage allows a homeowner to get retirement income by borrowing against the equity in the home, and requires no repayment while the individual lives in the home.

# DEBTS AND CREDIT

**Credit is money you borrow and plan to repay, often with a charge for borrowing the money. If you get behind on credit payments, it can be very expensive.**



## Rules of the road

When you want to buy a car or home, your good credit rating is extremely important. A good rating will help you get the lowest interest rate and monthly payments. On the other hand, a poor credit rating will mean that you pay more for the home or the car. Prospective employers and landlords also may review your credit rating.

To get and maintain a good credit rating, you need a good history of paying your bills on time and repaying any loans when each payment comes due. Prospective lenders want to know that you will pay back the money that they lend to you on time.

Bankruptcy is a legal way for someone with heavy debts to get a new start. However, a bankruptcy can stay on your credit history for ten years.

## Decisions

Find out what your credit rating is. In addition, you should periodically check your credit report for errors and write the credit reporting companies to get them corrected. You can use the Internet, call, or write to get a copy of your credit report from each major reporting agency: Equifax, Experian, and TransUnion. These reports list personal data plus your record of paying bills and loans on time for several years. You should check all three, because each agency may have different information. From your report, each credit agency generates a score based on your credit history. Lenders often use the score to judge your risk. The Federal Trade Commission will create one central number to call for a free copy of your credit report in late 2004.

Compare the interest charges and annual fees for different credit cards. Pay off the cards with the highest interest rates and penalties first. If you are not paying off your credit card bill each month, consider transferring your credit card balance to a card with the lowest interest rate possible. The website www.cardtrak.com lists credit card interest rates and annual fees.

Better yet, pay off your credit card balances, and try to avoid using your credit card unless you can pay the bill each month. Minimize the number of cards you have. Cancel credit cards in writing and make sure the cancellation is reflected in your credit reports. Review each monthly credit card bill for unexplained charges, and contact the company to deal with any errors.

If your debts start to pile up, deal with the problem before the creditors confront you. Ask your creditors to let you pay more slowly, then don't let them down. If you need help, contact the National Foundation for Credit Counseling: 800-388-2227.

Vickie Elisa, a community activist, said she was personally devastated when she first learned about the high level of poverty that older women face – particularly older African-American and Latina women. Vickie had a high level of debt due to a bad divorce situation, and realized that poverty was something that could happen to her unless she did something about her own financial situation. She decided the only way she could become debt-free was to work three jobs. Five years later, she retired her debt and is able to save money for her future.

One way to avoid getting too deeply in debt is to set aside some money to cover emergencies, like a car breaking down, a major illness, or a job loss. Some experts recommend that you have enough to cover 3 to 6 months of everyday expenses so that your budget won't go totally off track when something goes wrong. Use part of each paycheck to build a rainy day fund.

Keep in mind that some financial emergencies often can be anticipated and planned for with different types of insurance.

## How to Contact the Credit Agencies

Equifax
www.equifax.com
800-685-1111

Experian
www.experian.com
800-311-4769

TransUnion
www.transunion.com
800-888-4213

For Credit Scores: www.myfico.com

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# PLANNING FOR RETIREMENT

**The money that you have to support you during retirement generally comes from a combination of Social Security, employer retirement plans, and personal savings.**

Social Security offers a base layer of protection, but is not meant to be enough by itself to provide a comfortable retirement. About half of the workforce today is covered by employer-sponsored retirement plans and, for many reasons, those plans are not always enough to provide sufficient income throughout retirement.

As a result, personal savings are a very important source of retirement income, whether or not you have an employer-provided pension. And, the sooner you start saving, the longer those savings have to grow.

# SAVING FOR RETIREMENT

**If you want to have adequate funds for your retirement years, you need to save during your working years.**

## Rules of the road

Your basic steps are:

- Make a rough estimate of the total retirement income you'll need.
- Estimate how much income you can expect from Social Security, employer-paid plans, and personal savings.
- Make a plan to start saving enough to make up the difference.

You'll get a big payoff by starting to save early because it gives your money more years to earn interest.

## Decisions

Each person has to decide what would be adequate retirement income. As you near retirement, reconsider your earlier estimates of what income you'll need after retirement. Your estimate will depend on a number of factors, including whether you will have monthly payments for a home mortgage or rent, or health insurance to supplement Medicare.

One rule of thumb is to save 15 percent of your pay over a long period for retirement. However, if you start later, you will need to save a higher percentage of pay. Don't get discouraged if you can't save that much. It is important to start saving what you can now, and increase the amount you save later if you can.

| Age when you start saving | % of pay you need to save * |
|---|---|
| 25 | 9.4% |
| 35 | 13.3% |
| 45 | 20.4% |
| 55 | 39.6% |

* Based on replacing 70% of pay after age 65, assuming 7% interest, 5% annual pay increases, and 3% inflation.

# INDIVIDUAL RETIREMENT ACCOUNTS (IRAS)

## An IRA is a great place to start saving for the long haul.

You can establish an IRA at a bank or other financial institution or through a mutual fund company.

With a traditional IRA, you can get an income-tax deduction on the amount you contribute if you meet the income limits established by the Internal Revenue Service. Your money grows tax-deferred, so you don't pay any taxes until you take the money out. Even if you don't qualify for the deduction on the amount contributed, you can take advantage of an IRA to allow your money to grow tax-deferred.

With a Roth IRA, you don't get an income tax deduction when you contribute to the IRA. However, you won't owe any taxes on the money when you take it out, so the investment grows tax-free.

An individual can contribute $5,500 a year to an IRA. If you are age 50 or older, you can contribute $6,500 a year. A married couple can each put in the individual amount. For example, if you are both 50 or older, you can contribute a total of $13,000 a year. These contribution limits will be increasing over the next several years, so if you're one of the lucky ones with more money to save, look into how much more you can put into an IRA.

However, only a small percentage of us put any money at all into an IRA. Keep in mind that you can put in less. $500 or $1,000 a year will get you started. It may be easier to set up an an IRA arrangement that will automatically transfer, say $50 a month from your checking or savings account to an IRA, than to make a single large payment each year.

You can open an IRA with a mutual fund or bank, and choose where to invest your IRA contributions. For example, they can go into a CD or mutual fund.

You also can roll over an employer retirement account into a traditional IRA. If you roll over funds to a Roth IRA, you must pay income tax on the amount of the transfer.

## USING RETIREMENT FUNDS BEFORE YOU RETIRE – LUMP SUMS AND LOANS

**Many retirement or savings plans let you withdraw money when you change jobs or retire. Resist the temptation to spend it for non-retirement purposes.**

### Rules of the road

The wiser rule of the road is to leave your money in the employer's retirement plan or roll it into an IRA when you change jobs.

If you cash out the amount of money that you have in a defined contribution plan, you will owe income taxes and, in most cases, a 10% IRS penalty. Early in your career, the amounts distributed look small and it's easy to find many ways to spend the money. However, if you leave it there, it can grow into a substantial amount by retirement. For example, a $5,000 lump sum at age 25 will grow into $74,872 by age 65 if it earns 7% interest.

A more difficult question is whether you should break the rule of leaving your money untouched and use it to pay off a high-interest credit-card debt. Let's take an example of someone with $10,000 of credit-card debt, being charged an interest rate of 18% and paying $1,800 a year in interest payments alone. That individual could use a $10,000 lump sum (after taxes and penalties) to pay off the credit cards. This only works if this individual forever becomes a savvy credit-card user and is committed to a new long-term savings plan.

### Decisions

When you take money out of an IRA or 401(k) plan before you reach age $59^1/_2$, unless you meet one of the exceptions under the law, you'll owe income tax (federal, state, and local, as applicable) plus a 10% penalty to the IRS for early withdrawal.

When you leave an employer with a traditional pension plan, you may be able to choose to receive a lump sum payment. You can avoid taxes and the IRS penalty by rolling the lump sum payment directly into an IRA. If you have the choice, it may be best to leave the money right where it is, particularly if you can choose to receive a lifetime, guaranteed monthly pension benefit at retirement.

## YOUR RETIREMENT – WHEN AND HOW

**Many of us cannot wait to retire. However, when you are thinking about retiring, think through the details of how you are going to pay for it.**

### Rules of the road

When planning to retire, take a careful look at all your savings and benefits. Ask the Social Security Administration to provide an up-to-date estimate of your benefits, including estimates of how much you can get at full retirement age, and at earlier and later ages. Get estimates of any pension benefits, when they can start, and whether they would increase if you waited a few years longer.

For people who want to retire before Medicare eligibility (age 65), health insurance for those early years can be very costly. Even with Medicare, prescription drug and long-term care expenses can be enormous.

Keep in mind that during the years you are retired, inflation will make everything cost more, especially medical care.

For couples, find out which benefits would continue to each of you as a widow or widower, and how much they will be.

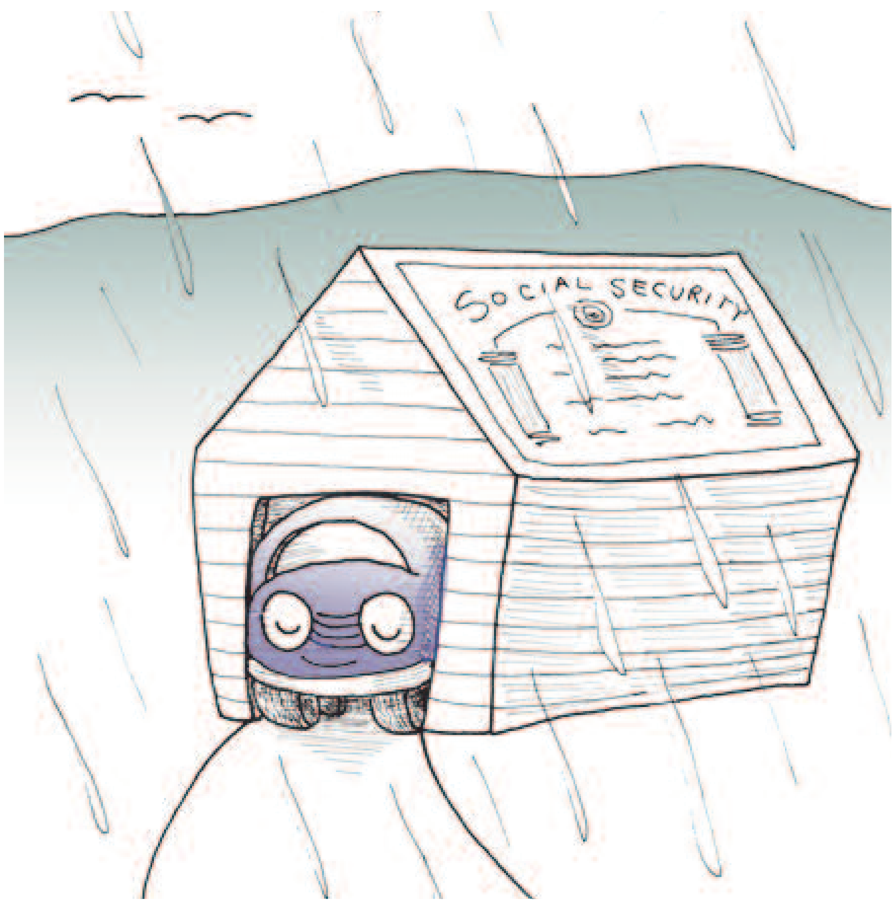
## Decisions

### Pension Benefits

If you have a defined benefit pension, ask for an estimate of what monthly benefit you can receive at full retirement age and as an early retirement benefit. If either you or your spouse has a defined benefit pension plan, when you apply for retirement you need to decide whether you want the benefit to continue to a surviving widow or widower. For example, when you apply for benefits, your spouse has to consent to give up survivor's benefits, signing a statement that he or she understands that pension benefits will not continue if you should die first.

If you have a defined contribution pension and/or personal savings, try to estimate how you will make those savings last throughout your retirement. It can be very difficult to estimate your retirement income needs and how long you will live. Consider purchasing an immediate annuity, which can guarantee payments for as long as you live.

With both types of pension plans, you may have a choice about how you receive the benefit — a lump sum payment all at once, or as an annuity with payments spread out over your lifetime, or other variations.



Bill and Marilyn H. are the same age, and Bill earned a larger income over his career. Bill can receive a Social Security retirement benefit of $1,600 a month at his full retirement age of 66, or at age 62 he can get the reduced amount of $1,200. If Bill starts collecting Social Security benefits at age 62, and dies a few years later, Marilyn's widow's benefits would be $1,200, with annual cost-of-living increases based on that amount. However, if they wait a few years and take Social Security at 66, Marilyn would get his full $1,600 benefit as a widow.

### Social Security

You can receive Social Security benefits as early as age 62, but they will be reduced because you are taking them early. You can receive full benefits between ages 65 and 67, depending on your year of birth, without reduction even if you still are working. Appendix B contains more information about Social Security, including the scheduled increase in full retirement age from 65 to 67.

If you start collecting Social Security benefits before your full retirement age and you are still working, your benefits will be reduced if you earn income above a certain amount. But you'll get them back later, once you reach full retirement age or when you stop working. Your benefits will be recalculated to give you a lifetime benefit increase that makes up for the earlier deduction.

Married couples need to think through the financial consequences to both spouses if the higher earner — usually the husband — starts collecting Social Security at age 62. A widow's benefit, based on her spouse's work record, will be reduced throughout her lifetime as a result, as is shown in the example.

## MAKING YOUR MONEY LAST THROUGH YOUR RETIREMENT – IMMEDIATE ANNUITIES

**It can be quite challenging to manage your life savings after retirement because there are many unknowns. Few of us have really thought about how to make our retirement savings last for 20 or 30 years after we stop working.**

### Rules of the road

Immediate annuities give you guaranteed income for life. You buy the annuity with one single payment. In return, the insurance company will provide you with a guaranteed lifetime income, regardless of how long you live. There are two types of immediate annuities:

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Ron Gebhardtsbauer's mother had money in an IRA when she turned 70 and started taking out the minimum amount that the government required her to take each year. Ron convinced his mother to look into purchasing an immediate annuity. She did, and was pleasantly surprised to find that she will be getting more money each year, and she doesn't have to worry about it running out, even if she lives a long time.

- fixed immediate annuities, which pay you a fixed amount each month; and
- variable immediate annuities, which also pay you income as long as you live, but the amount varies based on what you choose to invest in, like the stock market.

Immediate annuities have different payment options. You can choose to receive payments for your life only, for your life plus a survivor benefit, or with a "period certain" so that if you die before, for example, a 10 year period certain, your beneficiary will receive the balance. There are other options, as well.

You probably don't want to put all your retirement savings into an annuity. However, for many people who are age 70 or older, it makes sense to put part of your savings into an annuity. This is especially true if you are in good health and want the certainty of knowing you will receive monthly payments for as long as you live.

Immediate annuities should not be confused with deferred annuities, which are used primarily to accumulate funds while you are working.

## Decisions

After retirement, consider whether you want to manage your money yourself. One way to do this is to set up a program to draw money on a regular basis from your retirement savings. Consider the pros and cons of using some of your money to buy an immediate annuity to provide you with payments for the rest of your life. For additional information on whether an immediate annuity might be right for you, read WISER's booklet "Making Your Money Last for a Lifetime: Why You Need to Know About Annuities."

# 6

# INVESTING FOR LONG-TERM GOALS

**First, you need to decide how to allocate your investments among stocks, bonds, and other investments. Then, choose specific investments or funds that fit into your asset allocation.**

# INVESTMENT BASICS

**Whether you are saving in a company retirement savings plan, an IRA, or other personal investment, you need to learn some of the investment rules of the road.**

## Rules of the road

Many people learn about financial planning by reading financial material in newspapers, magazines, and books, and by requesting information from investment firms. Many also learn from family and friends. You may decide to seek the help of a professional financial planner. Even so, it's a good idea to know some of the basics so you can better understand the planner's recommendations.

When you think about where to invest your money, one factor to consider is how soon you are going to need it. As you near your savings goal — whether buying a house, or paying for education or retirement — you may want to shift to a different investment strategy.

Investments in the stock market have historically produced a greater return than bonds or other investments. While stocks offer the highest potential for keeping ahead of inflation, stock prices also may decline sharply and suddenly. However, if you can leave your money invested for ten years or more, an investment in the stock market has a greater chance of paying off.

One important decision you'll have to make is your investment mix — what percentage of your savings will be invested in stocks, bonds, and cash equivalents (certificates of deposit, savings accounts, money market funds). One way to try to balance the risks and rewards is by putting some investments in stocks, some in fixed-income (such as bonds), and a little in investments that can be easily converted into cash (such as money market funds). For example, you might put 60% of your investments in stocks, 35% in bonds, and 5% in a money market fund. Many people invest in stocks and bonds by purchasing mutual funds.

### Annual return on stocks, 1926-2006

| | Over 1 year | Over 5 years | Over 10 years |
|---|---|---|---|
| Highest return | 54.0% | 28.6% | 20.1% |
| Average return | 10.4% | 10.4% | 11.1% |
| Lowest return | -43.3% | -12.5% | -0.9% |

Source: *Stocks, Bonds, Bills and Inflation 2007 Yearbook*, Ibbotson Associates.

Sometimes, people think they will keep their retirement money safe by putting it into certificates of deposit or a money market fund. This strategy avoids the risks of the stock market, but it disregards the risk of inflation, as shown by this table.

### Average annual investment return, 1926-2006

| | Cash equivalents | Bonds | Stocks |
|---|---|---|---|
| Total return | 3.7% | 5.4% | 10.4% |
| Minus average inflation rate | 3.0% | 3.0% | 3.0% |
| Net return, after inflation | 0.7% | 2.4% | 7.4% |

Source: *Stocks, Bonds, Bills and Inflation 2007 Yearbook*, Ibbotson Associates.

## Decisions

How do you decide on a reasonable investment mix? Consider these issues:

- Your investments should reflect your risk tolerance, meaning your willingness to take risks that may or may not lead to a higher return. If you're losing sleep because the stock market is going down and costing you money, or because the market is going up and you don't own stocks, you may want to change your investment mix.
- Your investment choices will also depend on what other sources of income you have, because these can stabilize your finances when your investments aren't doing well.
- Your time horizon, meaning the length of time remaining before you'll need the money, will be part of your decisions. For example, some investors use a rule of 115 minus their age, so that someone aged 45 would put 70 percent into stocks.

Every year or so, you need to review how much you have in stocks, bonds, and other investments, and rebalance your portfolio of investments.

- You should diversify by using different types of investments and also diversify within each type, so you'll have a better chance of avoiding heavy losses when some investments do poorly.

  If possible, don't invest heavily in the stock of your employer. If your company doesn't do well, you don't want to risk losing both your job and your savings.

As you approach retirement, or your other savings goals, you may want to rebalance your portfolio to include fewer investments in stocks and more in bonds.

## Investment Detour/Roadside Assistance

Now that you've given some thought to how to allocate your investments, here is some information about what those investments are and how they work.

# STOCKS

Shares of stock are the basic units of ownership of a corporation. When you own a share of stock, you own part of the company and you are entitled to a share of the profits, usually paid out in cash dividends. If the company grows and prospers, your shares become more valuable, but if the company is not profitable your shares lose value.

Stocks have historically provided a better return over time than other investments, but also carry more risk of loss. Therefore, stocks are best used as a long-term investment. An investor in stocks should be prepared for the inevitable ups and downs of stock prices.

Keep in mind that you need to diversify your investments to help reduce your risk. Also consider how soon you will want to sell an investment to get cash. If the economy is doing poorly, the entire stock market will usually decline, and it can take a number of years to recover.

Most people invest in stocks through mutual funds. If you buy stocks or stock mutual funds through a 401(k) plan or an IRA, investment gains will grow tax-free until you take money out.

# BONDS

When you buy a bond, you are essentially making a loan to a government or corporate entity. In turn, the business or government agency promises to pay you back on a specific maturity date, with interest along the way. In other words, a bond is an IOU, and as a bond investor you are a creditor or lender.

There are three different characteristics that define bonds:

1. **Issuer:** Bond issuers include the federal government, state and local governments, and corporations.
2. **The quality of the bond:** Bonds are rated on how safe the bond is from a credit point of view, with the highest rated (A or above) as the most secure.

The lowest rated are least secure. Riskier bonds (so-called junk bonds) pay the highest rates of interest but have a greater chance that the issuer of the bond may be unable to pay the interest.

3. **Maturity:** This refers to the amount of time until the principal — your investment — is repaid. Short-term bonds generally mature in less than 2 years, intermediate in 2 to 10 years, and long-term bonds in more than 10 years. Longer term bonds carry the most risk due to market value changes before maturity.

Short-term government bonds such as Treasury bills are generally the safest types of securities, but also provide the lowest return.

Interest on corporate bonds is taxed as ordinary income. Interest on state and local government bonds ("tax-free municipal bonds") is usually exempt from federal income taxation, and also from some state and local income taxes.

Bonds carry a different kind of risk from stocks because of their link to interest rates in the U.S. economy: bond prices move in the opposite direction from interest rates — when one goes up the other goes down. For example, when interest rates rise, the value of bonds goes down. This is because as interest rates rise, older bonds that pay lower rates become less attractive, and their prices or values go down.

People often buy bonds through mutual funds, which invest in a number of individual bonds so there is no exact maturity date for your shares, making them easier to sell. Bond mutual funds are sorted out by investment objectives, reflecting the different categories of individual bonds.

## MUTUAL FUNDS

Many people find it easier to invest in stocks and bonds through mutual funds. If you are in a 401(k) plan at work, you may have a selection of mutual funds to choose from.

A mutual fund is a pool of money from many investors, which the mutual fund company invests on their behalf. Mutual funds typically invest in a portfolio of stocks, bonds, or both. By purchasing shares in a mutual fund, you own a piece of the fund, the stocks and bonds that it holds, and share in the gains and losses. Mutual fund shareholders can usually sell their shares at any time, but the price fluctuates daily, depending upon the market value of the securities held by the fund.

There are different types of mutual funds: those that invest only in stocks or only in bonds, and some that invest in a mix of stocks and bonds. Within these types, mutual funds have varying investment objectives and styles. Some mutual funds invest for growth in the value of the fund, while others are income-oriented and emphasize dividends.

An "index" fund simply invests in every (or practically every) stock or bond within a broad category such as the Standard & Poors 500 stock index, and charges a very small annual fee. An S&P 500 index fund can be a good place to start investing. An "actively managed" fund invests in stocks or bonds that are selected by the experts who work for that fund.

All mutual funds charge some fees, which are deducted from the money invested in your fund. Some funds also charge a commission (called a load) when you buy into the fund. Some funds charge much larger fees than others, so the amount of the fees is worth paying attention to.

No investment is risk-free. If the entire stock market declines in value, the value of most mutual fund shares will go down as well, no matter how diversified the portfolio. Also, keep in mind that having several mutual funds does not guarantee a greater degree of diversification. You have to look at what those funds are invested in. The more funds you own, the more likely they are to be holding some of the same stocks.

## Money Market Accounts and Funds

You can open a money market account at a bank if you have the minimum amount required. The bank will pay interest, but generally less than you would get for a CD. You can usually write a limited number of checks on the account and the account is insured by the federal government.

Mutual fund organizations also manage money market mutual funds and let you write checks against the balance. They usually pay a little higher interest rate than money market accounts, but they are not insured.

Money market accounts and funds are generally invested in short-term debt, such as Treasury bills and CDs.

# SAVINGS ACCOUNTS AND CERTIFICATES OF DEPOSIT (CDS)

You can have a savings account at a bank, credit union or savings and loan. The government insures your money up to $100,000. The bank or credit union may charge you fees for certain services. It may also pay a small amount of interest on the money in the account. Savings accounts are among the most conservative investments, yielding very low rates of return. As a result, you may want to periodically review the balance in your savings account, and move some funds that you do not need immediately into an account or investment that might earn a higher return.

Certificates of deposit (CDs) are time deposits with banks. They usually offer a guaranteed rate of interest for a specified term, such as one year. Terms generally range from three months to five years, and CDs are typically sold in denominations of $500 to $100,000. As with other bank accounts, the government protects the money you have on deposit to a limit of $100,000. Before you invest in a CD, find out if you're allowed to withdraw your money before maturity and what penalty will apply.

# SAVINGS BONDS

People seem to understand and trust savings bonds because the U.S. government stands behind them. The I Bond is the newest type of U.S. savings bond. One of the things that makes it different from the EE bond is that part of the interest rate is tied to the inflation rate, so your investment will at least keep up with inflation.

Interest rates for all savings bonds can be changed every 6 months, in November and May. You can earn interest on them for as long as 30 years, and can redeem them after 12 months. You need to hold them at least five years to avoid a small penalty — you lose three months interest if you cash them in sooner. The earnings are exempt from state and local taxes and may be free from federal income tax if used to pay for college.

You can buy savings bonds in person at most banks or credit unions. You can get more information by visiting the savings bonds website at www.treasurydirect.gov or by calling 800-487-2663.

# FINANCIAL PLANNERS AND ADVISERS

Choosing a financial adviser can be complicated because they offer a range of services. If you decide to consult a financial planner, be sure you understand how you will pay for the services — some charge you a fixed hourly fee, some charge a percentage of your assets that they manage, or they may get commissions when you buy products or securities, or a combination of fees and commissions. With a fee-only planner, you will not have to worry that the planner is selling you a product in order to get the commission for him or herself.

Be very careful about giving another individual the right to control your money. The person you're dealing with should be licensed, with no record of bad conduct, and preferably working in a sizeable organization that can be held responsible if there's a problem.

A key to choosing a planner is knowing what services they provide and what services you need. You should know exactly what services you are getting, how much they will cost, and how your planner gets paid. Ask a lot of questions. No investment is too complicated to be explained to you, and you deserve clear answers.

# 7

# INSURANCE

**Insurance provides a measure of security for you and your family against many of the bumps in the road. Having the protection is valuable even if you never use it.**

# LIFE INSURANCE

**If family members are relying on you for financial support, life insurance can provide peace of mind for all of you.**

## Rules of the road

The amount of life insurance you need depends on several factors, including who is depending on you for income and whether they have other sources of income to support them in place of your income. If your employer provides life insurance, learn what coverage it provides and decide if you need more. Keep in mind that life insurance generally costs more as you get older and that some people with serious health problems may not be able to buy life insurance.

Term insurance provides coverage for a certain number of years. You can buy it for as little as one year or as long as 20 or 30 years. It only provides life insurance coverage — that is, it pays a benefit to your beneficiaries if you die while you are covered by it. A term life insurance policy may be renewable, meaning you can renew or extend your policy without a medical exam. It may also be convertible, so that you can convert it to a permanent plan down the road. Some policies guarantee that premiums will not increase.

Permanent or cash value insurance is life insurance plus an investment vehicle. When you make a payment to the life insurance company, part of the payment goes to provide life insurance death benefits and part goes to build up the cash value of the investment. Make sure you understand the charges associated with setting up the policy, plus the agent's commission. The savings option works best if you hold on to it for life, or at least for a very long time. You may be able to borrow against the value of the policy, but be sure you understand the terms of the loan.

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Nancy Ibarra's husband died at the age of 35. Nancy and her husband had decided that she would stay home with the children when they were young. They had no life insurance because they had focused on buying a house and didn't think that anything would happen. While Social Security survivor benefits provided much-needed income, life insurance could have provided additional security.

## Decisions

Your employer may provide some term life insurance, usually based on your salary. If you need more, you may be able to purchase additional life insurance through your employer.

Life insurance becomes more important when others — your spouse or partner, children, aging parents — depend on your income. You may want your spouse or partner to buy life insurance if you are dependent on them for income.

Remember to re-designate the beneficiaries on your life insurance contracts if you get divorced, unless you and your former spouse have agreed to do otherwise. You may want to remain the beneficiary of your ex-spouse's life insurance contract if you depend on that person for child support or alimony.

Review life insurance needs whenever you have a major change in family or employment status. Depending on other resources and income that will continue for your surviving spouse, you may or may not want to continue life insurance after retirement.

# HEALTH INSURANCE

**Workers, retirees, and their families place a high value on employer-provided health insurance — it can protect both your health and your financial well-being.**

## Rules of the road

Health insurance is the benefit that most people know to ask about while they are working or choosing a job.

### While you are working

Many people get health insurance through their employers. Your employer can provide you with information on how your health coverage works, what it covers, and what costs you may have to pay.

If you are laid off, leave your job, or are terminated from a company that employed 20 or more employees, you can usually continue the health insurance coverage you had with that employer. A federal law, the Consolidated Omnibus Budget and Reconciliation Act of 1986 (COBRA), provides this type of coverage for up to 18 months. You have to pay the full cost of the policy plus an administrative fee, which can be expensive. If you have lost coverage because of the death of a spouse or divorce, you can continue coverage for up to 36 months under COBRA. Another federal law, the Health Insurance Portability and Accountability Act of 1996 (HIPAA), contains additional provisions to extend health coverage.

A number of people working either full-time or part-time do not have health coverage. If you don't have health insurance through your employer, you may be able to get group health insurance through a membership organization that you or a family member belong to. You may also be able to buy health insurance on your own but, again, it may be quite expensive. Be certain to get bids from several different health insurance companies and local managed care organizations. If you buy insurance on your own, check with your state insurance department to make sure the plan is licensed and in good standing. (www.healthcare.gov)

Medicaid provides health coverage for very low-income individuals and families. Low and moderate-income children can often be covered through the State Children's Health Insurance program (SCHIP), and some state programs are now covering parents and childless adults as well.

**In retirement**

Some retirees receive health insurance from their former employers, although fewer employers are providing retiree coverage each year.

Medicare provides valuable health insurance coverage to most people aged 65 and over. In 2006 Medicare added an optional prescription drug benefit—Medicare Part D, but you must sign up with a private plan to receive this benefit. For more information on Medicare coverage or the optional Part D prescription drug benefit, call 800-MEDICARE or visit the Medicare website at www.medicare.gov.

Seniors with very low incomes, and very limited assets, may also be eligible for Medicaid.

## Decisions

If you are under age 65 and working in a job not covered by health insurance, look into policies to cover yourself and your family. If they all seem too expensive, consider a high deductible or a short-term policy that covers unexpected illnesses but not routine care.

Look into COBRA coverage if you lose health care coverage due to a job loss or loss of a spouse. You have 60 days to sign up for it.

Workers who retire or become unemployed before age 65 frequently have difficulty finding suitable health insurance coverage before they become eligible for Medicare. You need to think about health insurance coverage for both you and your spouse when you consider early retirement.

If you are in a job with health insurance, are close to retirement age, and your employer provides retiree health insurance, find out how much service is needed, or any other conditions that must be met for your employer to continue health insurance after you retire. You may want to work a little longer in order to qualify for retiree health benefits.

# DISABILITY INSURANCE

**Disability insurance is designed to replace employment income because of illness or injury.**

## Rules of the road

Employer sick leave practices usually cover only short-term illnesses or injuries. After you have used up any paid sick leave you have earned at work, your paychecks are likely to stop while medical bills and other expenses continue.

Many employers provide short-term disability insurance. The cost to the company is often low, so if your employer doesn't offer it, it might be worth asking about. Larger employers are more likely to provide long-term disability insurance, which is designed to replace part of your income (usually 50 to 60 percent, up to a specified minimum) when your illness is ongoing or permanent. The policies are often written to provide benefits until you become eligible for Social Security or Medicare.

Social Security pays disability benefits after a waiting period of at least five months, replaces part of your pay, and covers only those who are unable to work at all.

## Decisions

Check to see if you have short and long-term disability coverage through your employer, and see if the policy provides you with enough coverage. You can buy an individual disability policy if you don't have one through work, or to supplement coverage through your company's group policy.

It's important to choose an adequate benefit amount and a long benefit period, protecting you and your family against the worst cases.

# LONG-TERM CARE INSURANCE

**Long-term care insurance can help pay for services that older people sometimes need when they experience health problems that limit their ability to live on their own.**

## Rules of the road

Medicare does not pay for most long-term care. It primarily covers acute care, such as hospital and physician bills. Retirees who do not have additional insurance or adequate resources can find that one or more serious illnesses can be financially devastating.

Private long-term care insurance policies can cover a wide choice of services, ranging from services in one's own home, an assisted living facility or a nursing home. Long-term care insurance can pay for services that might let you stay in your own home when you are no longer able to do certain things for yourself. It can also help you afford more choices in the type of assisted living facility or other place you might prefer to live.

## Decisions

Long-term care policies can be purchased on an individual basis and sometimes through an employer.

Policyholders can choose the amount of coverage, the deductible period and the amount of time that the benefits will be paid. Policies can also provide protection against inflation, a guarantee that premiums will not increase, various levels of care, and other levels of benefits.

The cost of long-term care insurance partly depends on the age of the person buying it, and generally increases with age.

Try to choose an insurance company that will be financially sound in the future, has an excellent reputation and a strong customer service record.

# APPENDIX A:
# FOUR WAYS TO SAVE FOR RETIREMENT

**This table compares four different ways that you can save for retirement in addition to, or instead of, a traditional defined benefit pension plan. The examples show how investing in an IRA or 401(k) plan will increase your retirement savings.**

# FOUR WAYS TO SAVE FOR RETIREMENT

| | Bank account or mutual fund | Roth IRA |
|---|---|---|
| **How it works** | * You contribute after-tax money.<br>* There are no limits on how much you can contribute.<br>* You pay income tax each year on the investment earnings and pay no taxes on the money you take out. | * You contribute after-tax money.<br>* There are limits on how much you can contribute each year.<br>* You pay no taxes on your investment earnings and no taxes when you take the money out. |
| **Penalties for taking the money out too early (59½)** | * No. | * Yes, with some exceptions. |
| **or too late (70½)** | * No. | * No. |
| **An example: Four individuals each have $3,000 a year to put into retirement savings and start at** | | |
| | * Anne has $3,000 that she earned at work. First, she pays $600 in income taxes. She then has $2,400, which she contributes to the account each year.<br>* By age 65 her account has grown to $186,805, on which she owes no taxes. | * Bob also has $3,000, pays $600 in taxes, and contributes $2,400 a year to a Roth IRA.<br>* By age 65 his account has grown to $242,575, on which he owes no taxes. |

1 Each numerical example assumes that the individual uses $3,000 of gross annual pay as a source of retirement savings, and retiring in 30 years, and in a 20% tax bracket (federal + state) both before and after retirement. The savings fund earns

| Traditional IRA | 401(k) with 50% employer match |
|---|---|
| * You contribute pre-tax money if you fall within the IRS income limits & deduct the contribution from your taxable income.<br>* There are limits on the amount you can put in each year.<br>* You pay no taxes until you take the money out. | * You contribute pre-tax money.<br>* There are limits on how much you can contribute each year, but they are higher than the IRA limits.<br>* You pay no taxes until you take the money out. |
| * Yes, with some exceptions.<br>* Yes. | * Yes, with some exceptions.<br>* Yes. |
| age 35.[1] | |
| * Carol contributes $3,000 a year from pre-tax income to a Traditional IRA.<br>* By age 65 her account has grown to $303,219. After taxes, her account is worth $242,575. | * Dave contributes $3,000 a year from pre-tax income, and his employer makes a $1,500 matching contribution.<br>* By age 65 his account has grown to $454,829. After taxes, his account is worth $363,863. |

pays tax either before or after contributing, depending on the Tax Code treatment. Individuals are 35 years old, 7% a year before taxes.

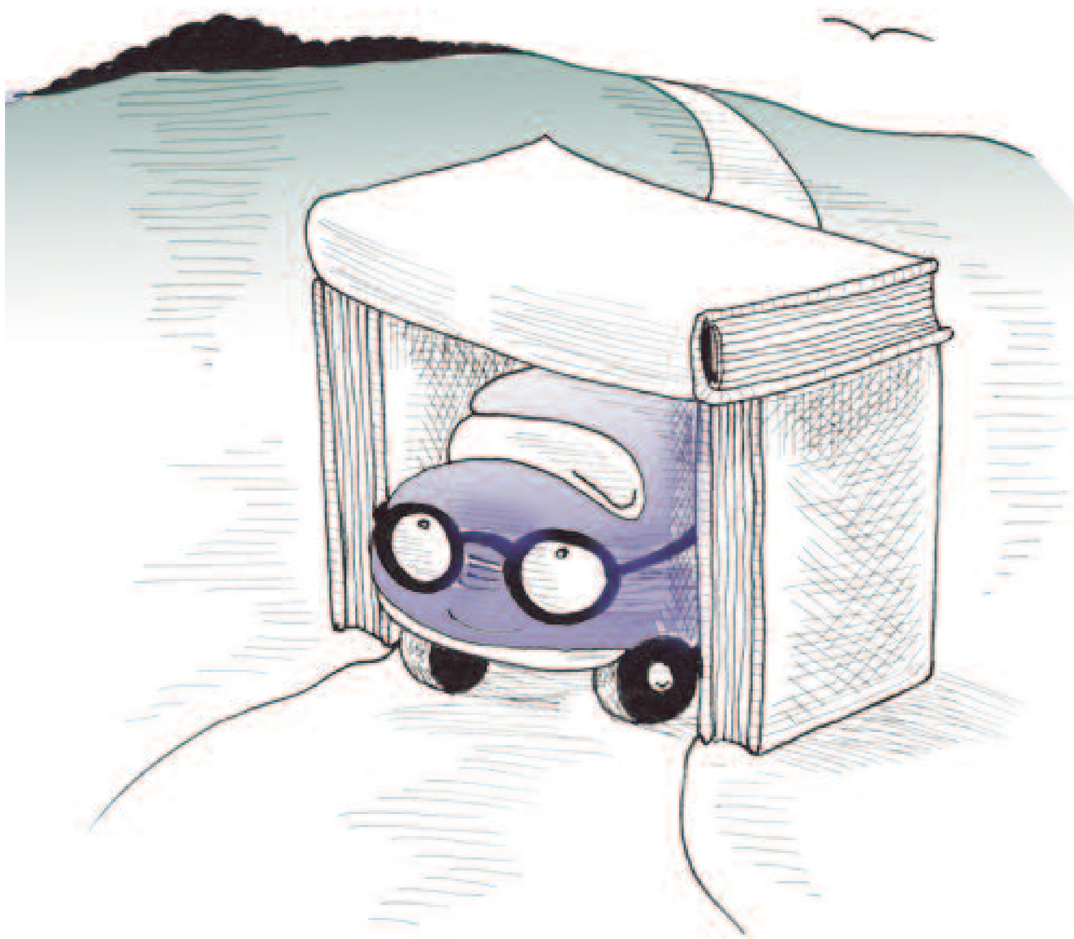
# APPENDIX B: SOCIAL SECURITY BENEFITS

| Provision | |
|---|---|
| **Worker's retirement benefit** | The amount paid is based on a worker's 35 years of highest earnings, adjusted for inflation.<br>The individual must have worked at least 10 years under Social Security. |
| **Full retirement age** | The full retirement age is 65 for workers who were born before 1938.<br>The full retirement age is gradually increasing from 65 to 67 as follows:<br>Year of birth — Full retirement age<br>1938 — 65 & 2 months<br>1939 — 65 & 4 months<br>1940 — 65 & 6 months<br>1941 — 65 & 8 months<br>1942 — 65 & 10 months<br>1943-1954 — 66<br>1955 — 66 & 2 months<br>1956 — 66 & 4 months<br>1957 — 66 & 6 months<br>1958 — 66 & 8 months<br>1959 — 66 & 10 months<br>1960 & later — 67<br>You will still be able to collect at age 62, but the benefit will be reduced to reflect early retirement. |
| **Spouses of retired workers** | You can collect benefits based on your spouse's work record and receive one-half of the worker's benefit. If your spouse dies before you, you will receive 100% of the benefit. |

*continued*

| Provision | Basic Rules |
|---|---|
| **Surviving spouses** | Widows or widowers with children under 16 can get benefits at any age.<br>Widows or widowers without children can get benefits as early as age 60 (50 if disabled). |
| **Former spouses** | Former spouses can collect a spousal benefit based on their ex-spouses' work record if the marriage lasted 10 years and the former spouse is unmarried. |
| **Spouses who are retired workers** | If someone qualifies for benefits as a spouse and also as a retired worker, that person gets the larger of the two amounts. |
| **Remarriage** | Benefit payments to a spouse who has remarried usually end if:<br>* A surviving spouse remarries before age 60;<br>* A former spouse remarries at any age. |
| **Cost-of-living increases** | The monthly payments go up each year based on increases in the Consumer Price Index. |
| **Children** | Children of retired, disabled, or deceased workers can receive benefits until they are 18; until 19 if they're unmarried and attending high school. |
| **Disability benefits** | Benefits are paid to disabled workers who are unable to work after a 5-month waiting period. The individual must be unable to work in any substantial gainful activity based on medical evidence. |
| **Benefit reductions for some non-covered workers** | Individuals with a pension from federal, state or local government who were not covered under Social Security while they were working may find that their Social Security benefits are reduced. |

# APPENDIX C:
# OTHER RESOURCES



## Non-Profit Resources

AARP
601 E Street, NW
Washington, DC 20049
888-687-2277
www.aarp.org

The Actuarial Foundation
475 North Martingale, Suite 600
Schaumburg, IL 60173
847-706-3535
www.actuarialfoundation.org

American Bar Association
Consumer's Guide to Legal Help
321 North Clark Street
Chicago, IL 60610
800-285-2221
www.americanbar.org

American Savings Education Council
1100 13th Street NW, Suite 878
Washington, DC 20005
202-659-0670
www.asec.org

Credit Union National Association
PO Box 431
Madison, WI 53701-0431
800-356-9655
www.cuna.org

Freddie Mac
Credit Smart Program
www.freddiemac.com/creditsmart

National Alliance for Caregiving
4720 Montgomery Lane, Suite 205
Bethesda, MD 20814
www.caregiving.org

National Association for Area Agencies on Aging
1730 Rhode Island Avenue, NW
Suite 1200
Washington, DC 20036
202-872-0888
www.n4a.org

National Council on the Aging
1901 L Street, NW, 4th Floor
Washington, DC 20036
202-479-1200
www.benefitscheckup.org

National Foundation for Credit Counseling
2000 M Street, NW, Suite 505
Washington, DC 20036
202-677-4300
www.nfcc.org

Plan Sponsor Council of America
20 N. Wacker Drive, Suite 3700
Chicago, IL 60606
312-419-1863
www.psca.org
www.401k.org

Women's Institute for a Secure Retirement
1140 19th Street, Suite 550
Washington, DC 20036
202-393-5452
www.wiserwomen.org

**Pension Counseling Projects**
The Administration on Aging pension information and counseling projects provide free pension and retirement savings plan counseling and assistance to older individuals.

Pension Rights Center
1350 Connecticut Avenue, NW Suite 206
Washington, DC 20036
202-296-3776
www.pensionrights.org

**Pension Help Centers:**

Illinois Pension Assistance Project
Serving Illinois
Toll Free: 888-425-6067
www.umb.edu/pensionaction

Michigan Pension Rights Office
Serving Indiana, Michigan, and Tennessee
Toll Free: 866-735-7737
http://mid-americapensions.org/

Ohio Pension Rights Office
Serving Kentucky, Ohio, and Pennsylvania
Toll Free: 866-735-7737
http://www.proseniors.org/oh_pension.html

New York Pension Rights Office
Serving New Jersey and New York
Toll Free: 800-355-7714
http://www.sbls.org/index.php?id=253

New England Pension Assistance Project
Serving Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont
Local: 617-287-7307
Toll Free: 888-425-6067
http://www.umb.edu/pensionaction

Texas Pension Rights Office
Serving Arkansas, Louisiana, Missouri, New Mexico, Oklahoma, and Texas
Toll Free 800-443-2528
http://www.southcentralpension.org/

Minnesota Pension Rights Office
Serving Minnesota, North Dakota, South Dakota, and Wisconsin
Toll Free: 866-783-5021
http://www.midwestpensions.org/

Iowa Pension Rights Office
Serving Iowa
Toll Free: 800-992-8161
Local: 515-282-8161
http://www.iowalegalaid.org/

California Pension Rights Office
Serving Arizona, California, Hawaii, and Nevada
Toll Free: 866-413-4911
Local: 916-930-4911
http://slh.lsnc.net/

## Government Resources

Eldercare Locator
Administration on Aging
800-677-1116
www.eldercare.gov

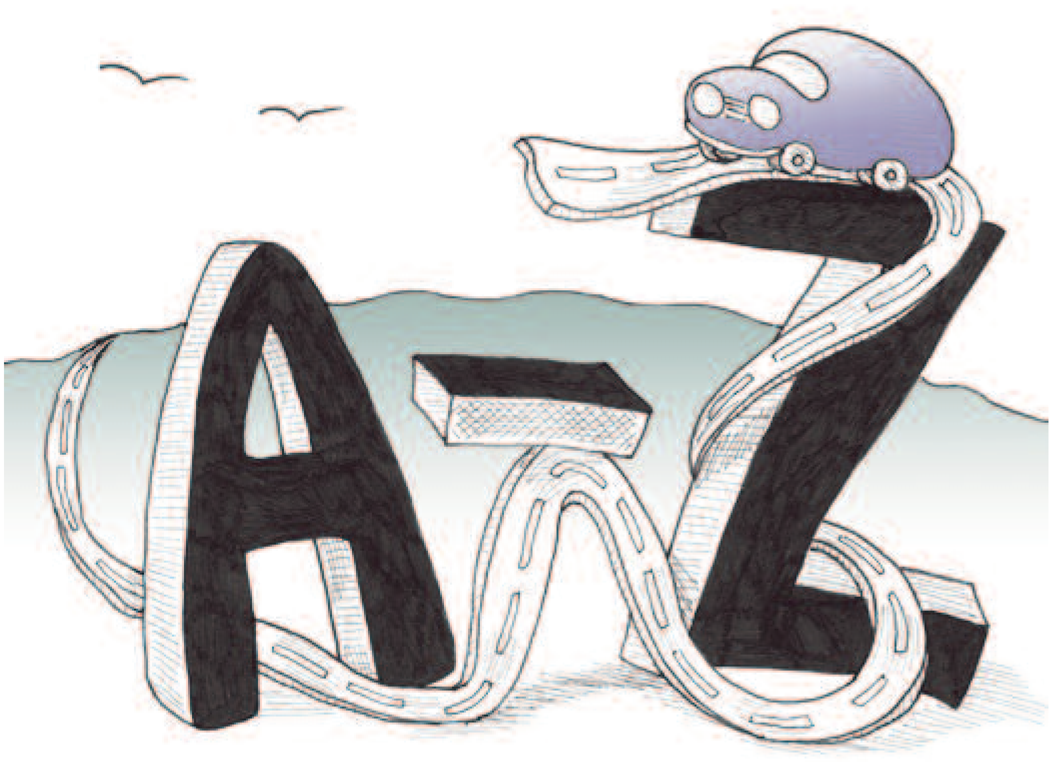
Centers for Medicare and Medicaid Services
Prescription Drugs & Other Assistance Programs
1-800-Medicare
www.medicare.gov

U.S. Department of Labor
Employee Benefits Security Administration
202-219-8771
www.dol.gov/ebsa

Securities and Exchange Commission
Office of Investor Education and Advocacy
800-732-0330
www.sec.gov/investor

Social Security Administration
800-772-1213
www.ssa.gov

# APPENDIX D:
# GLOSSARY OF FINANCIAL TERMS



**after-tax** – Funds on which an employee has already paid all income taxes; for example, amounts held in a bank account or a Roth IRA.

**annuity** – (1) A series of periodic payments. (2) A contract under which an insurance company promises to make a series of regular payments to a named individual for life.

**asset (and asset allocation)** – An asset is anything you own that adds to your net worth. Asset allocation means that you decide how you will invest your savings among stocks, bonds, money market funds and other assets.

**balanced portfolio** – A set of investments balanced between riskier and more conservative investments.

**before-tax or pre-tax** – Funds on which an employee has not yet paid income taxes. For example, money can be put into a qualified 401(k) plan or traditional IRA before income taxes are subtracted. Taxes are deferred (or delayed) until you take money out from the qualified plan or IRA.

**beneficiary** – A person, institution, trustee, or estate named to receive death benefits from insurance or annuity contracts, or anyone receiving Social Security benefits.

**bond** – A formal certificate of debt, issued by corporations or units of government. When you buy a bond, you are making a loan to the government or corporate entity that issued it. You receive an IOU for the amount, a future date at which that amount will be paid back to you, plus interest on the money invested.

**bond fund** – A mutual fund that holds municipal, corporate, and/or government bonds.

**certificate of deposit (CD)** – A short-term debt security, which can have a maturity period of anything from a few weeks to several years. Typically, you invest a fixed amount of money for a specific amount of time and receive a fixed amount of interest in return.

**compound interest** – Interest that is earned on both the principal (the initial investment) and previously earned interest.

**defined benefit pension plan** – A traditional pension plan, usually insured by the government, that pays a certain benefit usually based on your age at retirement, rate of pay and the number of years you worked. The employer's pension administrator controls investments and bears the risk of investment.

**defined contribution pension plan** – A retirement plan in which contributions are made by the employee, the employer, or both. The final payout will depend on how much is invested and the success of the investments. This type of retirement plan is not insured by the government.

**disability insurance** – Insurance that replaces income for individuals unable to work due to accident or illness.

**diversification** – A strategy to reduce risk by spreading assets across a mix of companies, investments, industries, geographic areas, maturity dates, and/or other investment categories.

**equity –** Ownership of stocks or real estate.

**401(k) plan –** A voluntary retirement savings plan in which employees can choose to contribute a portion of their earnings before tax and employers may match some or all of the employees' contributions. 403(b) and 457 plans are similar to 401(k) plans.

**immediate annuity –** An annuity which you can buy at or after retirement. The payments begin right away and are guaranteed to continue for as long as you live.

**individual retirement account (IRA) –** A retirement savings vehicle for individual workers. Traditional IRAs allow tax-deductible contributions, with earnings tax-deferred until withdrawal, subject to minimum distribution rules; contributions to Roth IRAs are made with after-tax funds, and withdrawals are tax-free.

**joint and survivor annuity –** An annuity that provides a series of payments to two individuals guaranteed to continue as long as one or both of them live.

**life insurance –** Insurance which promises to pay a specified amount of money upon the death of the insured.

**long-term care (LTC) insurance –** Coverage available on an individual or group basis to provide medical and other services to patients who need care in their own home or in a nursing home.

**lump-sum distribution –** A single-sum payment from a pension or employee benefit plan to a participant retiring or leaving employment.

**mortgage –** A loan made to finance the purchase of real estate, which serves as the collateral for the loan.

**mutual fund –** An investment company that pools funds from individuals to buy securities to meet stated investment objectives.

**reverse mortgage –** A contract with a financial institution that allows a homeowner to get retirement income from the equity in the home, with no repayment needed for as long as the individual lives in the home.

**risk –** The possibility that an investment will lose value.

**rollover IRA –** A type of individual retirement account usually funded with money transferred from a former employee's company-sponsored retirement plan account. Investment earnings continue to grow tax-deferred until benefits are distributed.

**Social Security –** A federal government program that provides retirement, survivor's, and disability income benefits for eligible workers and their families.

**survivor's benefit –** Income payable to a beneficiary, often the widow or widower, from a defined benefit pension plan, Social Security, annuity or insurance policy when the employee or policyholder dies.

**tax deferral –** The postponement of taxes on the earnings or growth related to certain investments until the earnings are withdrawn from the investment or account.

**vesting –** The right of an employee, earned over a specified period of time, to receive some retirement benefit, regardless of whether he or she remains with the employer.

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