

WISER/Actuarial Foundation Paper

“Retirement Planning: Taking Your Money Out” (The Consumer Booklet Will Be Available Soon!)

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Retirement Planning: Taking Your Money Out

Executive Summary

Many workers choose to take their money out of a retirement plan in the form of a large lump-sum payment. While the ability to receive lump sums is good news in many ways, unfortunately people often lack the skills and discipline to manage such sums effectively for retirement purposes. Taking a lump sum can be a good idea in some situations, but it is a bad idea in others. This paper discusses how to avoid a number of pitfalls:

- Underestimating how long a retiree may live
- Paying too much in taxes
- Paying too much for administrative costs and fees
- Not preserving assets for retirement
- Not diversifying investments
- Not getting good advice on retirement planning
- Taking a lump sum that one can't manage effectively
- Failing to protect against risks after retirement
- Not preparing for lifestyle changes including long-term care
- Not preparing for possible loss of a spouse
- Losing retiree health insurance or other non-pension benefits
- Losing one's share of marital property

This paper provides an overview of what kinds of retirement plans are available, when they may let participants take money out, and what to consider when making distribution choices in each type of plan. It also offers insight into the possibility of buying an annuity, creating a personal life-income plan.

The intended audience for the concepts discussed here is middle-income Americans, with particular emphasis on women. The Actuarial Foundation is making available this educational paper as part of its consumer education efforts. Initially, the contents are intended to furnish information for a brochure to be published by the Women's Institute for a Secure Retirement (WISER).

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The views expressed are their own, not those of any employer or other institution. There is no professional consensus on some matters discussed here, e.g., how retirees should invest their retirement savings or rapidly they should draw down savings after retirement. The paper is meant for general guidance, and persons wanting specific advice suitable for their own circumstances should engage a qualified professional advisor such as an actuary, attorney, tax expert, or financial planner to help them understand the issues and answer the questions raised here.

A. Introduction and Scope

Americans can build resources for retirement through Social Security, employer-sponsored pension plans, and personal savings. Many employer plans allow you to decide between receiving regular monthly income after retirement from a pension or annuity, or instead taking a lump-sum payment that you can

invest and draw down as needed. This paper provides background information intended to help you understand the implications of choosing between pension or annuity income vs. a lump-sum distribution from an employer plan. Some of these distribution choices preserve your assets for retirement purposes, while others do not. Some distribution choices require you to manage and invest your retirement funds yourself while others (e.g., a pension or annuity) do not. Some distribution choices protect you against outliving your income, or losing purchasing power to inflation, while others do not.

Many of these same issues arise when you're deciding whether to convert assets held in an Individual Retirement Account or other personal savings into a lifetime income by purchasing an annuity. Insurance companies sell several kinds of annuities, and the terminology can be confusing. This paper will discuss only the kinds that are designed for retirees to receive income, sometimes called immediate annuities, lifetime payout annuities, life annuities, or income annuities. These are annuities that you buy with a lump sum of money when you want to begin receiving a guaranteed stream of lifetime income. Insurance companies also sell "deferred annuities" and "variable annuities," which are used mainly to accumulate funds before retirement and won't be discussed here.

The paper will discuss:

- How you can use different types of programs to build resources for retirement
- When you can decide between income vs. other assets at various stages of life
- How you can take money out of defined benefit plans, defined contribution plans, and IRAs
- Issues involved in self-managing your assets during your retirement years
- Some pitfalls you need to avoid

Several types of public and private programs are available to provide retirement resources. The main focus of this paper is on taking your money out of private programs. Information on Social Security is also provided because it works in partnership with the private programs:

- **Social Security** covers the vast majority of American workers and their spouses, paying them basic retirement income for life, including increases to keep pace with inflation. The Social Security Administration sends annual statements that include benefit estimates to workers and former workers aged 25 or older. You probably won't consider Social Security adequate by itself but you can supplement it from one or more other sources of retirement income.
- **Defined benefit (DB) pension plans** are generally provided by long-established public or private employers. The traditional kind of DB plan computes your monthly pension based on your years of service and usually on your average pay as well. Cash balance plans are a newer kind of DB plan which compute your benefit payment as a lump-sum amount based on the contributions and interest that your employer credits to your account. The employer often pays the entire cost of a DB plan and is responsible for investing the pension fund. When you leave the employer, you may be able to elect to get a lump-sum payment instead of a lifetime pension.
- **Defined contribution (DC) pension plans** are a rapidly growing type of employer plan. Under 401(k) and 403(b) plans, employees usually may elect to make tax-deductible contributions, with the employer matching a percentage of those contributions. Under employee stock ownership plans, money purchase plans, and profit-sharing plans, the employer usually pays the full cost. In a DC plan, you may be responsible for deciding how to invest all the money in your account, or you may be required to keep some of it in employer stock. Your account balance under a DC plan reflects all the contributions made by you and your employer and any investment gains & losses. When you leave the employer or afterward, you usually can take your money out in a lump sum. A Roth 401(k) is a newer kind of arrangement with different tax treatment from a traditional 401(k).

- **Individual Retirement Accounts (IRAs)** are tax-favored arrangements that let you and your spouse save part of your pay for retirement. Workers often contribute on their own to an IRA if they don't have an employer plan, and some small employers set up payroll deduction arrangements that enable employees to contribute to IRAs. Perhaps more important, you can roll over to an IRA a lump-sum amount that you've accumulated in an employer's DB or DC plan – most IRA money today is in rollover accounts. Individual workers or their beneficiaries control the money in their IRAs and decide how to invest it. A Roth IRA is a newer kind of arrangement with different tax treatment from a traditional IRA.

Personal Savings and Assets represent money you have saved on your own outside an IRA or DC plan and includes money received from an insurance policy, inheritance, sale of a home, etc.

- **Home Ownership as an Asset:** For many Americans, their home is their most valuable asset in retirement. You can use this important asset to support retirement in several ways:
 - You can move to a less-expensive home, a rental property, or an assisted-care facility, using the assets freed-up to help finance your retirement.
 - You can rent out part of your home to generate income.
 - You can use a reverse mortgage which pays you monthly income for life. These arrangements are not used widely but could become much more popular.
- **Public Assistance Programs:** Americans with very limited resources for retirement may be able to get public benefits in addition to Social Security and Medicare through SSI, Medicaid and other programs.

Regulation of Pension Plans: The vast majority of private-employer pension plans in the U.S., both DB or DC types, as well as IRAs, are regulated by the Internal Revenue Code and ERISA (Employee Retirement Income Security Act). Most of those regulations do not apply to executive compensation plans or governmental pension plans. References in this paper to the law and regulations, or to employer practices, do not reflect changes after mid-2005.

Related Topics: Some readers may want to use other sources to look into the following topics, which will not be discussed further in this paper.

- **Estate Planning:** Many individuals need to consider the topics discussed here in the broader context of an estate plan which seeks to protect their families, provide for smooth handling of assets after death, and reduce taxes on assets that they leave to heirs.
- **Executive Compensation:** In many organizations, highly paid individuals can build assets for retirement and other purposes through deferred compensation and other special programs. Some of these programs are voluntary, require decisions by the individuals, and have special tax treatment.

B. What choices will you have in taking money out of retirement savings?

A pension plan or IRA usually gives you some freedom to choose when and how to take money out in the form of a lump sum, lifetime income (pension or annuity), or rollover to another plan. You'll want to be careful because in some situations IRS imposes a tax on amounts that you take out, or neglect to take out.

1. When can you take money out of retirement funds?

Before retirement, you may have access to retirement funds in the form of a loan, hardship withdrawal, or lump-sum cashout. You should avoid taking money out for non-retirement purposes unless it's an emergency or other extreme situation and you have no other source of funds. Preserving your savings for

retirement allows your money to grow tax-free while taking it out gives up future tax benefits, it triggers immediate income taxes, and it may expose you to additional taxes for a premature distribution. Besides tax disadvantages, remember that dipping into long-term savings prematurely will make it more difficult to retire when you want to.

Your transition to retirement status brings a more-complex set of choices and decisions. 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.

The table below briefly summarizes choices and questions you may face when deciding to take money out of a DB plan, a DC plan, or an IRA. You should make such decisions in the context of your total retirement picture, considering all plans and programs over the long term. Later sections of this paper will discuss such decisions in detail.

Taking Your Money Out: Issues to Consider			
	DB Plan	DC Plan	IRA
When you’re staying in a job		<ul style="list-style-type: none"> • Take a plan loan? If so, how rapidly should you repay (must be within 5 years)? • Take a hardship withdrawal? 	<ul style="list-style-type: none"> • Withdraw funds?
When you change jobs	<ul style="list-style-type: none"> • Take a lump sum, if available? • Roll over the money to an IRA or another employer’s plan? 	<ul style="list-style-type: none"> • Roll over the money to an IRA or another employer’s plan? • Cash out and spend the money? 	<ul style="list-style-type: none"> • Consolidate your retirement savings in one place?
When you divorce	<ul style="list-style-type: none"> • Should benefits be split between spouses? If so, how? • What benefits are available? What is their lump-sum value? 	<ul style="list-style-type: none"> • Should benefits be split between spouses? If so, how? 	Same as for a DC plan
When your spouse dies	<ul style="list-style-type: none"> • What benefits are available? • Should you leave benefits in the plan? • Are survivor benefits paid as required? • How do you preserve assets for retirement? 	Same as for a DB plan	Same as for a DB plan
When you retire from a long-term job	<ul style="list-style-type: none"> • Take a lump sum, if available? • Take a single-life annuity or a joint & survivor annuity? • Request a guaranteed-certain period? 	<ul style="list-style-type: none"> • Leave the money in the plan? • Annuitize all or part? • Roll money over to an IRA or another plan? • Cash out and spend the money? • Take systematic withdrawals of funds? 	<ul style="list-style-type: none"> • Consolidate your retirement savings in one place? • Annuitize all or part? • Cash out and spend the money? • Take systematic withdrawals of funds?
When you reach age 70 ½	<ul style="list-style-type: none"> • Comply with minimum withdrawal rules by using an annuity or lump-sum cashout? 	<ul style="list-style-type: none"> • Comply with minimum withdrawal rules by using an annuity or annual withdrawals? 	<ul style="list-style-type: none"> • Comply with minimum withdrawal rules by using an annuity or annual withdrawals? (These rules don’t apply to Roth IRAs.)

2. Taking your money out of retirement plans: How do taxes affect the choices you’ll make?

Developing a strategy for taking distributions from your tax-deferred savings can give you more spendable retirement income by reducing your taxes. The strategy should consider your total taxable income and distributions under all of the taxation rules. Because investment income on personal savings

is usually taxable each year, financial advisers often suggest that you take retirement income from savings first and let any IRA or 401(k) funds keep growing tax-free as long as possible.

Money that you take out of retirement plans is generally taxed by IRS in one of several ways

1. **Payments to you from a pension plan or traditional IRA** are taxed as ordinary income if you didn't contribute to the plan or if any contributions you made were "before tax" (tax-deferred). Examples of before-tax contributions include your elective deferrals to a 401(k) plan and tax-deductible contributions to a traditional IRA. However, if you made after-tax contributions, a part of the payments to you will be tax-free because it's treated as a return of contributions on which you've already been taxed.
2. **Your investment return** on retirement savings is also taxed as ordinary income.
3. **Distributions from a Roth IRA or Roth 401(k)**, including investment return, are not taxable if you meet certain distribution rules.
4. **Withdrawals of funds before age 59 1/2** will also trigger a 10-percent penalty tax in many cases.

Several helpful exceptions apply to these tax rules:

- **Lump sum distributions that are rolled over** from a 401(k) plan or defined benefit plan to an IRA or another employer 401(k) plan are not taxed if the rollover is made directly from the trustee of the old plan to the trustee of the new plan. Making a direct rollover is important. If you take a lump sum instead of getting the trustees to make a direct rollover, then the trustees must deduct 20% withholding tax from the full amount. You still can preserve the tax-deferred status but it won't be easy. You would have to deposit the full amount of the distribution into an IRA or another employer's 401(k) plan within 60 days of receipt, including the 20% part that was withheld. In such a case, you will later receive the 20% taxes withheld as part of your tax refund (if any) for the year of the distribution.
- **Distributions from an inherited IRA** can be paid out over the lifetime of the surviving beneficiary. Tax treatment of an inherited IRA follows special IRS rules that can be important to surviving spouses 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.
- **Distributions of employer stock from a 401(k) plan** get a special tax break if you meet certain distribution rules. At the time of the distribution, you will owe ordinary income tax on the cost basis of the shares. If you hold the shares for at least 12 months after the distribution, you will owe capital gains tax (rather than ordinary income) on the investment earnings in excess of the cost basis when you sell the stock.

Minimum required distributions are a tax pitfall to watch out for after age 70 1/2. The IRS requires that annual withdrawals from a DC plan or an IRA, except a Roth IRA, generally begin no later than the year you reach age 70 1/2. For a qualified pension or 401(k)-type plan, payouts must commence when you reach age 70 1/2 and are no longer working for the employer that sponsors the plan. For the year in which you attain 70 1/2, you can defer distributions until April 15 of the following year.

The minimum amount that must be distributed is calculated from an IRS table. The distribution gets taxed as ordinary income, even if you just move that amount into your personal investments instead of spending it. The IRS charges a very stiff 50% excise tax on any shortfall in your actual distribution compared to the minimum required for a calendar year. The IRS looks at each year separately, so that someone who takes out more than the minimum in one year may not count the excess toward the minimum for a later year. But the IRS looks at all your IRAs together, disregarding Roth IRAs, so that someone with several IRAs may add them up and withdraw the total minimum required payment from one account.

When you're holding additional retirement savings outside an employer plan or IRA, for example proceeds from the sale of a home or an inheritance, investment income on such assets is taxable each year. The tax rates on dividends and capital gains on stocks are lower than on ordinary income, based on rules that are complex and subject to frequent change. If you invest in both stocks and bonds, you may want to take advantage of these tax breaks by keeping stocks outside an IRA or 401(k) plan while holding bonds inside. If you'll have taxable investment income, you may arrange to keep your tax withholding amounts up-to-date (federal, State and local, as appropriate) so you don't incur penalties for late payment, or you may pay estimated taxes in quarterly installments.

Also, as much as 85 percent of your Social Security benefit may be taxable as ordinary income when all your income (including your spouse's income, if any) exceeds a certain amount.

State and local income tax rates vary greatly, with some states having no income tax and others having substantial tax breaks for retirement income. Retirees must follow the tax rules in the state where they live, and so they may want to consider moving to a place with favorable taxation of retirement income.

C. Defined Benefit (DB) plans: How will you take your money out?

Q1. Where can you find out how you may take money out of your DB plan?

- A1. You can find this valuable information in the plan's *Summary Plan Description (SPD)*, in the plan document itself, and in other material which your plan administrator may have made available in writing or online.

Each private pension plan is required to furnish plan participants with written material describing the plan provisions. It is usually supplied in a booklet format, and is known as the plan's SPD.

The SPD will tell you the eligibility requirements for becoming a plan member, the conditions for receiving plan benefits (such as for normal retirement, early retirement, disability retirement and death benefits), the formulas used to determine your benefits, and the alternative ways that are available for you to receive your benefits.

Q2. What are the usual ways available to take distributions from a DB plan?

- A2. Benefits are typically paid in monthly installments. Each DB plan specifies standard and optional ways for you to receive your benefits. The standard way usually is a life annuity or an annuity during your lifetime with payments guaranteed for a period of time, such as 5 or 10 years. Optional methods include paying benefits to you and your spouse or designated beneficiary, or paying your entire benefit in one lump sum.

If you're married when you retire, special conditions usually apply. A married employee must take a joint-and-survivor annuity unless both the employee and spouse reject this choice in writing. This provision is required in private pension plans, not governmental plans, and it sometimes has a one-year marriage requirement.

Q3. How does a life annuity benefit work?

- A3. A *life annuity* provides you with income for the rest of your life. This means that payments continue as long as you live. If the plan pays you \$500 per month, you will receive these payments until you die.

A *life annuity with payments guaranteed for a fixed period of time (such as 5 or 10 years)* provides you with income for the rest of your life. However, should you die before receiving

payments for 5 or 10 years (as the case may be), benefits will continue to your beneficiaries or your estate until a total of 5 or 10 years' benefits have been paid on your behalf.

Q4. How does a joint-and-survivor benefit work?

A4. A *joint-and-survivor annuity* is payable to you for life. After your death, a percentage of your benefit amount (typically 50% or 100%) is continued to your surviving spouse or designated beneficiary for the rest of their lifetime. The monthly benefit payable to you under the option will be lower than without the option because the plan may have to continue benefits to your survivor. The following examples may help explain this concept.

Example 1:

Janet can retire at age 65. Her standard benefit before electing an option is \$1,000 per month. This benefit is payable as a *life annuity* so that her plan benefits will cease upon her death.

Janet's husband is age 67 at the time of her retirement. She wants to protect him by taking a smaller monthly benefit during her lifetime, and providing him with 50% of her benefit after she dies. In this case, her plan will pay her \$900 per month during her lifetime. After her death, her husband will receive \$450 per month (50% of her benefit) for the rest of his lifetime. This type of payment method is typically called a *50% joint-and-survivor annuity*.

Example 2:

John is planning to retire at age 67. His standard benefit would be \$2,000 per month payable in the form of a *life annuity with payments guaranteed for 5 years*. His wife will be age 64 when he retires. Without an option, he is guaranteed to receive benefits for at least 5 years even if he doesn't live 5 years. However, if he lives for just 6 years and then dies, his wife would not receive any further benefit payments under the plan.

John is considering the election of a *joint and 100% survivor annuity*. Under the terms of his plan, he could receive \$1,600 per month during his lifetime. When he dies, his wife would receive the same \$1,600 per month (i.e., 100% of his benefit amount) for the rest of her lifetime.

Considerations:

When considering whether or not to elect this option, both Janet and John had to consider the health and potential longevity of themselves and their spouses as well as what other income will be available after their deaths. For example, if the retiring employee were in poorer health than the spouse, then it might make sense to protect the survivor for as long as possible. The family income during retirement should also be taken into account.

In most plans the option cannot be changed once benefit payments have started. So if John's wife were to die shortly after payments began, he would still receive only \$1,600 per month for the rest of his lifetime.

A few DB plans offer a "*pop-up*" *joint-and-survivor option*. In this situation the employee's benefit payment would be restored to the standard monthly amount after the spouse died. 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 more protection.

Q5. How does a lump-sum benefit work?

A5. In several situations, as listed below, you may be able to receive your benefits in one lump-sum payment. In such cases, you can tell the trustees to roll the lump sum over to an IRA or another pension plan so you preserve it for retirement and don't pay a current tax on the distribution. Or you can use the money immediately, in which case it will be subject to federal tax (including penalty in some cases) and possibly State & local tax. Remember that the purpose of a pension plan is to accumulate money for your retirement, and spending the money prematurely can defeat your retirement needs.

- At termination of employment for any reason, with entitlement to a vested benefit that has a lump-sum value less than \$5,000 - For such a relatively small benefit, the plan administrator may require you to take a rollover or lump-sum payment.
- At termination of employment when you have a vested benefit with a lump-sum value over \$5,000 - Whether or not you can receive a lump-sum distribution depends on the plan provisions. You should consult the plan provisions or the plan administrator.
- At retirement - Whether or not you can receive a lump sum distribution depends on the plan provisions. You should consult the plan provisions or the plan administrator.

Q6. How do you decide whether to take a lump sum distribution?

A6. First, remember that the money in your pension plan is intended to provide you (and possibly your survivors) with a source of income for life. This is in addition to your Social Security, income from other pension plans, personal savings and other assets. So before you seriously consider taking your benefit in the form of a lump sum, ask yourself if you feel very confident that you can make this money last for your lifetime.

On the other hand, you may want to consider the possibility that the plan may become unable to pay the benefits owed to you. If your pension is payable from a guaranteed insurance company annuity contract, you can expect a high degree of certainty that your benefits will be paid when due. If your pension is payable from a trust fund, there may be some likelihood that the plan won't be able to pay all its benefits because of plan termination with insufficient assets. However, the pension plans of most private employers are guaranteed by the Pension Benefit Guaranty Corporation. This is a federal agency which gives pension benefits currently being paid high priority when a plan terminates. The amount that's guaranteed is limited, so that your actual benefit could be reduced.

The amount of your lump-sum distribution from a DB plan is based on government rules that don't always reflect the true value of your pension. For example, lump sums may be too low if you're eligible for early retirement. You can check this by comparing the amount of annuity that the lump sum could purchase from an insurance company against the annuity amount actually available to you from the plan.

Your health is very important because the amount of the lump sum assumes you'll live an average lifespan. If you're in poor health, you may want to take the lump sum and invest it or else elect a joint-and-survivor annuity to protect your spouse.

Some employers make available post-retirement health insurance or other valuable post-retirement benefits that are offered only to a current retiree (and spouse), not to a former employee who has taken a lump sum. Such plan provisions vary among employers, so it's important to find out the facts. Other extra benefits for ongoing retirees vary widely but can include life insurance or similar benefits. Some telephone companies give retirees free telephone

service. A large public employee retirement system allows annuitants to pay for retiree health insurance from accumulated sick leave, which they would forfeit if they took a lump sum.

You need to understand that non-pension benefits from a prior employer are not necessarily guaranteed forever. Employers can generally change health insurance or similar retiree benefits they offer prospectively. Many employers are reducing benefits, asking retirees to pay more, or even terminating retiree health insurance and other non-pension benefits.

Finally, you may want to get expert advice on tax considerations to be taken into account.

D. Defined Contribution (DC) plans: How will you take the money out?

Q1. What happens to your money in a DC plan when you retire?

A1. At retirement, you'll have several basic types of choices:

- You can convert all or part of your savings into lifetime income from an annuity. Lifetime income can include continued payments after your death to your spouse or another named contingent beneficiary. Few DC plans offer an annuity option directly. If an annuity option is not offered directly, you can roll the funds over to an IRA to provide an immediate annuity.
- You can leave your money in the DC plan and have funds paid out over time. This allows you to withdraw invested funds on a planned basis, for example 4% or 5% a year, or periodically as needed. You also can withdraw a large amount at one time for purchase of a home or other special needs.
- You can roll over funds from a DC plan into an IRA. Within the IRA, you have various options that include managing the investment of funds yourself, hiring an investment manager, buying an immediate annuity, or using a combination of these options. You can make several purchases of annuities at different times to diversify interest-rate risk and spread out payment of taxes.
- You can take a lump-sum distribution from the DC plan and not roll over the money. Taxes and potential penalties will then be payable on the full amount of the distribution. After that, you can spend the funds whenever you wish, or set them aside to buy an annuity later.

Things to think about in choosing how to take your money out of a defined contribution plan include the following:

- ❑ What sources of retirement funds are available? Social Security and employer pensions guarantee income for life. What about other sources of income?
- ❑ How long might you live? While on average people who retire at 65 live into their 80s, a few live to 100 and beyond. Withdrawal should provide for the maximum period of potential life.
- ❑ What about needs of your spouse and other dependent family members? Remember that your spouse may outlive you.
- ❑ How will you cope with ongoing inflation? Costs are likely to rise year by year, and the impact of these increases over time can be very big.
- ❑ 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? Do you have retiree health

coverage or supplemental coverage on top of Medicare? If so, what premiums are payable and how are they likely to change?

- ❑ How can you handle potential emergencies (e.g.: home or car repairs, unexpected medical bills, family emergencies)? Will you need special withdrawals from your funds to cover these?
- ❑ What if you'll need long-term care, assistance at home, or special housing? Costs for these will rise later in life. For some people, long-term care insurance will cover part of such costs.
- ❑ Can you fulfill your retirement dreams? Many people like to travel extensively early in retirement and may choose to withdraw larger amounts.
- ❑ Will you be able to manage your funds? Investing assets requires significant know-how.

Q2. What happens to your money in a DC plan if you change jobs before retirement age?

A2. If you leave a job before you're ready to retire, a basic question is whether you'll preserve your savings for retirement or instead withdraw the money and spend it quickly. If you wish to spend the retirement money immediately rather than preserving it for retirement, then you can take it out in a lump sum and pay the taxes. But it's generally important to preserve your savings for retirement, and you can do this in several ways.

- You may be able to leave funds in the DC plan with your former employer. Then at time of retirement, the options described above will become available.
- You can roll over the money into an IRA. This provides continued tax-deferred accumulation until time of retirement, when you can start withdrawing funds. Once your funds have been moved into an IRA, you can decide to purchase an annuity later with all or part of the funds.
- You can withdraw the funds in a lump sum, pay the taxes, and invest the net proceeds in a taxable account. This is generally not a good strategy if you're trying to preserve the money for retirement.

Q3. What if you need your money that's in a DC plan while you're still working?

A3. In an exceptional case, you can access retirement funds while still working.

Defined contribution plans typically offer in-service withdrawals while you are still employed. Many plans offer such withdrawals only in the event of a "hardship" as defined in the plan. Typically, hardship situations include medical expenses, educational expenses, purchasing your principal residence, and preventing eviction from your principal residence. The plan will define whether it allows an in-service withdrawal and what conditions you must meet.

In addition, defined contribution plans may allow you to borrow from your account. The plan will define whether loans are available, what conditions you must meet, and the terms of the loan for interest and repayment period. Usually, loans from the plan are offered on more favorable terms than you could get from consumer credit. In either case, you are withdrawing funds from your retirement savings and using them for current consumption. You may be jeopardizing your long-term retirement plans in so taking funds from the defined contribution plan.

IRA funds can be withdrawn before retirement, but at a very high price. Income taxes and penalty taxes must be paid, and any funds spent will no longer be available for retirement.

The table below summarizes pros and cons of different ways you can handle DC funds. This is based on government rules and employer practices in mid-2005.

Taking Your Money Out of a DC Plan: Choices to Consider				
	Leave Money in the DC Plan	Withdraw and Spend Funds, or Move Funds to a Taxable Account	Roll Over Funds to an IRA	Move Funds to New Employer Plan
Advantages	<ul style="list-style-type: none"> ▪ Assets will continue to grow on tax-deferred basis ▪ Taxes and 10% penalty for early withdrawal will not apply now ▪ Plan may allow loans and other favorable provisions ▪ Money can be rolled to new employer plan at later date ▪ Spouses are provided a death benefit and joint & survivor annuity unless they sign a waiver. This rule can be bypassed by using a lump-sum distribution ▪ Assets are not subject to creditors ▪ Retirement income will be preserved 	<ul style="list-style-type: none"> ▪ Funds will be available to meet immediate needs ▪ Employer stock held in plan and taken in kind may have favorable tax treatment ▪ Broadest range of investments will be available in the market 	<ul style="list-style-type: none"> ▪ Assets will continue to grow on tax-deferred basis ▪ Taxes and 10% penalty for early withdrawal will not apply now ▪ Money can be rolled to new employer plan at later date (for specific type of IRA) ▪ Broader range of investments available within limits of IRA offerings ▪ Access to funds is easier and quicker ▪ Assets usually not subject to creditors (depends on state law) ▪ Retirement income will be preserved 	<ul style="list-style-type: none"> ▪ Assets will continue to grow on tax-deferred basis ▪ Taxes and 10% penalty for early withdrawal will not apply now ▪ Plan may allow loans and other favorable provisions ▪ Money can be rolled to another employer plan at later date ▪ Spouses are provided a death benefit and joint & survivor annuity unless they sign a waiver. This rule can be bypassed by using a lump-sum distribution ▪ Assets are not subject to creditors ▪ Retirement income will be preserved
Disadvantages	<ul style="list-style-type: none"> ▪ Investment options are limited by the plan ▪ Plan expenses will apply, if any ▪ Plan's rules will specify how you can invest and how you can take money out ▪ Access to funds is limited by plan's procedures and usually takes more time before you receive distributions 	<ul style="list-style-type: none"> ▪ Assets will no longer grow on tax deferred basis ▪ Taxes and 10% penalty for early withdrawal will be due – reducing net funds available ▪ Distribution may increase taxes otherwise due by raising the marginal tax rate on all income ▪ Money can't be rolled to IRA nor new employer plan at later date ▪ Spousal rights aren't protected by private plan rules ▪ Assets subject to creditors unless protected otherwise ▪ Retirement income will be reduced if you spend funds on 	<ul style="list-style-type: none"> ▪ Need to choose IRA provider and manage funds yourself or hire investment manager ▪ IRA expenses may apply – usually reasonable though ▪ IRA loans are not available ▪ Spousal rights aren't protected by private plan rules ▪ Direct rollover rules must be met – otherwise indirect transfers subject to 60-day completion rule and 20% backup withholding 	<ul style="list-style-type: none"> ▪ Rollovers are not accepted by all employer plans ▪ Different plan rules may apply to rollover funds than other plan funds ▪ Investment options are limited by the plan ▪ Plan expenses will apply, if any ▪ Plan's rules will specify how you can invest and how you can take money out ▪ Access to funds is limited by plan's procedures and usually takes more time before you receive distributions ▪ Direct rollover rules must be met – otherwise indirect transfers subject to 60-day completion

		immediate needs		rule and 20% backup withholding
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Tax Treatment	<ul style="list-style-type: none"> Estate taxes due on funds held at death if non-spousal beneficiary 	<ul style="list-style-type: none"> Taxes due at current income level 10% penalty for early withdrawal due 20% backup withholding may apply Employer stock may get favorable capital gains treatment, if taken in kind Estate taxes due on funds held at death unless protected otherwise 	<ul style="list-style-type: none"> If direct rollover – no taxes or penalties If indirect rollover – 20% backup withholding applies Taxes and 10% penalty for early withdrawal apply on amounts not rolled over (including any backup taxes withheld and not made up in the total rollover) Estate taxes due on funds held at death if non-spousal beneficiary Favorable tax treatment available to heirs inheriting your IRA funds held at death 	<ul style="list-style-type: none"> If direct rollover – no tax or penalties If indirect rollover – 20% backup withholding applies Taxes and 10% penalty for early withdrawal apply on amounts not rolled over (including any backup taxes withheld and not made up in the total rollover) Estate taxes due on funds held at death if non-spousal beneficiary
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When Best Used	<ul style="list-style-type: none"> You don't need funds immediately You may want to change jobs You want to defer paying taxes and penalties You consider the plan's investments, expenses, and restrictions favorable 	<ul style="list-style-type: none"> You need funds immediately and other sources are not available You want the broadest choice for investment options You're comfortable with choosing investments and distribution options based on your own capabilities or with help from professionals You want favorable capital gains tax treatment for employer stock 	<ul style="list-style-type: none"> You don't need funds immediately You may want to change jobs You want to defer paying taxes and penalties You want a broader choice for investment options You're comfortable with choosing investments and distribution options based on your own capabilities or with help from professionals You want to consolidate your retirement assets while maintaining the tax deferred status 	<ul style="list-style-type: none"> You know the new plan accepts direct rollovers or can make an indirect transfer timely You don't need funds immediately You may want to change jobs You want to defer paying taxes and penalties You consider the plan's investments, expenses, and restrictions favorable
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E. How will you manage your savings after retirement?

Here we'll look at your financial issues and choices after you retire. Back in the 20th century, typical retirees would supplement Social Security with an employer pension earned during their careers. That usually didn't require much planning, effort, or expertise. But if you're retiring in this century, you usually must find ways to manage the nest egg you've accumulated through DC plans, IRAs, or personal savings and assets.

To manage your own retirement savings, you can decide how much you can afford to spend each year and how to invest your money. Or you can instead choose to get a stream of lifetime income from an employer pension plan or an insured annuity. We'll discuss the pros and cons of this choice and explain how to shop for an annuity.

You may want to get help from a financial planner to answer such important questions as these:

- 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 spendable income will you have each year?
- How should you handle estate planning?
- Should you buy long-term care insurance?
- Should you put some of your assets into an annuity?

The final decisions are yours, even if you get expert advice, so you'll want to have some understanding of the issues and alternatives.

Medical care ranks high among retirees' needs and expenses, and 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 (Medigap) unless you're lucky enough to be among the minority of retirees with an employer-paid plan. Retirees below age 65 usually are not covered by Medicare, and so their medical insurance can be very costly. It's difficult for retirees to plan far ahead for medical insurance costs because health care costs are rising faster than the Consumer Price Index and the Medicare program will soon need reform before it runs out of money.

1. What if you have a traditional employer pension?

Employees who will get substantial lifetime pension payments from an employer plan are fortunate because their retirement income usually is predictable and secure. Private pension plans require married employees to provide that payments continue after their death to the surviving spouse, unless the spouse agrees to waive this requirement.

Perhaps the biggest financial concern for retirees is living on a relatively fixed income despite inflation and unexpected major expenses, such as for health care, long-term care, family needs, and major home repairs. Social Security benefits go up annually with the Consumer Price Index, and so do many governmental pensions, but very few private firms increase ongoing pension payments to help keep pace with inflation. Before retirement, workers can get pay increases to keep up with inflation, but after retirement their pensions are unlikely to increase and they may have a hard time finding part-time work to supplement their income.

2. What if you have an IRA or other investments?

a. How do you manage your savings after retirement?

Managing your life savings after retirement is a major challenge, with many uncertainties. Here is a checklist of ongoing tasks you should perform, perhaps with professional assistance.

- Invest for income and security but try to keep your income rising with inflation
- Withdraw enough spendable income to pay your bills but leave a substantial rainy-day fund to handle unusual or unexpected items.

- Draw down your savings at a pace that's not too fast or too slow. Try to make your money last at least as long as you do.
- Adjust your living standards if your assets will not be able to meet your lifetime expenses.
- Plan how to manage all your financial resources together – Social Security, pensions, 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 sources of income to meet your living needs.
- Stay informed about tax issues affecting retirees. Be sure to take minimum required withdrawals after age 70 ½.
- Consider how to cope with risks such as longevity, inflation and lifestyle changes with available insurance and investment products.
- Keep track of how your investments are doing, your needs for income, how financial markets and products are changing, and how annuities might help you achieve your goals.
- Understand how to choose and use investment brokers and financial planners.

Making your money last a lifetime is not a simple undertaking. But with the proper organization and professional help, you can make it work. Remember, nobody knows how long they'll live, or how the economy will behave. If you make a costly financial error after you retire, you may never have a chance to make up for it. With your financial future on the line, you'll want to be organized and have good help or expertise.

b. How do you invest your savings after retirement?

Here's a summary of key issues for investors to consider after retirement.

- **What percentage of your assets should be in stocks vs. fixed-income investments such as bonds?** How will you protect against losses on a few investments that may not work out well? Your answers will go a long way toward determining your investment success. A retiree's investment mix should be a bit conservative, but still may include a significant commitment to the stock market if you have a solid base of ongoing income and you're willing to accept the risks along with the rewards.

With retirement often stretching over several decades, as time goes on your investment objectives can increasingly put income ahead of growth. It's important to follow a good plan, knowing that a few surprises are bound to happen. Ideally, that plan should spread your investments among different kinds of securities instead of putting most of your eggs in one basket, such as a small business or the stock of your former employer. But you don't want to have too many baskets because keeping track of them can become unwieldy. You'll need to review and rebalance your investment mix at least every few years, recognizing that your financial picture and investment markets will change over time.

- **How will you use fixed-income investments?** When managing your own retirement funds, don't just focus on certificates of deposit, Treasury bills and money-market funds. Such short-term investments are very unlikely to lose money, and they'll pay you a modest amount of interest, but over time they haven't kept up with inflation. Instead, consider investing in longer-term securities that pay higher interest rates. You can buy shares of low-cost diversified mutual funds that give you convenient access to practically any kind of fixed-income security. Mutual fund investments are diversified among many securities, allowing you to absorb a few losses if some go bad. Here are a few key concepts about the risks and rewards of owning fixed-income investments.

1. Interest risk. A general rise or fall in interest rates causes swings in the market value of all bonds, especially long-term bonds. But longer-term bonds pay higher rates of interest, so you should own some if you're investing for the long term. You can "ladder"

a portfolio of bonds or CDs, using staggered durations to take advantage of longer-term interest rates while still having ongoing access to funds as needed.

2. Credit risk. U.S. Treasury bonds are considered risk-free because Uncle Sam can always find ways to pay the principal and interest, even in a depression or other economic calamity. That's why Treasury bonds pay relatively low rates of interest. In contrast, corporate bonds involve some degree of credit risk, because an unprofitable company may become unable to fulfill its contractual promises to bondholders, and so they pay higher rates of interest. Whether you own investment-quality bonds of stronger companies, or high-yield ("junk") bonds of weaker companies, be sure to diversify them widely so you can absorb a few losses.

3. Inflation risk. The dollars you get from any fixed-income investment will tend to buy less each year. You can buy Treasury Inflation-Protected Securities (TIPS), whose payments of principal and interest automatically go up with the Consumer Price Index. You can either purchase TIPS directly from the Treasury or invest in mutual funds that specialize in TIPS.

4. Tax-free municipal bonds. These can be a good investment if you're in a high tax bracket. But you should never hold tax-free municipals within 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.

- **How will you invest in stocks?** Index mutual funds have grown in popularity because of their very low expense rates and good investment performance. A hidden advantage is that individuals need little know-how or effort to use an index fund with its "automatic pilot" way of owning a wide range of stocks through thick and thin. By holding just a few stock index funds, you can diversify among a vast number of large and small companies, domestic and foreign. Exchange traded funds (ETFs) are an increasingly popular alternative way of investing in stock indexes. Alternatively, if you want more of a hands-on approach, you can instead own actively managed mutual funds or individual stocks. This requires you to keep close track of your holdings and the stock market, confident that you can choose stocks or funds that best meet your investment goals while still keeping your assets diversified.
- **How can you use your home to produce income?** 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 remaining in your current home. The amount of income you receive depends on the equity in your home, the appraised value of the home, the terms of the loan, and your age and marital status.

c. How much can you afford to spend from your retirement savings each year?

- You can't know for sure how much of your savings you can afford to spend each year without ever running out of money. The reason is that it's impossible to predict how long you'll live, what will happen with inflation or your investment performance, or what unexpected expenses you may have. Computer models based on economic experience can be very helpful, but some are more reliable than others. Some do not handle more complicated situations correctly, and some accept unreasonable input and assumptions without warning you.

Many financial planners tell retirees to plan on spending a certain percentage of assets the first year, then raise the dollar amount a little each year to allow for inflation. Some optimistic retirees believe they can initially spend 7 or 8 percent of assets per year, expecting that investment growth over an

average lifespan will keep them from running out of money. Conservative retirees will hold initial spending down to 3 or 4 percent per year, guarding against poor investment returns, rapid inflation, or a long lifespan. A middle course is to start out spending about 5 percent a year and be ready to reduce spending later if conditions turn adverse.

Many retirees use such a formula, at least initially, but managing a withdrawal program never goes exactly as planned. Your strategy may look fine on paper based on your planned expenses and historical averages for the economy, but real life is full of surprises. That's why you need to be conservative about how much to withdraw, and redo 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 far below a level you could afford.

- **What are some other strategies that retirees use to take money out of savings?**

1. You could base withdrawals on your life expectancy, planning to gradually spend principal and interest over the expected number of years. This method might turn out very badly, even if you could predict how your investments will perform. The problem is that life expectancy is only an average figure for a large number of people, with about half of them living longer. So this method may work for the half who don't live past their life expectancy, but the other half will go on living after all their money is spent. A safer method is to assume you'll live long beyond your life expectancy, e.g. to age 90 or 100, then review your withdrawal strategy at least every few years.

2. You could withdraw just the investment income, keeping principal intact. This method is often used, and it may work for a while, but it has long-term weaknesses. You may overuse fixed-income investments that give you stability and high current income instead of growth. When interest rates fall, so will your spendable income unless you dip into principal. Eventually, even moderate rates of inflation will shrink the standard of living you can afford.

3. Married employees could wait a few years after retirement to apply for Social Security, drawing on their retirement savings in a DC plan or IRA for temporary income during those years. Some financial advisors note that this has two possible advantages over the conventional strategy of applying for Social Security at retirement and using retirement savings for lifetime income. First, by spending down their DC or IRA funds more rapidly, the couple may be able to reduce income taxes payable on their Social Security benefits later. Second, by waiting to collect Social Security, the worker will get a substantial benefit increase for each year that 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, the couple would need a careful review and explanation of advantages and disadvantages taking into account their total finances, tax picture, and anticipated longevity.

4. You may recognize that an annuity offers valuable protection against outliving your savings, but you just don't want to give up control over your investments. Accordingly, some insurers have introduced moderately priced deferred annuities that begin paying lifetime benefits after many years, e.g., beginning at age 85. This niche product can help retirees manage their own finances for many years without spending too conservatively because of concern about living far beyond their life expectancy. This arrangement must fit into the retiree's total financial picture and must be carefully explained.

- **What about IRS rules for “minimum required distributions” after age 70 ½?**

Amounts being paid in the form of a lifetime pension or annuity usually will satisfy these IRS rules in a simple way that does not expose the annuitant to the 50% excise tax, discussed earlier. But retirees who

reach age 70 ½ with funds in an IRA or 401(k)-type plan must be very careful to take the minimum required distribution each year. Financial institutions or plan administrators usually will make the necessary information available to individuals so they can avoid running afoul of these rules. Still, these rules are a potential pitfall for retirees with IRAs who want to manage their own retirement funds instead of using a pension or annuity.

3. What if you use a lifetime payout annuity?

- **How does a life annuity work?**

The insurer who sells you an annuity contract is guaranteeing to pay you a stream of monthly income for the rest of your life, no matter how long you live or what the economy does. The insurance company invests the money and makes regular payments, either by check to you or by automatic deposit to your bank or financial institution. Although you'll have the security and assurance of an income that you can't outlive, it's important to understand that typical annuities don't allow you to take any lump-sum withdrawals or make other changes once income payments begin.

What happens to the money the insurer is holding for annuitants when they die? The insurer uses that money to help pay the other annuitants who survive, allowing their payments to continue no matter how long they may live. In other words, the risk of living "too long" gets spread over everyone who buys annuities.

- **What are advantages and disadvantages of annuities?**

An annuity gives you a form of security that traditional investments can't. Annuities are not for everyone, but they can be very helpful in securing retirement income by letting an insurance company bear the risk that you'll live many years. Managing your own retirement savings without an annuity is uncertain and requires substantial skill and attention.

If you apply for Medicaid or other means-tested benefits, annuity benefits may not count as income in determining your eligibility. Likewise, part of your pension benefits may not count as income under rules for means-tested benefits.

On the other hand, the price of an annuity includes costs for the insurer's marketing, administration, and profit that you may not want to pay before you have to. The insurer's assumptions for longevity usually recognize that only the healthiest people tend to buy an immediate annuity, and the assumed investment return is based on fixed-income securities such as bonds and mortgages. Perhaps most important psychologically, when you buy an annuity with part of your assets you give up control of those funds forever. You lose the flexibility to invest in stocks which historically have higher yields, to use the money for unexpected expenses, to change your mind should your health deteriorate, or to leave money to heirs. Still, in some situations you may be perfectly willing to commit some funds to buy an annuity.

Most annuities pay a fixed income that will lose purchasing power with inflation, although a few annuities pay income that increases to help cover rising prices. Variable annuities have payments that vary with stock market performance, which may outpace inflation or may go in the wrong direction.

People in poor health probably won't get their money's worth from an annuity. Younger retirees can get almost as much income from long-term bonds as from annuities, or they may prefer equity investments to protect against inflation. Buying an annuity makes the most sense for retirees who are older, in good health, and ready to transfer to an insurer the job of managing part of their assets.

- **What kinds of annuities are available?**

An annuity can provide an income tailored to your needs. The amount of income is based on a number of factors including your age, sex, purchase amount, income option selected, and interest rates at the time of purchase (or investment performance of a stock portfolio). You can buy an annuity with payments that continue for a minimum number of years, even if you no longer are living, or that continue after your death to one or more joint annuitants.

Annuities that pay a fixed amount of monthly income will lose purchasing power with inflation. You may instead consider a variable annuity, where income varies with a stock portfolio that you choose, but in a sense this is trading one kind of risk for another. Some variable annuities have been criticized for high expense charges or fees that reduce their yield. Another alternative is an annuity with payments that increase each year, perhaps based on the Consumer Price Index, although prices for such annuities may seem high.

Charitable annuities, available from many nonprofit institutions such as colleges and churches, are used by some people who want to leave money to a charity and increase their retirement income. Charitable annuities come in various forms that allow individuals to make a donation to the charity, get an immediate deduction, and get regular income.

- **When is a good time to consider buying an annuity?**

Normally this decision will come at the time you retire or later. In fact, you'll have several good opportunities to consider buying an annuity.

- At your retirement
- When you retire from another job
- At your spouse's retirement or death
- Between about ages 70 and 80
- When you no longer want to manage your assets
- In stages, using multiple annuities

Remember, the purchase of an annuity is an irrevocable decision and you can't get your money back. You always want some money for emergencies or for special uses such as to provide extra care when you are ill. As you get into your 70s or beyond, it often makes sense to annuitize a substantial part of your savings for several reasons:

- More attractive annuity rates as you get older
- Less desire and ability to control your assets
- Less exposure to future inflation
- More concern about running out of money

For younger retirees, buying an annuity may not produce much more current income than simply investing in fixed-income securities. The picture changes as you get older and find that an annuity pays substantially more current income than other fixed-income investments. Note too that buying an annuity after reaching age 70½ has the advantage of satisfying IRS rules for minimum required distributions.

- **How do you shop for an annuity?**

Think about the kind of annuity and approximate cost. If you use an annuity, the exact form you choose represents a trade-off between maximizing income and leaving money to someone else if you should die early. Don't look at just the single-life option. Be sure to compare different options that may satisfy your need for lifetime retirement income and still provide for survivors or heirs in case of

early death, such as a joint-and-survivor annuity, or an annuity that's guaranteed to be paid for at least 5 years or 10 years.

Use a financially strong insurer. You want a life insurance company that has a very strong financial rating because the annuity business 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.

Find good rates. For fixed annuities, comparing rates among different insurers requires little paperwork and no physical exam. For variable annuities, cost comparisons are much more complex but are important, as noted above. The Internet can be extremely helpful, with some services offering to find competitive rates. You can also get help from a trusted agent, accountant, actuary, or tax professional, or personal contact. Start shopping before you're ready to buy, getting a sense of what the stronger companies are offering, and don't worry if you soon find all the prices have changed a bit (perhaps for the better as you get older).

Seek other help. Your state insurance department won't recommend an insurer, but they can help clear up any problems you have with a specific company or representative. Each state also has a guaranty fund to protect individuals in the unlikely event an insurer becomes unable to pay benefits in full. You may want to find out how this fund would cover your annuity contract, including any dollar limits that apply. Some of these state funds don't guarantee an annuity value that exceeds \$100,000.

F. What are some pitfalls you should avoid?

Before taking money out of a retirement plan, it's a very good idea to check into the tax and legal implications, and to understand how the distribution fits into your long-term financial plan. In most cases, you'll be preserving the money for retirement and you're moving funds around to manage them better, not to buy something you don't need. Still, in some cases you may really need to use the money currently to dig your way out of a financial hole. Make sure you know what you're doing, avoiding costly mistakes and not losing a golden opportunity for lifetime financial security.

1. Underestimating how long you may live

How long can people retiring now expect to live? Let's look at "best estimate" figures from actuaries at the Social Security Administration, who anticipate that longevity will keep improving in the future. For Americans reaching age 65 in the year 2005, the average future lifespan ("life expectancy") is 17.0 years for men and 19.7 for women. These figures suggest that you should plan on living to your early 80s. But life expectancy is just an average figure for a large group of people, and it can be very misleading for an individual. Here are the percentages of men and women aged 65 who are expected to survive to the ages shown:

Percentage Surviving from Age 65 to Age Shown		
Age	Men	Women
65	100%	100%
70	89%	93%
75	76%	83%
80	59%	69%
85	39%	52%
90	19%	31%
95	6%	13%
100	1%	3%

For example, a 65-year old woman chosen at random has a 31% chance of living to age 90 or beyond, and needs to plan accordingly.

2. Paying too much in taxes

You should seek tax advice to ensure you understand the tax implications before you take any distribution from a retirement plan. Some tax mistakes you want to avoid when you consider taking money out of a plan are:

- Not developing a strategy for withdrawing your retirement funds to reduce your total tax liability
- Taking distributions before age 59½ and causing a 10% premature-distribution penalty
- Taking a lump-sum distribution in a check instead of a direct rollover. In that case, failure to follow all the steps for an indirect rollover will create taxable income and potential penalties
- Taking employer stock from a qualified plan without considering the potential tax savings
- Taking a lump-sum distribution that puts you in a higher tax bracket, increasing your tax liability on other income
- Not taking minimum required distributions from your retirement plan or IRA after age 70½, resulting in a 50% excise tax for late or incorrect distribution amounts
- Not considering the taxation, if any, of your Social Security benefit when determining your retirement income needs
- Naming non-spousal beneficiaries for your IRA, thus accelerating distributions at death

3. Paying too much in administrative costs and fees

Terminated employees sometimes leave funds in a former employer's 401(k) plan that charges high fees against participants' account balances instead of rolling them into a lower-cost IRA. Individuals saving for retirement can pay too much by using mutual funds or deferred annuities without checking on whether the fees or costs are excessive.

4. Not preserving assets for retirement

Employees who change jobs often are tempted to cash out a 401(k) account balance which could grow into a sizable sum for retirement. As a result, they may later find that their retirement savings aren't enough to let them retire as early or as comfortably as they want.

5. Not diversifying your investments

Diversifying the investment of your assets is one of the basic tenets of good investing for reducing the risks you assume while potentially increasing the return you can realize. However, even after widely publicized cases such as Enron and WorldComm, some employees continue to hold too much employer stock in their retirement programs and in their other assets. Ideally, you should not hold more than about 10% of your total assets in any single investment, especially your employer's stock.

Employees don't always have a choice because many employers contribute stock to employee plans that must be held for a specified length of time. Employees in this situation must keep informed about when they can exchange the employer stock for other investments, and the tax implications, mindful of how their financial future can be destroyed if the employer has financial problems:

- You can lose the value of your assets held in employer stock
- You can lose your job
- You can lose retirement benefits and health coverage

If you are near retirement when such a disaster occurs, you may be unable to retire as planned and will need to work even longer to recapture your lost finances and build back your retirement funds.

Small business owners face another dilemma. They often invest most of their assets in developing and maintaining their business. Diversification is difficult to achieve until the business matures into a profitable enterprise. Small business owners need to be aware of their retirement needs and how the business can be used to provide for their retirement income. Diversification of any other assets should be made to avoid concentration in the business or related industry.

6. Not getting good advice on retirement planning

Retirement planning involves a long-term goal with many complicated factors such as inflation during your retirement years, how much taxes you will need to pay, how long you expect to live, how much assets you have, 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 any assets to your heirs. You will need to consider your spending needs for both basic living expenses and special interests you want to pursue in your retirement years. You will also need to consider your medical needs and long-term or extended-care needs as you age.

You should carefully assess your interest and ability to handle your retirement planning alone. Seeking advice early in the retirement planning process helps ensure that you are on the right path to a financially secure retirement.

If you do not get good advice that considers all these factors affecting your retirement, you may make mistakes that negatively affect your life in retirement. For example:

- You may underestimate the amount of income you will need in retirement and have to reduce your living standards during retirement or return to employment,
- You may spend or gift your retirement assets too quickly and run out of money before your death,
- You may spend too little of your retirement assets and deny yourself unnecessarily,
- You may miss opportunities to use your assets better to enhance your retirement lifestyle and income, and
- You may not be able to leave the intended assets to your heirs or charity

You should seek good advice at least 3 to 5 years before your scheduled retirement date. You should also seek advice whenever an event in your life occurs that changes your financial plans.

7. Taking a lump sum that you can't manage effectively

Employees who reach retirement, like people who win the lottery, may be unable to handle a large sum of money themselves. Without good advice, they may soon fritter much of it away or make unwise investments and miss their one opportunity for long-term financial independence. Other common errors are systematically over-spending retirement savings and later running out of money, or else under-spending and thus not living as comfortably as you could.

8. Failing to protect against risks after retirement

People typically experience many changes during retirement, and these changes can be costly. Post-retirement risks include poor health that generates costs not covered by Medicare, losing a spouse and needing to live alone, and gradually losing the ability to care for oneself and one's affairs. Other risks include investment losses, family members needing help, home and automobile repairs, inability to manage in one's own home, etc. Some of these uncertainties can be covered by insurance or other risk transfer, and others should be covered by contingency funds. Insurance and risk transfer is a good

solution for many, but not everyone. Be sure to consider your own situation instead of just copying an approach that works for someone else.

9. Not preparing for lifestyle changes, including long-term care

Many older persons are active and fully able to care for themselves and their affairs. Others are not and suffer gradual (or sometimes sudden) mental or physical decline. Some tasks which people may need help with include paying bills and managing finances, making doctor appointments, managing medication, shopping and household tasks. In more severe cases, people may need help dressing, eating, using the toilet, getting in and out of bed.

Long-term care insurance can help finance the more severe needs, but there is no coverage available for more moderate help. Moving to a continuing care retirement community is another way to get some help. Family members are often the main source of help. It is important to think through how one is preparing for such possible changes. People who live beyond age 80 often need help, and many persons need help before then. Medicaid is the system of last resort for financing nursing home care in extreme situations.

10. Not preparing for possible loss of a spouse

Many people retire as couples, but women live on average to an age about five years higher, and wives are often younger than husbands. Women are much less likely than men to remarry if they're widowed. It is very important to plan in retirement for the well-being of the survivor after one member of the couple dies. Social Security survivor benefits are not adequate to do this alone. Many widows suffer a significant decline in economic status on death. Life annuities with a joint-and-survivor feature are a good method of protection.

11. Losing retiree health insurance or other non-pension benefits

Before deciding to take your benefits as a lump sum distribution, it's important to find out if you'd be giving up other valuable benefits, especially retiree health insurance for you and your spouse.

12. Losing your share of marital property

Married employees can lose their right to a share of their spouses' pension benefits through careless handling of a benefit distribution or a divorce settlement.

Federal law requires that a private pension payable to a married worker from a defined benefit plan include a survivor benefit for the spouse unless the spouse agrees in writing to waive that protection. For example, a male employee wishing to elect either a lump-sum payment or a single-life annuity must ask his wife to waive her right to receive surviving spouse's benefits if she were to outlive him. Before signing such a waiver, the non-working spouse should consider what other sources of income would be available after the worker dies.

Individuals may also find pensions diminished due to divorce. Federal law requires that pension assets of divorcing spouses be divided in accordance with the terms of a court-approved Qualified Domestic Relations Order (QDRO), if one has been filed and approved. In a divorce without a QDRO, state law governs the division of pension assets, which can vary considerably depending on the state and the judge. Non-working spouses may lose a valuable later-life asset if they fail to lay claim to a share of pension assets, while working spouses may be disappointed to lose valuable pension assets when a QDRO is issued. Consulting an expert can be very helpful in protecting pension assets at divorce and in drafting a suitable estate plan, especially in a second or later marriage.