

WISER/Actuarial Foundation Paper: Life-Defining Decisions

May 2003

Table of Contents

A. Setting the Stage	1
B. Education and Career	3
1. Investing in Your Education.....	3
2. Taking a Job, Including Re-Entering the Workforce	5
3. Leaving a Job	8
4. Staying Home Full-time.....	10
5. Outside Activities.....	12
C. Marriage and Family	12
1. Getting Married	13
2. Children.....	15
3. Divorce.....	16
4. Remarriage	18
5. Living Together	19
6. Caring for Parents.....	20
D. Home and Other Property	21
1. Buying and Owning a Home	21
2. Mortgage Loans	23
3. Debts and Credit	24
4. Preparing for Emergencies.....	26
E. Planning for Retirement	27
1. Saving for Retirement	27
2. Using Employer Plans	29
3. Making Decisions in Employer Plans	30
4. Using Retirement Funds for Non-Retirement Purposes.....	32
5. Timing Your Retirement	34
6. Post-Retirement Risks.....	36
F. Other Financial Issues and Decisions	37
1. Life Insurance.....	38
2. Health Insurance	39
3. Long-Term Care	40
4. Bank Accounts and Certificates of Deposit (CDs).....	41
G. Outline of Lifetime Decisions	43

Appendix A – Investing for Retirement	45
1. Stocks	45
2. Bonds and Other Fixed-Income Investments	46
3. Mutual Funds	47
4. Stockbrokers and Investment Advisors.....	49
Appendix B – Four Ways to Save for Retirement	51
Appendix C – Social Security Benefits	52
Appendix D – Other References and Resources	53
Appendix E – Glossary of Financial Terms	55

This paper was written by a task force of retirement planning specialists with a wide range of backgrounds including actuaries, benefit consultants, economists, and attorneys, as follows:

Linda Brothers
 Monica Dragut
 Jon Forman
 Matt Greenwald

Karen Holden
 Peter Plumley
 Anna Rappaport
 Pat Scahill

Dick Schreitmueller
 Elaine Stevenson
 Lelia Stroud
 Nancy Winings

The views expressed are their own, not those of any employer or other institution. There is no professional consensus on some matters covered here, such as an adequate amount of retirement income or how to invest. Because the paper is meant for general guidance, 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. © 2003 The Actuarial Foundation

Life-Defining Decisions

The Actuarial Foundation is making available this educational paper as part of its consumer education efforts. The purpose is to help Americans understand how choices they make throughout life will affect their ability to retire when they wish. Such choices go well beyond merely saving and investing for retirement, encompassing one's education, career or vocation, marriage and family life, ownership of a home and other property, and management of personal finances. Initially, this paper is intended to furnish information for a brochure to be published by the Women's Institute for a Secure Retirement (WISER) as a source of guidance for women.

A. Setting the Stage

Attaining financial security throughout their retirement years has always been a challenge for women. And if you're a working woman who hopes to retire some day, you'll face an even bigger challenge in the years ahead.

Do you desire to retire before you expire? Then you need to start planning and saving early in life.

You'll want to understand that decisions you make long before retirement – such as choosing a career, getting married, having children, buying a home, starting to save and invest – will have a big impact on your financial security in retirement.

This paper is intended to help you identify decisions that can make a big difference in your retirement security, letting you make the kind of choices you'll be happy with later, and gain an appreciation of how the decisions you make each and every day may change your retirement security.

Let's begin by mentioning 5 reasons why your retirement is likely to be different and more costly than it was for earlier generations of women.

- 1. Longevity:** People are living longer now, especially women. And the gains in life expectancy are expected to continue, if not intensify. For example, half of the women who are now 65 years old will live beyond age 85, with one out of 25 living to 100! By the time you reach 65 (if you're not there already), your chance of living to age 85 or 100 will be even greater because of advances in medical science and health practices. A longer life usually means a longer retirement – and a more costly retirement.
- 2. Personal responsibility:** Those who spend many years in the paid labor force have seen a shift in the responsibility for financing a worker's retirement, from the employer to the employee. Many women who are now retired spent their careers working for employers offering traditional defined benefit pension plans or married to husbands covered by such plans. Under that type of plan, the employer had to set the money aside and invest it. Later, retirees were paid a monthly income for life without taking any action themselves to make it happen. Fewer women working today are covered by traditional defined benefit plans, but many more are in 401(k) plans. With 401(k) plans, you must decide how much money to put into the plan and how to invest it. These decisions have a direct impact on how financially secure your retirement will be. Many of these plans don't offer you a guaranteed income in retirement, as traditional pension plans did.
- 3. Need for understanding:** Unfortunately, few employees understand the wide range of financial choices now available to them. If you're like most employees, you don't know enough about getting ready for retirement or managing your money while retired. You need a better understanding of how to plan,

budget, save, and invest for retirement. You could know more about seeking advice from your employer and outside experts, about using the internet, about staying in touch with the financial world that your retirement depends on. You could use better guidance about when you can afford to retire, how much spendable income you'll have, where the money will come from, and how to make it last.

- 4. Lifestyle:** Another factor is the greater expectations and more expensive lifestyle of today's women. Almost all the women retired today were born during or before the great depression of the 1930s. Having lived through the hard times of the depression and World War II, they know what it's like to cut back. Today, they may not find it such a hardship to cut back as their retirement goes on.

The generation of women now working are more educated. They have broader interests and want to do more when they retire. They'll be healthier and more energetic during their retirement years. They grew up in more affluent times and are used to higher lifestyles. This means they'll want more retirement income to maintain these lifestyles and do all the things they want.

- 5. Family structure:** Women now tend to marry later and have fewer children than their mothers or grandmothers did. They're more likely to work outside the home, get divorced, remarry, and make a long-distance move. They have fewer siblings to help take care of very elderly parents. With the decline of the traditional extended family structure, women have become more independent and self-reliant. Those who want to remain independent after retirement must start early, gradually building a financial structure to replace some of the traditional family support system.

Women have many options with regard to their lives. Some spend their entire adult life in the paid labor force, others spend all their adult lives as care-giving family members. There is a spectrum in between these two situations. Women can make a valuable contribution to society in a wide range of roles, but the actions needed to ensure retirement security differ, depending on the roles chosen. It's important to remember that the resources for retirement are built up over a working lifetime, from age 20 to 65 or some part of those years, and they're used after retirement to the end of life. Decisions made early in life about education and jobs affect earning power for the entire period of working life and family responsibility.

You have available a wide range of financial products to help you accumulate money for retirement and manage your money when you do retire. But you can't make good use of these tools until you know what they are and how they work.

How familiar are you with life annuities, which can provide you with a stream of income guaranteed for life? With long-term care insurance? With stocks, bonds, and mutual funds? It's hard to make finance-related decisions if you aren't familiar with all the choices you have.

One way to tell if you're on track is to do a retirement needs calculation. This may seem complicated, but a lot of sources are out there to help you get it done. These sources include professional financial advisors, worksheets (available on the internet and other places) and software packages. Doing a retirement needs calculation requires you to set a target retirement date, make some decisions on the lifestyle you want in retirement, then estimate the level of income needed to maintain that lifestyle. Of course the process is more complex than that, and there are so many unknowns in retirement (how long you'll live, what inflation will be, whether you'll need long-term care) that any number you get is only an estimate. The retirement needs calculation does, however, provide a goal.

Decisions you make in the days between now and retirement will affect whether you reach your goal or not, and what your life in retirement will actually be like. The rest of this paper outlines a number of the crucial decision areas. We hope this information will help you make better decisions on the road to the financially secure retirement of your dreams.

B. Education and Career

Your retirement security is linked to your education and career. That is, you accumulate retirement assets from lifetime earnings and employer-provided benefit plans, and education gives you access to better jobs. Thus, investing your time and money in education or training increases your potential earnings, retirement benefits and assets. Though retirement-related issues usually will not be a decisive factor in taking a job, you should weigh retirement issues along with other factors.

This paper will not get deeply into the often-discussed problems of mothers who work outside the home. Instead, we'll explain how people can gain or lose future retirement benefits by entering or leaving a job. In that way, mothers and others who are weighing the pros and cons of having a job can look beyond the immediate paycheck and see the long-term financial effect.

Women today have a great many career paths and opportunities, including some you may not have considered. At times, a temporary or part-time job may work out best. Or you may choose self-employment, perhaps following the lead of the many women with successful home-based businesses.

Careers and jobs that pay well often have attractive benefits too, such as health insurance, retirement plans, time off with pay, etc. If your career provides good pay and a 401(k) plan, you can build a sizeable retirement savings account even if you change jobs or careers several times along the way to retirement. In contrast, to get a substantial employer pension, you usually must work most of your career under one employer's traditional pension plan. When you're considering changing jobs, it helps to understand how this would affect your benefits under different kinds of retirement plans. Of course, you won't get retirement income from any kind of plan if you cash out your account when you leave the employer.

1. Investing in Your Education

Background

Education often is a key to better job options. Lack of education can block career progress.

Education beyond high school traditionally comes from a college or university. College graduates are highly valued as prospective employees, and some careers require undergraduate or graduate degrees.

A college may offer courses at its main campus, at local branches, or on the internet. In awarding a degree for completing a program of study, a college may count credits earned at another institution, but practices for transferring credits vary widely and students should check them carefully. Full-time students will usually earn a bachelor's degree in four years. A master's degree usually takes another year or two, while a doctorate takes longer than that, depending on the program and the individual.

Alternatively, many non-college training programs now teach valuable career skills using classrooms, study groups, the internet, or self-study from printed material. College graduates often use such training to launch a new career or update their skills. In some professions, active members must participate in continuing professional education. Many employers do their own training of employees or customers about the firm's products or services.

Life-Cycle Issues and Retirement Focus

Significant education usually occurs early in life, at the beginning of a career.

Mid-career education:

- Continuing education occurs through life
- Additional education can pave the way to career change or return to employment

- Firm-specific education through current employer leads to promotions and enables updating of skills needed to retain job as environment changes
- Employees may be able to get a tax deduction if they pay the current cost of education that maintains or improves skills needed in their current line of work

Late-career education:

- You must keep skills up-to-date to remain employable
- Some individuals seek career changes
- Training in a new field can jump-start a post-retirement job.

Financial Issues

Sources of financing can include:

- Parents and grandparents
- Systematic savings program
- Part-time work
- Student loans
- Scholarships
- Grants
- Work-study program
- U.S. Armed Forces (ROTC and GI Bill)

Some of these sources require that you prove you need the money, while other sources make you repay the money with interest, or render service as an employee.

Other ways to finance in mid-career:

- Part-time or full-time work
- Accumulated savings
- Employer support

Risks

You need to be very aware of the job outlook for any career that interests you. Investment in education may not be financially worthwhile if there's little demand for the career chosen.

Income level in different occupations is not directly linked to education required. For example, Ph.D in engineering may have high market value, while Ph.D in music may not. Relative value of different backgrounds may shift with changing technology or business conditions. As more and more jobs require a college education and up-to-date skills, people without such credentials may be unable to change jobs and have good reason to fear a layoff. Another endangered species is the specialist in a "hot" occupation that rapidly cools off when technology changes. Business cycles also create job instability, as no firm needs large numbers of support people when business is slow.

Comments, Action Needed

Find out whether work-related educational expenses may be reimbursable by employers or be tax-deductible

Payback of student loans is an ongoing financial issue.

Educational opportunities and employer support can be an important factor in your job choice.

You can use self-assessment and organization-assessment tools to help decide on your career and education. Get more information from career counselors at your Human Resources department or job placement office.

2. Taking a Job, Including Re-Entering the Workforce

Background

Employment history has a major influence over retirement security. Early career decisions can have a significant influence because they play a big part in defining later options, some jobs are available mainly to new labor force entrants, and retirement dollars invested early earn much more investment income.

Most people want to choose a career with a future, one that will pay you well for using all your talents. Not everyone knows that within any career or profession, for jobs with comparable paychecks, some employers may offer far more attractive opportunities to build wealth and retirement benefits. For example, teachers, librarians, nurses, and accountants all can choose to work in a wide variety of situations – public or private employers, large or small organizations, perhaps self-employment – where the most money now and the most security don't always match. You may find it very worthwhile to check out a range of opportunities in your chosen field, paying close attention to the kind of retirement security they offer.

Women have been found to have poorer negotiating skills, a weakness that can reduce starting compensation in a new job. Training can improve negotiating skills, helping to achieve your goals in ways that benefit both parties and preserve a good relationship.

Part-time or temporary jobs are important employment options. Temp agencies can offer you a series of limited-term assignments to provide a flexible work schedule or get you acquainted with a number of prospective full-time employers.

No longer is there a clear demarcation between work and retirement. For many people, retirement has a work component.

Employer-sponsored pension plans are either the defined benefit (DB) or defined contribution (DC) type. Many employers have both types, e.g., a basic DB plan plus a supplemental DC plan that lets employees contribute from before-tax pay with employer matching.

Traditional defined benefit pension plans use a formula to determine an individual's retirement benefit:

- Benefit usually is based on employee's years of service and highest average pay level
- Employees accumulate credits in the form of lifetime income or lump sums. Employees do not make investment choices.
- Most of the benefit buildup occurs in later years, so an employee who leaves in early or mid-career, even with full vesting, gets only a relatively small deferred pension.

Defined contribution pension plans use individual retirement savings accounts:

- Cash contributions are made each pay period to employees' accounts.
- Employees choose from investment options. The value of equity investments will vary with stock market prices.
- DC plans include 401(k), 403(b) and 457 types, depending on the type of employer.
- Benefit buildup is fairly level over a career.
- Employees who leave after full vesting don't lose any money from their accounts, but if they spend the money at time of job change it will not be available for retirement.

The cash balance plan, a newer type of DB plan, credits employer contributions to an account similar to the cash contributions in a DC plan. For these plans, the benefit buildup depends on the formula, but is more level over a career than in traditional DB plans.

Life-Cycle Issues and Retirement Focus

Early career experience includes part-time jobs and internships prior to full-time work. Focus here is on work after completing initial education.

Temporary employment is useful to employers and employees as a screening device for possible full-time employment.

Job attitude can emphasize career or "just a paycheck."

Mid-career issues:

- Career can easily flatten out or stagnate
- Important to maintain skills and consider re-training
- Individual's goals can change with professional and personal interests, family status
- May work part-time while raising children
- Retirement issues start to look important

Your retirement security may depend on how you and your spouse balance work vs. family life. Retirement security may be less for the individual who is bearing more household responsibility.

Women who re-enter the workforce in mid-career often have serious problems with retirement security unless other family members contribute to their retirement security.

Late-career issues:

- May continue to work full-time, part-time or volunteer
- May work as trainer and/or mentor with younger employees
- May stay with same employer or move
- Retirement issues become very important

If your compensation includes retirement plan coverage, your retirement security will be closely linked to your career history:

- Salary growth
- Opportunities to advance
- Job tenure and number of jobs held

Under a DC plan, the contributions you elect to make are very important. Any employer matching of your contributions, say at \$.25 or \$.50 for every \$1.00 you put in, is free money that you can't afford to pass up. And your own contributions usually are tax-deferred.

Financial Issues

Compensation at first full-time job:

- Sets pace for future income (anchor)
- Health, disability, life insurance is important
- Retirement often is not noticed until later

Networking is an important aid in getting a job, especially when re-entering the workforce. Referral from someone currently employed helps both employer and employee. Employees hired by referral tend to outperform those hired from more formal sources (less turnover and absenteeism, better attitude).

In mid-career, to expand promotional opportunities and avoid stagnating, an individual can pursue self-development or develop a personal mission statement to enhance skills.

When re-entering the workforce, temporary employment can be a good initial strategy. Financial considerations are similar to those for a first job. An existing network is very helpful.

Effect of a new job on future pension benefits depends on:

- Expected salary level, initial and future
- DB plan's pension formula, vesting period
- DC plan's contribution and matching formulas, vesting, investment choices

The post-retirement package potentially includes cash and health benefits, but health benefits are offered only to a minority – most commonly by large companies or government employers.

Risks

A temporary or part-time job probably has lower pay and much lower benefits.

If you stay in a job with little or no pension benefits, you must either accumulate a substantial retirement fund on your own or expect to work a very long time.

A pension plan that is adequate now may get changed before you retire. Or you may leave your job before earning a large enough pension or before satisfying the vesting requirements.

A woman re-entering the workforce after years of absence may lack the skills, experience, or network needed to land a job that pays well.

Comments, Action Needed

Choosing a job depends on financial and non-financial considerations. Quality of life and other non-financial issues are mostly beyond the scope of this paper.

You can use temporary and part-time employment to gain experience, training, and a network of contacts.

When mid-career stagnation is a concern, consider training and education, a lateral move, or sabbaticals with the current employer. Moving to another employer is another possibility.

To reduce the risks on re-entry, you can maintain or enhance skills while out of the workforce by:

- Taking courses offered by correspondence, the Internet, or community classes
- Staying current with technology, especially computer skills
- Maintaining or enhancing contacts with others in the workforce
- Volunteering part-time to stay involved in the workforce, gain experience, and enhance resume

An employer with a DC plan may be a better choice if you are:

- A younger employee, likely to change jobs
- Anticipating breaks in your career due to family care issues
- Likely to be laid off

An employer with a DB plan may be a better choice if you are:

- Unlikely to change jobs or be laid off
- An older employee with long service in a pension plan that has a high accrual rate

Your best choice may be an employer with both a DB and DC plan.

3. Leaving a Job

Background

Voluntary reasons for leaving a job:

- Get more education
- Better job or pay elsewhere
- Better working conditions elsewhere
- Problem with superiors
- Move with spouse
- Stay home with children
- Career change
- Poor health of spouse, child, parent (in such cases, you may have legal rights to reemployment)
- Decision not to work
- Retirement

Involuntary reasons for leaving a job:

- Dismissal
- Layoff
- Severe medical disability
- Death

When you leave a job, you may lose valuable retirement benefits:

- In a DC plan, you must satisfy the vesting schedule or lose the employer money in your account.
- In a DB plan, your vested pension usually is frozen when you leave. Inflation erodes the value, and the reduction at early retirement typically is more than if you had stayed.
- Private pension benefits usually vest in 5 years or less, but public sector DB plans may have longer vesting periods.
- Post-retirement health insurance generally is not provided to employees who leave before retirement age or take a lump sum benefit.

Retirement plans of all types may have waiting periods up to a year or more before new employees enter the plan and begin to earn benefits. For example, a waiting period may exclude service before age 22 and 6 months of service. Because of waiting periods, workers who change jobs many times in their working years will probably earn no retirement benefits for a few of those years.

Life-Cycle Issues and Retirement Focus

Early career – Job changes among younger workers are common, and make sense if they provide more pay, opportunity, or a better fit with your interests and career.

Mid-career – Those who change jobs have more to lose in the way of retirement rights, seniority, etc.

Later career – Job changes are to be avoided when you're not quite eligible for retirement. Early retirement may provide an opportunity to change careers or phase out of the work force gradually.

Early retirement windows give employees a chance to leave during a limited period and get added benefits.

Key retirement issues include:

- Leaving in a way that preserves or enhances retirement benefits
- Comparing the value of benefits available from your current job vs. alternative job opportunities
- Being aware of possible buyouts or early retirement windows
- Knowing how you can get retiree health insurance

- Waiting to retire until you have adequate retirement benefits
- Using retirement benefits to get lifetime income, not a lump sum that soon is spent
- Employers sometimes will hire back their own retirees as part-timers or independent contractors, and so they get paid without losing retirement benefits. When changing jobs, it's a good idea to leave the door open to getting rehired as an employee or freelance worker.

Financial Issues

Financial concerns when you leave voluntarily include losing seniority and fringe benefits, especially health and pension benefits.

In a final-average pay DB plan, leaving your job stops benefits that you've already earned from growing with future pay increases. This can make it costly to leave an employer after many years under a DB plan. For example, this is why someone who stays 30 years with Employer A may get a much bigger pension than someone else who moves around, staying 10 years each with Employers A, B, and C, all with similar pension plans.

One of the big issues with early retirement windows is whether the financial incentives are adequate. They may include severance pay, an increase in pension benefits, and continued health coverage.

Risks

Changing jobs too soon or too often causes loss of benefits that are not vested.

One risk of switching to a new job is turnover that occurs soon afterward because of mismatch between employee and employer.

Any time you leave a job without having another one, there's a chance you'll have a hard time landing a new job without a cut in pay.

Time spent care giving will disrupt accumulation of retirement assets, and the family may not adequately provide for all members. This can have a particular impact on widows and divorced women.

Risks with early retirement windows:

- Cash incentives may not offset loss of benefits
- An employee who refuses offer may get downsized or laid off
- An employer who continues health insurance may later raise your contributions, change the benefits, or discontinue coverage

Comments, Action Needed

You are in charge of your own career and advancement:

- Keep up your skills and outside contacts
- Inter-personal skills are especially important
- Find out what your employer wants done, then do it and make sure the employer knows

To avoid problems of changing to a new employer, consider improving your situation with your current employer by seeking promotions and opportunities at the same firm.

Before leaving an employer with a traditional DB plan where you've earned substantial benefits, do the math. If you switch jobs, even a substantial pay increase may not offset the value of pension growth you'll lose. DC plans and cash balance plans usually have no such problem.

Seek out the most advantageous way to leave. At involuntary termination, severance pay and support are common. Support can include:

- Retraining

- Job counseling
- Placement services
- Resume writing
- Severance packages
- Early retirement windows
- Negotiating skills

Consider making annual contributions to an investment fund or IRA in your name for future needs.

When leaving a job before retirement, be careful about cashing out any lump sum benefit. You can avoid IRS penalties and preserve the money for retirement by taking a direct rollover to an IRA or to another employer's plan.

4. Staying Home Full-Time

Background

The purpose of this discussion is not to suggest that everyone should work outside of the home or that mothers should stay home, but rather to encourage consideration of the impact of not working outside of the home when you have a choice. At each stage of life, try to weigh the rewards of working outside the home vs. staying home.

Reasons to work in the paid labor force:

- Current income - Cash compensation, current benefits for you and other family members
- Independence – With your own job history, skills, benefits, contacts, and credit standing, you're better prepared to live on your own if necessary.
- Tenure – Longer service brings rewards such as promotional opportunities, job security, more vacation days, time off with pay
- Service toward retirement – A DB plan counts each year of service under the benefit formula and also toward eligibility for early retirement. A DC plan has ongoing contributions that build up your account while you work.
- Service toward vesting - Full vesting, usually after 3 to 5 years, lets you keep all the benefits credited to you when you leave the employer.
- Keeping current – By staying in the labor force, you're in touch with ever-changing technology and practices. Once you get off that track, it may not be so easy to get back on.
- Networking – You can keep building relationships and contacts with peers and potential employers
- Intangibles - Job satisfaction, personal development, intellectual challenge, social importance, friendships

Reasons to stay home:

- Care-giving for children, a most important calling that can bring great satisfaction
- Care-giving for other family members
- Saving on taxes and other costs of working
- Avoiding on-the-job stress and office politics
- Working from home, perhaps part-time
- Pursuing outside activities
- Collecting retirement benefits from a pension plan or Social Security

Life-Cycle Issues and Retirement Focus

Early Career – After you complete your education, a primary reason for not working outside of the home is care-giving.

Mid-Career – Primary reasons for not working outside of the home are homemaking, care-giving and personal choice.

Later Career – Primary reasons for not working outside of the home are personal choice, homemaking, care giving and health.

Financial Issues

If you work outside the home, your pay is offset by any extra costs you'll have for:

- Childcare
- Income taxes (federal, state, local), which may make it costly for both spouses to work
- Payroll taxes for Social Security, Medicare
- Payroll deductions for benefit plans, etc.
- More expenses for clothes, cleaning bills
- Transportation, parking, lunches
- Housekeeping, eating dinner out

Every adult needs to establish and maintain an independent credit history. This is especially true for a non-working spouse staying at home, who generally will not have her own independent credit history. When joint credit cards get cancelled in the event of a divorce or death, it is very difficult for her to get a new one in her own name.

Retirement issues will be discussed in more detail in the sections on “Marriage and Family” and “Planning for Retirement.”

Social Security will pay partial retirement benefits to a worker's spouse even if the spouse has little or no earnings under Social Security. So a working spouse pays additional taxes into Social Security, but may not get much greater benefits than a non-working spouse.

Risks

In deciding to leave the workforce permanently, a key issue is making sure the family's financial resources will support lifetime security even if one spouse dies, gets disabled, or you divorce.

A married woman who decides not to work outside of the home, counting on her husband for financial support, should be aware of possible consequences:

- Divorce or death can change the amount of current income and pension benefits she will receive
- Divorce may affect the household assets she is entitled to (divorce is a major source of women's financial vulnerability as they get older)
- Health care coverage can be compromised by the death or divorce of the employed spouse
- Lack of her own credit history can impair her financial flexibility

Health insurance benefits usually depend on the coverage of the employed spouse. Thus, if an employed spouse dies, the surviving spouse may be vulnerable in terms of health coverage. The surviving spouse may be able to continue coverage for a while. After that, an individual policy can be very expensive.

Comments, Action Needed

Staying in the labor force protects you against suddenly having to begin supporting yourself. Even a woman who intends to stay at home may find it wise to have some workplace skill “in the bank” should she suddenly find herself having to earn a living outside the home.

Families with non-working spouses should find out what coverage is in effect if the employed spouse were to die or become disabled. Such benefits are part of Social Security, and you can get additional benefits under employer plans or individual insurance policies.

5. Outside Activities

Background

Voluntary and extracurricular activities throughout life can provide personal growth, lasting personal contacts, and achievements or skills to put on your resume.

Life-Cycle Issues and Retirement Focus

Young people deciding on their education and career may find spare-time activities to be very helpful. Such activities offer valuable clues about potential areas of interest and let the individuals try out new roles on the stage of life.

Working adults who make time for outside activities can broaden their interests, skills, and personal contacts. Such activities sometimes provide a greater sense of fulfillment than one's job and career, helping avoid burnout on the job and at home.

Outside activities when you are out of the workforce can be very helpful in later re-entering employment. Workers entering retirement often look forward to having more time for their favorite outside pursuits, perhaps leading to second careers or part-time employment.

Financial Issues

Participating in extracurricular activities can be expensive, or it can be a source of extra income.

Risks

Some individuals get so deeply involved in outside activities that it detracts from their career advancement, personal finances, and family life. An ongoing sense of priorities and the need for moderation help avoid such imbalance.

Comments, Action Needed

Volunteer work, organizational memberships and other outside activities can be important in building skills, confidence, and contacts that are important both on and off the job.

C. Marriage and Family

Marrying, living together, divorcing, separating, having and raising children -- all can make a big difference in the assets and income we'll have after retirement. Of course, people make decisions about such family events every day without giving a thought to retirement. If we could always foresee the long-lasting financial effects, would we make the same decisions? Often the answer will be "Yes," but sometimes it won't. We might learn to step back and ask a few questions before making a long-term commitment that can easily be postponed or changed. That's what this section is about -- helping us understand when we may be taking a big step away from retirement security without even knowing it.

Early planning and saving for retirement make great sense. But early in adult life is when we're also paying off college loans, making decisions about marriage, starting a family, and acquiring a home. Thus saving for retirement typically competes with a steady stream of household expenses and financial security costs including educational savings plans. Once we set aside funds for retirement, we soon learn that tax laws discourage us from using those savings for other purposes -- so we may hesitate to lock in money for retirement unless we give it a high priority.

Some of the recent changes in family structure are making it more difficult to retire. True, families are having fewer children, and more family members are getting paychecks. But our parents are living longer and they may be counting on our help when they're elderly. Fewer marriages are surviving to old age, so we

may end up paying for two residences instead of one, with both former spouses lacking a partner who's committed to helping them get through life.

In earlier cultures where the primary system for old-age support was the family caring for its own, having children was an important form of "retirement planning." Today, fewer children of our own means fewer sources of help we can turn to after we retire. Lower birth rates mean that we can't count so heavily on Social Security because the system soon won't have enough young workers paying in. And as life expectancy keeps going up, so does the cost of retirement.

Newer family structures and longer lives are giving us more choices than ever. To make good decisions about marriage and families, we can only benefit from understanding how retirement fits into the picture.

1. Getting Married

Background

Marriage is associated with financial benefits as well as costs. Families share expenses and income, are important in determining property rights, financial obligations and tax liabilities.

- Marriage alters ownership and financial control of property.
- Financial decisions must consider the economic well-being of the couple/family.
- Marriage requires actions to protect the financial well-being of spouses and minor children. Financial security products needed include life, disability, and health insurance. Legal arrangements involve wills, survivorship provisions, and ownership of assets.
- Although many spouses combine their assets, the couple may not stay together throughout retirement.

Social Security benefits are different for a married couple than for two single individuals. The lower-earning spouse gets the greater of benefits based on personal earnings and spousal benefits under Social Security. These spousal benefits equal 50% of the worker's benefit during the worker's lifetime, increasing to 100% after the worker's death.

Private pension plans, and some governmental retirement plans, also have special provisions for married employees and retirees to help protect spouses who survive them. Later sections of this paper discuss insurance, Social Security, and pensions in more depth.

Both spouses need to be aware of the financial security arrangements that are in place, and both should participate in any significant changes. Both spouses also need to discuss their level of spending, saving, and debt, and need to be comfortable with their decisions. These factors can be vital to reaching their financial goals -- and to staying married.

Life-Cycle Issues and Retirement Focus

Marriage most typically occurs when individuals are completing education, making job decisions, or paying off student loans.

Marriages now occur later in life, when both spouses may have their own homes, children, and other valuable assets, including retirement pensions and savings. The owner of these may wish to keep them as individual property.

Financial Issues

The earnings of both spouses will determine the future economic well being of the family. Thus job choices may have to take account of the other spouse's job prospects. Where one spouse is the primary wage-earner, the other spouse's may have less independence and financial security.

Since insurance benefits such as that covering health care costs, are largely employment based, marriage may affect the relative attractiveness of different jobs.

Property ownership changes with marriage. In community property states, all earnings during marriage are considered equally owned by each spouse. Spouses may need, therefore, to document property they brought into marriage and want to keep as individual property. Inherited assets should be segregated and protected to the fullest extent allowed by law. In common law states, couples should know what property can be legally considered partially owned by the other spouse.

Even the young may die unexpectedly and inheritance of modest assets should be specified through wills or survivorship arrangements. Couples should consider the consequences of probate in survivorship designations.

Income tax consequences: couples may pay more or less income tax than two unmarried people, depending on the division of income between them. These tax rules cause some couples to get married sooner or later than they otherwise would, thus speeding up or delaying the change in their taxes.

- When a single worker marries someone with comparatively little taxable income, that worker's income tax will decrease substantially. This is known as the "singles' tax penalty."
- But marriage partners who earn approximately the same income usually pay more tax than if they could file two separate returns. This "marriage tax penalty" occurs whether they file a joint return or two separate married returns.
- The tax law in effect in January 2003 provides some relief from the marriage tax penalty under new formulas that gradually take effect during 2005-2009.
- A few other IRS rules also affect married people differently, especially the estate tax rules, which are much more favorable for married couples with substantial estates.

Credit and debt: Even if in individual names, credit ratings of both spouses will appear on the credit rating of each spouse, and each spouse will be responsible for the other's debts.

Risks

If documents are not properly drawn up:

- State property rules may change ownership of property in unexpected ways.
- Other rules may not be those preferred by the couple.
- Couple may find that benefits are less protective of other family members than primary beneficiary.
- One spouse may later be responsible for debts that were not expected.

Comments, Action Needed

Joint decision on geographic relocation and job choice. Calculation of short and long-term costs of one spouse leaving an area and job for the other to accept a job.

Checking on family benefits in benefit programs and submitting all required documents.

Joint decisions on spending and saving

Clarify property ownership rules of state in which the couple lives. Drawing up legally viable documents that retain individual ownership of any property the couple wishes to keep in sole ownership.

Wills, power of attorney for health care, change in survivorship provisions on life insurance and other policies.

Change number of deductions for monthly income receipt.

If you change your surname or address, contact credit agencies, motor vehicle bureau, your employer, selective service (required of males 18-35), Social Security Office (tax refund may be delayed if name does not match what is on file), insurance carriers (e.g., auto rates may change upon marriage).

Tell spouse of location of important financial records.

2. Children

Background

Children require time and resources, forcing tradeoffs with their parents' other economic and leisure activities.

- Raising children may require reduction in work time or even total work withdrawal by one parent.
- Educating children may be the biggest expense of being a parent, making it difficult to save for retirement.
- Disabled children require additional time and costs.
- When desirable neighborhoods and schools are far from the job, commuting takes more time and money
- Need to protect dependent children against risk of one's own disability or death.
- The process of adopting children takes money, time, and commitment and may lead to additional travel, health and educational expenses.
- One may have financial obligations to children as a step-parent.
- Parents need to teach children about finances, especially daughters, but many parents have a lot to learn themselves.

Many government programs exist at the federal, state, and local levels to help low-income families get affordable food, housing and health care. Such programs are valuable, but they usually will not support a life style you would choose for yourself.

Life-Cycle Issues and Retirement Focus

Early career:

- For women, having children may coincide with important career choices.
- For couples children may require a decision about the division between spouses of hours of work and earnings. Children may affect decisions about job changes, career moves.
- Younger couples may have children before assets have been accumulated for housing and emergencies.
- All these changes are likely to affect accumulation of assets for retirement. A parent who leaves the paid labor force, or cuts back to part-time, loses a large amount of potential retirement benefits. That individual also may have fewer options available to return to the labor force.

Mid-career:

- Paying or saving for children's education may take priority over retirement saving

Late career:

- Educational costs and loan repayments often interfere with retirement plans

Financial Issues

Marriage creates many new financial priorities that can crowd out people's ability to save for retirement:

- Not all children are healthy: families may have children with significant disabilities.
- Adult consumption (travel, entertainment, eating out) may have to change to accommodate the increased costs of children, especially if there is an adjustment in work hours and earnings. Young families with young children and careers that are just getting started may have difficulty setting aside any savings.
- Saving for education expenses should begin early. A geographic move should take into account the quality of local primary and secondary schools, and potential cost of private schooling if public schools are deemed substandard.
- Children should be protected against the costs of parents' death/disability.
- The process of adoption is likely to be time consuming, stressful and expensive.
- Stepchildren may give rise to substantial costs and child-care obligations.

Many children help pay for their own college education. Tradeoffs exist among children's work effort before and during college, family savings, and loans. Each family needs to determine the parents' share of costs, including number of years and level of costs. Grandparents often help pay for their grandchildren's education. Families need to know about the tax treatment of college expense payments and savings plans (e.g., Section 529 educational IRAs).

Risks

- Insufficient protection against health care costs of caring for healthy or disabled children can deplete families' financial resources.
- Poorly designated survivor documents and wills may leave children without sufficient resources after a parent's death.
- Unexpected expenses due to adoption or step parenting (beyond those anticipated in biological parenting) may jeopardize financial stability for adults and children and change family relationships.

Comments, Action Needed

Check coverage of child-associated expenses in health plans.

Consider savings, especially tax deferred savings forms, from which savings can be withdrawn without penalty to coincide with child-related expenses (e.g., CDs, Education IRAs, Medical Expense Accounts).

Increase Life Insurance, disability coverage. Alter wills to reflect needs of each child and their different ages.

Explore whether adoption expenses may be reduced by insurance or tax deductions.

Be aware of prior agreements made between biological parents about the financial obligations of each parent for child-related expenses.

Become informed on available savings options for education including tax treatment and effect on potential grants and loans.

Get children to help decide how to pay for their education including their contribution, advance funding options, student loans, and outside sources of financing.

See the earlier section on Careers and Education for more information on paying for higher education.

3. Divorce

Background

About half of all marriages end in divorce. Later in life, elderly women are much more likely to be poor if they're divorced than if they're married. One reason is that decisions made at the time of divorce can have a big impact on long-term financial security. People getting divorced need to gain an understanding of the retirement implications.

Divorce reduces the resources, as well as the expenses and debts, in which one can share. The timing of divorce and divorce agreement influence the reduction in resources and consumption that follow a divorce.

- Timing: years of legal marriage may affect access to benefit programs that are based on marriage.
- Division of assets: weighing the importance of receiving assets producing current versus future income.
- Divorce may result in loss of important benefit programs, especially health insurance.

- Divorce alters parental obligations for children's current and future maintenance, education, and health care costs.

Why do so many couples divorce despite the emotional and financial pain for all involved? Expert opinion says divorce is rooted in five areas: insecurity, money, communication, clash of values, and insufficient separation from family. Couples with different attitudes about their family finances may soon have problems in several of these areas. Premarital counseling can uncover such differences and attempt to resolve them. Before marrying, couples need to pay close attention to each others' views about money and try to reach a common understanding. After marrying, individuals who are considering divorce need to be realistic about the financial effects of the divorce and ask themselves whether they'll be able to support current living costs plus future retirement and education needs.

Life-Cycle Issues and Retirement Focus

Divorce can occur at any time during one's life. It affects division of a couple's resources, changes expectations of future shared resources, has obligations for support of children, and alters access to benefits and income sources that are linked to the other spouse's current and future earnings. The division of assets and support obligations is likely to include the division of retirement assets between the ex-spouses.

Changes in the economic status of the parents may affect children's economic status and future economic goals. This in turn will alter the potential obligations of parents towards adult children in the future or the likelihood of support from children should retirement resources be inadequate.

Financial Issues

Divorce usually has immediate costs for the couple to get legal assistance plus subsequent costs to maintain separate homes. Often the wife will get ownership of their home plus little or none of the husband's pension. In such cases, the wife should consider the home a valuable asset for retirement purposes, but should avoid making hasty decisions about downsizing except in dire circumstances.

Divorce is governed by state law. Obligations of couples in divorce are different across states depending on whether it is an individual property or community property state.

Titling of property (which specifies legal control) may not be identical to ownership of assets under state law. Knowing the difference is important.

A spouse covered by the other spouse's health insurance is likely to lose that coverage as a spouse, but will be eligible to continue participation for a specific period of time (defined by Federal law but extended by some states) under COBRA.

Pensions are part of the assets of the couple, which may enter the divorce agreement as are other forms of property including home, financial assets, furniture, and football tickets. Federal pension law known as ERISA permits the division of pension benefits under private plans and includes requirements about such division. Public employee plans are subject to state law which has different requirements.

Support of child-related expenses including education should be specified in divorce agreements.

A marriage of less than 10 years' duration terminates rights to spousal or survivor Social Security benefits. Being close to that deadline may mean a postponement of the legal divorce date is wise. For couples divorced after ten years, the lower-earning spouse can get a Social Security pension figured the same way as for a current spouse. This benefit equals 50% of the benefit of the higher earner during that person's lifetime, increasing to 100% after that person's death. Spousal benefits are not paid in addition to benefits based on personal work history; the beneficiary gets the larger of the two. Remarriage affects the right to pension benefits.

Risks

- Poorly specified divorce agreements may jeopardize the well being of all parties, including children.
- Not knowing legal details of rights to benefits can lead to unexpected expiration of waiting periods and much later discovery that expected benefits are not forthcoming.

Comments, Action Needed

Check on how divorce changes coverage of self and children by previous Health Insurance.

Prior to divorce clarify property ownership rules of state in which the couple lives.

Before starting any negotiations, understand family assets and liabilities, and how they are distributed between the spouses.

Alter wills, power of attorney for health care, survivorship provisions on life insurance and other policies to reflect new status.

Change number of deductions for monthly income receipt.

If you change your surname or address, contact credit agencies, motor vehicle bureau, your employer, selective service (required of males 18-35), Social Security Office (tax refund may be delayed if name does not match what is on file), insurance carriers.

If necessary, change who is aware of location of important financial records.

4. Remarriage

Background

This section will focus on marital issues that often are different in a second or later marriage, such as step-children and property rights acquired before the remarriage. Many of the marital issues discussed above under “Marriage” also apply.

Remarriage, as does any marriage, may affect property ownership rights, access to benefits, to the other spouse’s current and future income. In addition, a remarriage may be affected by a previous divorce arrangement, may bring with it financial obligations for children.

- Prenuptial agreements may be important in specifying property ownership.
- His-hers-our children: what are the obligations of each spouse?
- Timing of marriage may affect current or future access to Social Security or pension spouse/survivor benefits.
- Previous divorce agreements have “remarriage” clauses that specify the cessation of financial responsibilities of one spouse upon the remarriage of the other.

Step-children are less likely to care for step-parents who did not raise them than for natural parents.

Life-Cycle Issues and Retirement Focus

Remarriage may occur after each spouse has had children and purchased their own home and accumulated other valuable assets they wish to keep as theirs. Some may have been inherited from parents many years prior to marriage. The owner of these may wish to keep them as separate, individual property following marriage. These may or may not be seen as assets that are to be shared during the retirement of the remarried couple or to be inherited by one should the other die.

Financial Issues

A waiting period following divorce may exist in some states. Marriage, even in another state, may not be recognized if that waiting period is violated.

Remarriage may redefine income and property ownership, especially in community property states.

Remarriage may terminate rights to Social Security benefits based on a previous spouse's record or to income specified as part of the divorce agreement.

Where employees or retirees have been married more than once, questions may arise about who gets benefits as their survivor under employer-sponsored plans.

Risks

Individuals may discover that the consequences and obligations of remarriage are different than those in first marriages (e.g., only partial share in second spouse's resources).

Comments, Action Needed

Should one or both partners consider a premarital agreement on property ownership and obligations for support of children?

5. Living Together

Background

Couples in non-marital relationships are usually not provided the same legal protection or automatic access to benefits as are legally married couples. Non-married couples must seek ways to provide these protections, which may require additional expense. Some benefits, such as Social Security spousal benefits, can't be protected.

- What additional protections does the couple want for one or both partners?
- What are the State and local laws that grant protection to "domestic partners?"
- What arrangement should be made for shared property ownership? Inheritance?
- How should one in the couple be protected against the death/disability of the other?
- How is the couple to share in the cost of individual health expenses, joint living expenses?
- How do couples assure the right to make health and financial decisions for the other?
- Does either partner have a prior spouse or child with legal rights to inherit property?
- What can be provided in exchange for pension benefits not protected?

Life-Cycle Issues and Retirement Focus

Some couples may choose not to get married, in part because of extensive career focus or modern culture. This may affect whether and the way in which they choose to jointly share savings in retirement and distribute them after the death of one.

Couples previously married may choose not to get married because of the impact on Social Security or pension benefits earned during a prior marriage.

Financial Issues

Some, but not all states, recognize "common law marriages." In those that do such unions may incur financial benefits and support obligations.

Employers and some jurisdictions may recognize "domestic partners" thus providing access to some benefits otherwise unavailable except as a married couple.

Social Security does not provide spousal or survivor benefits to common law marriages unless those are recognized under state law. Pension plans have no obligation to non-marital partners under default joint and survivor rules, unless pensioners designate the partner as the beneficiary.

Federal income taxes for a couple may go up or down when they marry. The difference can be substantial, as discussed above in the section on Getting Married.

Risks

Insufficient protection under different policies for the partner.

Problems defining the ownership of common assets, during life and after the death of one of the partners. If there are children, their legal status is not well-defined.

Comments, Action Needed

Check on the law regarding non-marital relationships in retirement benefits.

Keep each partner's property and debts separate, and have a clear understanding about how spending is allocated.

Seek ways of providing protection and research the expenses involved.

Discuss the possibility of legal marriage and the financial pros and cons.

6. Caring for Parents

Background

Elderly parents may require visiting to supervise care, or direct time and dollar commitments from children.

- What are the obligations of children to monitor quality of parental care, of parent's financial decisions?
- What is the division among siblings of parental oversight and direct care?
- How does one persuade parents of the need to share financial information with children?
- What should be the tradeoff between parental care and care of one's own family or one's work obligations?

Parental care may coincide with other family time and financial obligations: the raising of children, paying for children's education, one's own retirement.

Adult children may be asked to or feel obligated to assist parents with financial and health care affairs, even to pay for health care expenses.

Long-term care may be needed and adult children may have to make a decision about level of care needed and whether that should take place in a child's home or other arrangements are possible.

Financial Issues

Parental care may take time from adult children's work obligations.

Some parents will need financial support from their children. Children may also have to assist parents in managing their finances. Elderly parents need to discuss their finances with the children including estate tax issues, gifting, and inheritances.

For individuals without assets or resources who need long-term care, Medicaid may become an option.

Risks

Lack of discussion with parents may mean “discovery” of their wishes and appropriate documents is a more time-consuming process than would have otherwise been necessary. When time is lacking, there’s a greater chance of making a decision that’s not what the parent would want.

Poor financial management by parents may jeopardize their own financial well-being.

Lack of or poorly written Advance Directives may mean parental wishes are not followed by medical professionals.

Comments, Action Needed

Children should anticipate having to make future health care decisions for the parent using private or public programs, and should locate sources of information in advance:

- Check on parents’ resources to pay for care when needed.
- Discuss with parents their living and health care plans when physical abilities decline.
- Check on the existence and specificity in documents specifying Power of Attorney (for Finances), Power of Attorney for Health Care, and Living Will.
- Learn about alternative living arrangement options for parents.
- Check on parent’s health insurance coverage, the continuation of that coverage into their later years, and on State programs covering health costs and long-term care.

D. Home and Other Property

Owning your own home is a big part of the American Dream. Two-thirds of Americans own their own homes, including 4 of every 5 seniors.

Your home is primarily your residence, but it’s also an investment. In fact, Americans rate their home as the best investment they can make -- far ahead of 401(k)s, individual retirement accounts, and stocks. Moreover, despite the recent recession, many Americans have actually seen their net worth rise due to an increase in their home's value. Particularly as you get close to retirement, you should think about the kind of housing you’ll need, the location and cost of that housing, and how you’ll pay for it. You may even be able to use your home as a source of retirement income.

To buy a home, you’ll probably take out a mortgage loan and arrange to pay it off over many years. This is one of the largest financial transactions you’ll ever have, so it pays to learn about interest rates, points, credit ratings, and so forth.

Major consumer goods such as cars, boats, and appliances traditionally are bought on credit. Today’s consumer may also charge a host of smaller purchases instead of paying cash. Credit and credit cards are a mixed blessing. They can drive economic growth and create employment, but they can drive us deeply into debt and create bankruptcy. Consumers need to treat credit with respect, much as we respect fire – keep it on hand for when it’s needed, but don’t let it get out of control and destroy us.

1. Buying and Owning a Home

Background

Your home is a very costly and valuable asset, and can be a source of retirement income. It’s primarily your residence and only secondarily an investment. Your home differs from other investments because:

- It’s not liquid, that is, 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
- You can’t diversify this investment as you can other kinds of securities

- You use it every day, so if you sell your home you'll need to live someplace else.

Taxpayers who itemize deductions can usually deduct home mortgage interest and real estate taxes.

Life-Cycle Issues and Retirement Focus

When should you stop renting and start owning?

Is the house big enough for a growing family? Can it be expanded?

As children leave the home and at divorce, consider if your house is larger than you need

There is a trade-off between savings in financial instruments versus a more expensive home. Which turns out to be a better investment depends on many factors.

You may be able to use your home as a source of retirement income:

- Trading down to a less-expensive home, perhaps in a lower-cost area
- Tapping your home equity by getting a loan or reverse mortgage
- Renting out rooms or other space
- Operating a home-based business

At retirement, can you/should you stay in your house?

- Deciding where to live is an important part of retirement planning.
- You may need to move in retirement because of an inability to care for your own free-standing home, because you need personal or health care services, or because stairs, narrow doors and halls have become a problem.
- As a homeowner instead of a renter, you pay for insurance, real estate taxes, and upkeep

Financial Issues

Sources of down payment can include:

- Savings
- Parents and grandparents
- Withdrawal from IRA
- Loan from 401(k) account

Should an unmarried couple own a home jointly?

Selling your home can produce a big gain or loss. Try to buy a home that will at least hold its value.

Risks

Homes can go down in value. This happened recently in Silicon Valley, and earlier in New England mill towns.

You may not be able to sell a home easily or quickly.

Comments, Action Needed

Buying vs. renting depends on how settled you are in marital status, geographic area, job, etc. Don't let tax deductions drive this decision. Home ownership takes time and money, and closing costs to change houses are high.

A second home may make sense if you can afford it and want more sun in the winter or less sun in the summer.

2. Mortgage Loans

Background

Most people who buy a home use a mortgage loan. A bank or other lender puts up most of the money, and you make just the down payment. Then you make monthly payments of principal and interest to pay off the loan over 30 years or less. If you don't make the payments, you may lose your home.

Part of your monthly payment is for interest on the amount of the loan (principal) you still owe, and the rest is to pay off some of the principal. The amount of 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 principal. The monthly payments are figured so that the amount of principal you owe is zero at the end of the mortgage term. At that time you own the property free and clear, with no more mortgage payments.

Life-Cycle Issues and Retirement Focus

During your working years:

- Your mortgage is the largest debt that you owe. Try to pay it off before you retire, when your income may be lower and a tax deduction for mortgage interest is less valuable.
- If you are married, both you and your spouse are liable for the debt until the lender issues you a release from that liability.

At retirement:

- If your mortgage is not yet paid off, how will you make the future payments?
- A reverse mortgage on your home is worth considering if you need more money. A reverse mortgage is a contract with a financial institution that allows a homeowner to get retirement income by borrowing against the equity in the home, with no repayment needed while the individual lives in the home. Such arrangements can be complicated, so you need to get counseling from an independent person. Sources of information are listed in the Appendix.

Financial Issues

Factors to consider when taking out a mortgage include:

- How big is your down payment? A bigger down payment may cut the interest rate.
- Interest rate you'll pay?
- Do you want a fixed or variable rate mortgage? Variable starts out cheaper but your payments are likely to increase over time.
- Points – These are an additional up-front cost.
- The term of the loan. Mortgage loans are typically for 30 or 15 years
- Prepayment – You can usually pay off the loan early without any penalties or fees.
- Closing costs may include sales commission, loan initiation fees, appraisal, survey, title examination, private mortgage insurance, and lawyer fees. Find out the amounts you must pay before you get to closing.

A home equity loan usually is a better way to borrow than credit-card debt because interest rates are lower and interest payments often are tax-deductible.

When interest rates fall substantially, you should consider refinancing your mortgage. You'll have additional closing costs to get a new mortgage. You need to be able to save enough in mortgage payments, net after taxes, to recover such costs in a reasonably short time.

Risks

If you lose a source of income, you may have difficulty in meeting your monthly mortgage payments. In a severe economic recession, property values and incomes can fall so sharply that large mortgage payments are a heavy burden for many people, threatening their retirement security.

Failure to make your mortgage payments can result in foreclosure of the mortgage, in which the bank seizes and sells your home and secures a judgment for any remaining debt.

Comments, Action Needed

Most homeowners move before their mortgage is paid off, using the proceeds from selling the old home to pay off the loan and make a down payment on the new home.

Home equity loan may be available after a few years of ownership, letting the owner borrow for any purpose and get a tax deduction for interest paid on the loan.

Refinancing the mortgage can save money when interest rates have dropped. You need to stay in the home long enough to offset extra closing costs for refinancing.

Paying off the mortgage early may be an option for older homeowners who have money to invest. Should you pay off a mortgage when you can? Opinions differ. A financial advantage is that you may not be able to earn as high an interest rate on your savings as you'd be paying to the mortgage lender, net after taxes and tax deductions. Also, you may feel more secure owning your home free and clear. But some experts advise against investing most of your life savings in one piece of real estate, preferring that you have significant investments in stocks or other securities while you gradually pay down your mortgage.

3. Debts and Credit

Background

Credit is easily available to most consumers, helping people live better and fueling the economy but also tempting people to take on more debt than they can handle.

A common form of consumer credit is a credit card account issued by a financial institution, often using the name VISA or MasterCard. Merchants may also provide financing for products which they sell.

When it comes time for you to buy a car or home, your good credit rating is extremely important. A good rating will get you the most attractive options for an interest rate, down payment, and number of years to repay, in other words, the lowest possible monthly payments. On the other hand, a bad credit rating often will make it difficult or impossible for you to buy what you want.

To get and maintain a good credit rating, you need a steady source of income without more debt than you can reasonably handle. Perhaps more important, you need a good history of paying your bills on time and repaying any loans when each payment comes due. Prospective lenders simply want to feel sure they'll get their money back.

Credit ratings sometimes are used for other purposes too, such as in screening prospective employees or spouses to get a sense of their financial stability and identify those who have failed to meet their legal obligations.

Bankruptcy is a legal way for someone with heavy debts to get a new start. A bankruptcy court uses the debtor's assets to pay part of the amounts owed, but allows debtors to keep their homes and pensions plus other possessions in some situations.

Life-Cycle Issues and Retirement Focus

Over one's life cycle, borrowing may shift to lending:

- A young family's income tends to be stretched thin, making borrowing hard to avoid.
- Older workers should be saving for retirement. If they must borrow, a home equity loan is usually better than credit card debt.

- Retirees should be using their savings to produce income, investing part of their assets in CD's, bonds, and payout annuities. Such investments represent loans, as the money moves from financial institutions to people who need to borrow. Thus, people at this stage of life often are lenders, not borrowers.

Surprisingly, quite a few employees reach retirement with large unpaid credit-card balances, which at this stage of life suggest poor financial planning. At retirement, we should expect to have large amounts of assets, and few if any liabilities.

Financial Issues

Interest charges on credit card debt can be very high.

Annual fees on credit cards vary, but many cards have no annual fee.
Credit card interest rates and annual fees change from time to time.

You can use the phone or internet to get a copy of your credit report at little or no cost from each major reporting agency, namely, Equifax, Experian, and TransUnion. These reports list personal data plus your record of paying bills, etc., on time. From your report, each credit agency generates a FICO score, which considers your credit history over several years. Lenders often use the FICO score to judge your risk, and you may have to pay a small fee to find out yours.

Risks

At divorce, you may be responsible for the debts of your spouse.

Bankruptcy damages the person's credit rating, making further borrowing very costly or impractical for years afterward.

Identity theft is a possible danger. Someone may try to purchase goods or secure credit cards in your name. Securing a credit report periodically can show if someone has stolen your identity.

Comments, Action Needed

Compare the interest charges and annual fees for different credit cards. People should give high priority to paying off credit card balances, and try to avoid running up credit card debt. Keep track of the interest rates and annual fees on your credit cards, and minimize the number of cards you have. Most people can get by with just one, or perhaps two, all-purpose credit cards. Review each monthly credit card bill for unexplained charges, which can be reversed if in error.

If you're dissatisfied with some product or service that you bought by credit card and the seller won't give your money back, you usually can get help from the credit card firm (for example, VISA or MasterCard). By following that firm's procedures for disputed charges, you have an excellent chance to avoid paying for the item without hurting your credit rating. One lesson here is that you sometimes can gain peace of mind by using a credit card instead of using a check or cash for an unfamiliar purchase. If a seller won't take any major credit card, that's a warning that you may want to back away from the deal.

Bankruptcy is a serious step that should be taken only when no better way exists to get out of debt. You can avoid a lot of interest charges and other grief simply by not taking on too much debt. What can you do if your debts start to pile up after unexpected loss of a job, major illness, etc.? The best way is to confront the problem before the creditors confront you. Ask creditors to let you pay more slowly, then don't let them down. Look for ways to pay off debt that has high interest rates. Some lending firms specialize in helping people deal with these situations.

You should periodically check your credit report and get any errors corrected. Negative information that gets into your credit history will stay there for 7 to 10 years unless you get it changed.

4. Preparing for Emergencies

Background

Financial emergencies often can be anticipated and planned for. The insurance industry exists so that people can prepare for such situations, and many other sources of emergency aid are available.

To cope with unpleasant financial shocks, to what extent should you rely on:

- Advance planning through insurance, savings, lines of credit, etc.?
- Government programs to help those in need?
- Family, friends, and private charity?
- Good fortune?

Life-Cycle Issues and Retirement Focus

Young adults may have few resources to fall back on besides the “Bank of Mom.” A sign of maturity is to put in place an adequate insurance program (especially auto, health, and disability insurance) and start to set aside savings before you take on the obligations of marriage, home ownership, and a family. A later section covers various kinds of insurance.

In mid-career, you’ll need to protect your life, family and possessions against the unexpected. Besides insurance products, your best defense against mid-life emergencies is your and your spouse’s good health, credit ratings, and earning power.

When you buy a home with a mortgage, the lender will require you to have insurance against fire and other perils. A larger deductible saves you money in premiums and helps you avoid filing small claims that may cause the insurer to raise your rate or refuse to renew. Homeowners’ policies usually include a certain amount of liability protection against a lawsuit after someone’s accidental injury, e.g., from a fall on your property. A major accident could destroy you financially, so you should consider buying additional liability coverage inexpensively under your homeowner’s policy or a separate “umbrella” policy. As in all insurance matters, your premium dollars are best spent protecting against major losses, not small ones.

In retirement, you’ll want to have enough assets and income to support a comfortable life while your health permits. It also helps to be living with a spouse or other companion, and be near family, friends, and modern medical facilities.

Financial Issues

Financial planners can explain various risks and how to protect against them. Basic information is available free to anyone with a library card or Internet connection.

Every adult should have a ready source of cash in time of need, such as unemployment or unexpected major bills. You may want to set aside a rainy day fund, perhaps three to six months’ pay, before starting to save for retirement. Less conservatively, you may plan to borrow from a 401(k) account, from a home equity line of credit, or from credit card balances that you normally pay in full.

Risks

An emergency can happen at any time. Try to insure against large losses and self-insure against small ones. For example, collision insurance on your car will cost less if you choose a higher deductible.

Comments, Action Needed

Use part of each paycheck to build a rainy day fund and insurance program. Employers often have valuable employee benefit programs and may contribute toward the cost.

E. Planning for Retirement

This section deals directly with planning for retirement by making good use of employer-sponsored plans and other sources of retirement income. An Appendix compares four ways of saving for retirement, three of them having tax advantages, namely, a Roth IRA, a traditional IRA, and a 401(k) account. Numerical examples show that any of these three would provide more spendable income after retirement.

You can choose among many ways to invest your savings, and this choice can make a big difference in how rapidly your savings grow. An Appendix explains more about ways you can invest your retirement savings, including stocks, bonds, mutual funds, and annuities.

Retirement income usually comes from a combination of Social Security, employer retirement plans, and personal savings, perhaps supplemented by part-time work. Social Security offers a base layer of protection, but not an adequate retirement benefit. An Appendix outlines the benefits available from Social Security to retired or disabled workers and families of former workers, and lists sources of detailed information.

Employer-sponsored retirement plans cover about half of the working population:

- Older employees and higher-paid employees are more likely to be covered.
- Plans vary greatly by type of employer. Large private and public employers typically offer an employer-paid traditional pension plan for full-time employees. The most common formula is a percentage of pay based on length of service, with pay averaged over your highest few years. In addition, the employer may offer a matched savings program.
- Middle sized and smaller employers probably have only defined contribution plans, or may not offer any plan.

Because employer plans vary so much, you need to understand what benefits are available from your current employer and from prior employers.

1. Saving for Retirement

Background

If you want to have adequate funds for your retirement years, you need to save during your working years. 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 and any employer-paid plan
- To make up the difference, make a commitment to save on your own
- Set aside enough each month to accumulate a substantial sum by the time you want to retire
- Keep track to see how it is going.

Life-Cycle Issues and Retirement Focus

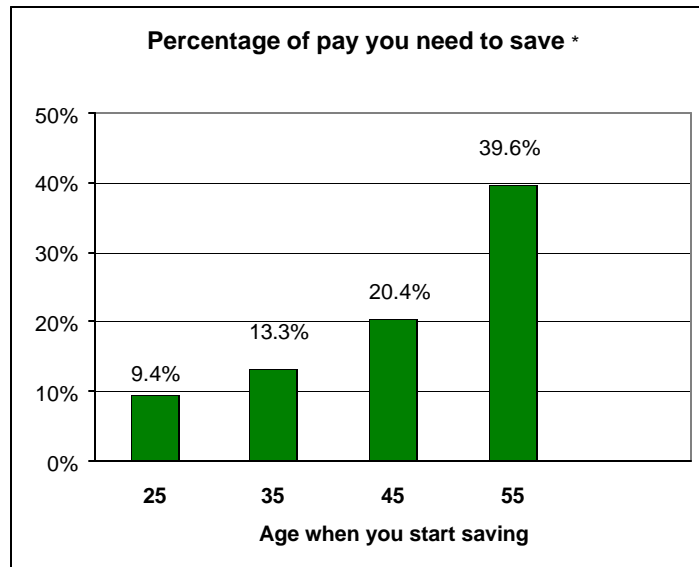
In saving for retirement, your goal is to become financially independent. You'll gain control of your life and your time – no longer concerned about holding down a job, commuting, or all the other cares that keep you from living where and how you'd like. Keep that vision clearly in mind and you'll make the right choices to achieve it. You'll get a big payoff by starting to save early. This takes a smaller bite out of your current paychecks and gives your money more years to earn interest.

Many people don't think much about retirement savings until age 40 or even later. Even so, they can lay a firm foundation by paying off other debt and saving for other needs such as housing and education while forming the habit of saving at least a little toward retirement each month.

Financial Issues

Adequate retirement income can be defined different ways. One rough guide often used is that total retirement income should be at least 70% of pre-retirement income before payroll deductions. (You need less than 100% because taxes and other payroll deductions are less after retirement.) As you near retirement, fine-tune this by estimating how many dollars a year you'll need after retirement. This recognizes your own situation, for example, you may not have monthly payments for a home mortgage or rent, but you need to pay the full cost of health insurance to supplement Medicare. You can also choose to move to a less-expensive home.

If you start later, you need to save a higher percentage of pay. See the chart below for examples.



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

Investing can be as simple or complex as you make it. You can easily learn enough about investing to get started, then find out more as your savings grow.

In thinking about saving, many people use the “Rule of 72.” This handy tool tells in an instant how long it takes to double an amount of money invested at any rate of interest. Just divide 72 by the interest rate to find the number of years. For example, if you invest \$1,000 at 6% interest, your money doubles to \$2,000 in 12 years (that is, 72 divided by 6 is 12). The Rule of 72 works like magic. The answer it gives is accurate within a few months at any common interest rate. If the answer you get isn’t a whole number of years, just round it off, for example, 72 divided by 10 will round to 7 years. Here are other examples:

If you earn this rate of interest	Your money will double in
5%	14 years
7%	10 years
8%	9 years
10%	7 years

Risks

Even the best-laid plans can go wrong. For individuals who control their own retirement funds, the risks include investment returns, inflation, unemployment, longevity, and the temptation to use funds for other purposes than retirement. But the greatest risk may simply be the failure to save. Someone once said that failing to save is just like other sins – the pleasure comes first and the consequences come long afterward.

Comment, Action Needed

Some fortunate employees work many years under a generous pension arrangement that fills all their needs for retirement income. Such programs are increasingly hard to find. The reality today is that most of us must determine how much to save on our own, then must commit to saving and following a strategy to invest the funds.

Contribute to any employer plan that's available to you, especially if it has a matching employer contribution. If no such plan is available, or the one you have is inadequate, set up an IRA and contribute to it. Banks and savings institutions make this easy but your investment options may be very limited, for example, only Certificates of Deposit. You can get a much wider choice of IRA investments by contacting any of the major mutual fund firms who advertise in the business section of your newspaper.

Contributing to an IRA is a good way to save for retirement:

- With a traditional IRA, you get an income tax deduction on the amount you contribute. Later you pay tax when you take the money out, so tax on your contributions and investment growth is deferred.
- With a Roth IRA, you don't get an income tax deduction when you contribute. But later you won't owe any tax on the money you take out, so the investment growth is tax-free. The amount you're allowed to contribute to a Roth IRA may be more than to a traditional IRA. In many cases, a Roth IRA lets you accumulate more after-tax savings for retirement.

You also can roll over to an IRA your account balance from an employer plan. Later, you may be able to roll over the IRA funds to another employer's plan. If you roll over funds to a Roth IRA, you must pay income tax on the amount of the transfer at the end of that year.

Deferred annuities are another way to save for retirement on your own. Income tax on the investment growth is deferred until you take money out. Pros and cons include no IRS limits on how much you can contribute, no tax deferral on the amounts you contribute, and relatively high expense rates charged against your account each year. If you use a deferred annuity, keep it separate from any IRA.

2. Using Employer Plans

Background

Employers offer different types of retirement plans. These tend to vary by segment of the employment market – larger vs. smaller firms, older vs. newer industries, private vs. public employers – though changes in retirement plans are gradually rippling through established employers.

You can gain greater retirement security by working in an industry with good retirement benefits. Or if your employer provides no help with retirement, you may be able to set aside more in a tax-deferred IRA than if you were covered by a pension plan.

Life-Cycle Issues and Retirement Focus

Every young worker needs to understand how retirement saving fits into a lifetime financial plan:

- First, get in the habit of saving
- Once some assets have been built up, learn how to invest
- By mid-career, make sure you're well along the path to retirement
- As you approach retirement, maybe at age 50, focus on the transition to retirement and how you'll use the money in retirement

Financial Issues

Traditional pension (defined benefit) plans tell you how much your pension will be. The employer has to come up with the money to fund the plan.

In the newer (defined contribution) plans, you take all the investment risks, and you may have to decide how much to save. Starting to save early is very helpful.

Risks

If you terminate employment before vesting, you lose the benefits provided by employer dollars.

Under a traditional pension (DB) plan, even a fully vested employee who leaves in mid-career loses heavily. The reason is that much of the future growth in pensions already earned is tied to future pay increases.

Most DC plans require the employee to bear the investment risk.

If you fail to participate, you lose the benefit of the plan and may not have enough money to afford retirement.

Comment, Action Needed

For people who have one available, a 401(k) plan is often the best place to save. Be sure to save enough to get the full amount of any employer match, which is “free money” that you don’t want to leave behind. Beyond that point, save as much as possible in a Roth IRA, a traditional IRA, or your 401(k) plan.

Keep track of any pensions or 401(k) account balances that you earned with prior employers, either by saving your latest certificates and financial statements or by rolling over the funds into an IRA that you control. If you lose contact with a prior employer whose pension plan covers you, the federal Pension Benefit Guaranty Corporation may be very helpful.

3. Making Decisions in Employer Plans

Background

You may have to answer several important questions:

- Whether to participate?
- How much to save?
- How to invest funds?
- If the plan changes, which plan to choose?
- If you leave before retirement, what to do with the money in your account?
- How to use funds at retirement?

Life-Cycle Issues and Retirement Focus

Allocation of your investments among different classes of securities (stocks, bonds, etc.) should vary, based on your time horizon before you expect to need the money. As you near retirement and the distribution phase, you may want to shift to a different investment strategy.

Financial Issues

Learning how to manage your investments is well worth the effort. Nobody else cares as much as you do about your money. Of course, you won’t have the specialized knowledge of a professional, but you can learn what’s important, how to get and use free information, and when to pay for expert help.

Asset allocation (or “investment mix”) is the most important issue by far. You can begin by trying to answer a basic question: What percentage of your investments do you want in equities (generally stocks) rather than fixed-income (generally bonds)? Most of your investment success or lack of it will result directly from the weightings you give to equities vs. fixed-income. Historical figures show that over any long time period in the last century (20 years or more), stocks have yielded greater returns than bonds. But the data also show that returns on stocks vary up and down widely, and are more likely to show a loss over a short period such as one year. Knowledgeable investors usually try to balance the risks and rewards by putting some

investments in stocks, some in fixed-income, and a little in liquid investments such as money market funds (known as “cash equivalents” because they’re virtually risk-free and can easily be converted into cash). Thus a simple investment mix might be described as 60-35-5, meaning 60% stocks, 35% bonds, and 5% cash equivalents.

A fairly common attitude is "I won't take chances with my retirement money, I'll keep it in CDs or a money market fund." This strategy avoids the risks of the stock market, but it disregards the risk of inflation. As this table shows, conservative investments suffer most from the effects of inflation.

Average annual investment return, 1926-2000			
	Cash equivalents	Bonds	Stocks
Total return	3.8%	5.7%	11.0%
Average inflation rate	3.1	3.1	3.1
Net return, after inflation	0.7%	2.6%	7.9%

Over time, conservative investments with stable values have produced the smallest net return after factoring in inflation. Stocks, on the other hand, offer the highest potential for keeping ahead of inflation. Of course, stocks prices that may decline sharply and suddenly. But over the long term, stocks have outperformed other investments. The next table shows how stock prices have varied historically, and how you can use time to help manage risk.

Annual returns on stocks, 1926-2000			
	Over 1 year	Over 5 years	Over 10 years
Highest return	53.99%	28.55%	20.06%
Average return	11.05%	11.10%	11.22%
Lowest return	-43.34%	-12.47%	-0.89%

Over periods of 10 years or more, the ups and downs of the stock market have tended to balance each other, keeping returns from being sharply negative.

How do you decide on a good balance for your investment mix? Consider these issues:

- Your risk tolerance, meaning your willingness to take risks that may well lead to rewards. For example, many mutual fund investors are very conservative and use only money-market funds, which are very safe but give you low returns that may not even keep up with inflation. 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 make a long-term change in your investment mix.
- Your other assets and sources of retirement income, which can stabilize your finances when your investments aren’t doing well. You probably will get a substantial benefit from Social Security, and you may also have earned a traditional pension. No matter what happens to the stock market, those programs will keep on paying you monthly income checks. In that case, you can invest a bit more aggressively than if you had nothing to fall back on besides your savings.
- Your time horizon, meaning the length of time remaining before you’ll need the money. For example, a simple rule that some investors use in allocating investments to stocks is “115 percent minus your age,” so that someone aged 45 would put 70 percent into stocks. Investors who wished to be more aggressive could change the 115 percent to 130, while others who wished to be less aggressive could change it to 100.
- Your confidence that the long-term business climate will be favorable and profitable.
- Your understanding that certain kinds of investments usually do well when others are doing badly. By balancing your funds among different classes of investments, you have a better chance of avoiding heavy losses when some kinds of investments are doing badly. This is part of what’s meant by “diversifying”: you own different types of investments, and within each type you own a number of different securities.

Once you decide on an investment mix, mutual funds let you diversify over a wide range of securities by owning one fund or just a few funds. It’s very important to diversify within each class of investments to

guard against heavy losses when one company or business sector does poorly, and mutual funds are an excellent way to diversify. Start with one or two “core” funds, investing in a very broad range of stocks or stocks and bonds. Later as your assets grow, you can build out from the core by putting small percentages into specialty funds that invest in overseas companies, real estate, etc.

Life cycle timing can be important as you move through life. Your asset mix should emphasize safer investments as you get closer to the time when you’ll need to convert assets into retirement income. Such timing will depend on individual circumstances, including any other income sources you have. At a minimum, review your investment mix five years and ten years before you expect to make significant withdrawals.

A final word about stock market timing -- don’t. Hardly anyone, even the most knowledgeable experts, can jump in and out of the stock market profitably. A large portion of stock market gains occur in short time periods, so that anyone who isn’t in the market then is likely to miss out entirely. You probably should just buy and hold, knowing that you won’t always be right but that the odds are on your side, until you have some basic reason to change your asset mix.

Risks

As you approach retirement age, one risk in making transition decisions is that you may work more or fewer years than expected. Your best investment decision may depend on accurately estimating how much longer you’ll be working.

Failure to make good decisions can leave the individual very vulnerable.

Let’s say a bit more about diversifying investments. Some employees of Enron and other high-flying companies learned the hard way not to put all their eggs in one basket, not even a basket that looks very secure. For example, if you own stocks, own a large number of them so that a few big losers won’t hurt you much. Better still, own several classes of stocks that respond to the economy differently, such as large vs. small companies, domestic vs. foreign, manufacturing vs. services, growth vs. value, etc. Likewise, you can own different kinds of fixed-income securities such as long-term vs. short-term bonds, investment grade vs. high-yield (“junk”) bonds, bonds vs. mortgages, etc. Often you can find a single “balanced” fund that lets you diversify across a wide range of investment classes.

A century ago, investors who owned any stock or bond that lost money were considered imprudent or reckless. Today, investors know that owning only the safest securities means accepting mediocre returns. Instead, a typical strategy is to balance risks and rewards by owning many kinds of securities, diversifying very broadly to avoid heavy losses whenever a few investments go bad.

Comment, Action Needed

Where investment choices are offered, it is extremely important to diversify investments, as explained earlier. You can do this easily by owning several mutual funds with different investment objectives. In allocating and diversifying investments, consider the investments you have in that plan and outside that plan.

If your employer makes available investment information or assistance at little or no cost, you probably will want to use them. In doing so, be mindful of any potential conflict of interest an advisor may have in recommending investment products that pay him or her a sales commission.

Employees who must save entirely on their own should use IRAs or other tax-favored arrangements. They should be especially careful to diversify investments because they have no basic pension plan as a safety net.

4. Using Retirement Funds for Non-Retirement Purposes

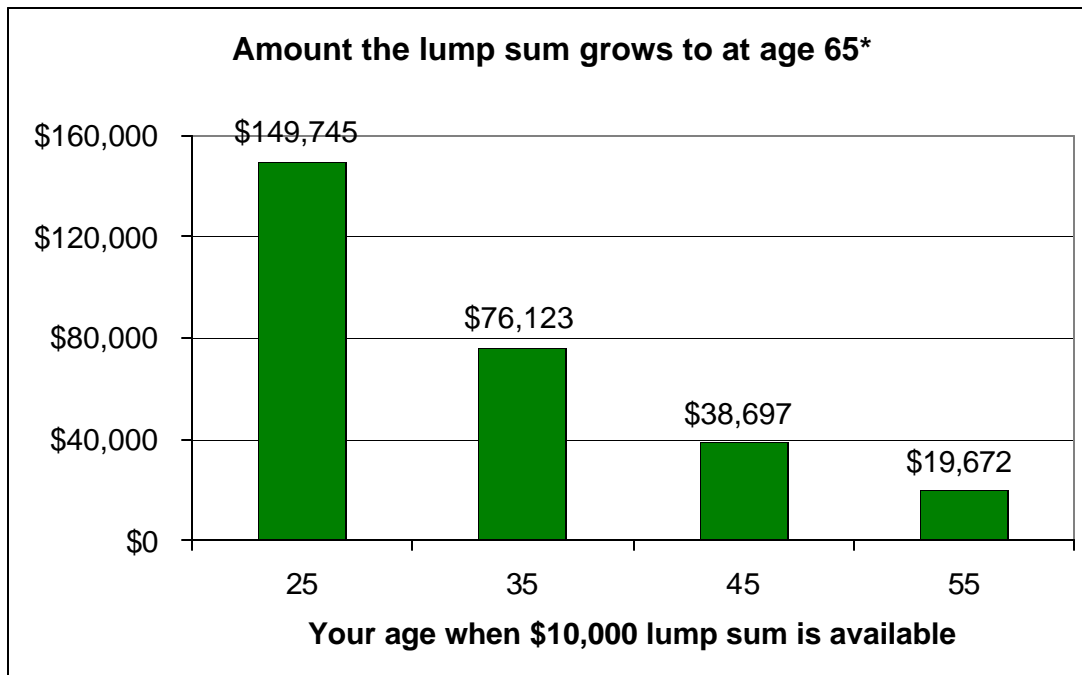
Background

Many retirement or savings plans let you withdraw funds when you change jobs or retire. And loan provisions are common in 401(k) plans, with full repayment required if you leave the company. These features make it easy to use the funds for non-retirement purposes.

Life-Cycle Issues and Retirement Focus

When employees change jobs, many of them elect to take a lump sum distribution of their 401(k) account, spending it or using the money to pay off loans. This may be short-sighted.

Early in your career, the amounts distributed look small and you can find many ways to spend them. But you can instead take advantage of the many years ahead for that small amount to grow. For example, a \$10,000 lump sum at age 25 will grow into \$149,745 by age 65 if it's invested at 7%. That amount may greatly improve your quality of life in retirement, such as by making available prescription drugs or other quality health care. The next chart has other examples of how a \$10,000 lump sum can grow before you reach retirement age.



*Based on 7% interest.

For an alternative strategy, consider someone with \$10,000 of credit card debt who's paying \$1,800 a year just for interest charges at 18%. That individual can use a \$10,000 lump sum (net after taxes) to pay off the credit cards, then contribute at least \$1,800 a year to an IRA, and keep contributing after the IRA balance reaches the amount of the lump sum (before taxes). This is a sure way to stop paying the 18% interest, a rate that few if any IRAs will earn, and get started on a long-term savings plan. Of course, that individual must also learn to control credit-card debt.

Later in life, it may be tempting to spend a lump sum payment on a new home, RV, or boat. Whether this is a wise decision depends on the situation. You don't need to decide right away and your best bet often is to choose a "direct rollover" into an IRA, where you'll keep control over the money and won't owe any taxes until it's time to take money out.

Financial Issues

When you take money out of an IRA or 401(k) plan before you reach age 59 ½, in most cases you'll owe income tax (federal, state, and local, as applicable) plus a 10% penalty to the IRS for early withdrawal. The fund trustee reports the transaction to the IRS and automatically deducts 20% withholding if it's a 401(k) account.

When you leave an employer with a traditional pension plan, a lump sum payment to you may be optional or mandatory, depending on the amount of your benefits. You can avoid immediate taxation by rolling over the amount into an IRA, preferably using a direct rollover, or you may want to elect a lifetime pension instead of a lump sum.

Risks

An ongoing risk is that funds earmarked for retirement may get spent for other purposes. This risk is growing as employees gain control of their own retirement funds.

Comment, Action Needed

You need to make careful decisions about retirement plan distributions, balancing your immediate needs against your future need for money to retire.

5. Timing Your Retirement

Background

Timing of retirement is a major issue for many people. People mean different things when they talk about timing of retirement, such as:

- When will I claim my Social Security benefits?
- When will I claim my company retirement benefits?
- When will I leave my long-term full-time job and work part-time or in a different job?
- When will I leave the labor force entirely?

More and more people are leaving the labor force in stages, planning to combine retirement with some sort of work. Social Security benefits are now payable at age 65-67, depending on your year of birth, without reduction even if you still are working, so that collecting Social Security and leaving the labor force don't necessarily coincide.

For couples, retirement should be a shared family decision, and the decision of one spouse to retire may affect the retirement timing of the other.

Many people end up retiring sooner than they had planned. Reasons include poor health of the worker or of family members, and job loss. Some workers are offered attractive early retirement windows, accept them on short notice, and often seek other employment. The considerations around timing of retirement are quite different for people in these situations than for people who retire on a planned basis based on personal preferences.

Life Cycle Issues and Retirement Focus

Research indicates that many factors enter into the decision to retire, recognizing that it is not clear what meaning is attributed to "retirement" by those who respond. Key factors include:

- Health status
- Availability of health care coverage and benefits
- Social Security retirement age
- Company pension retirement age
- Income and savings available
- Needs of family members for care – particularly important for women
- Expectations of everyone involved

Retirement timing can be viewed as a set of decisions in a logical sequence. First is the question of personal health. When health deteriorates beyond a certain point, the individual is virtually forced to retire (or go on disability).

When health is not a problem, the retirement timing decision will be based on one's financial resources – both cash and benefits -- plus personal preferences. Most people would like to maintain their standard of living after retirement. Others want to retire before they have funds to do this, so they decide to retire and live at a lower cost level. The ideal situation is the family with enough money to retire so that the decision becomes one of personal preference.

Financial Issues

In thinking through the timing of retirement, take a careful look at your financial picture, including savings and benefits from all sources. Get the Social Security Administration to provide an up-to-date estimate of your benefits. For people who want to retire before Medicare eligibility, health insurance for those early years can be very costly. Key financial issues include:

- Needs at the time of retirement – including money and benefits
- Your willingness to keep some money in the stock market with its risks and rewards
- Costs of health insurance to supplement Medicare by paying for prescription drugs and Medicare's various co-payments
- Needs that are likely to increase or decrease over time, apart from inflation
- Future inflation that will make everything cost more, especially medical care
- For couples, the needs of the survivor after the first to die (see example below)
- Potential expenses if one or both spouses need special care or become frail
- Potential requests for help from parents, children and other family members
- A financial cushion to absorb other unexpected costs such as higher taxes
- Retirement dreams, including special travel wishes and the desire to add a seasonal or vacation home

Some people retire without doing a thorough financial analysis, or understanding current resources and their implications. A trap for some people is that lump sums may look like a lot of money until you try converting them to lifetime income. A trap for others is the expectation of earning unrealistic investment returns.

Social Security benefits payable before the full retirement age (65 to 67, depending on when you were born) will be reduced if you earn income above a certain amount. But later your benefits will be re-figured when you stop working or reach the full retirement age, giving you a lifetime benefit increase that's comparable to the earlier reduction. Some people who retire early don't understand how this works and turn down the chance to earn extra income, not knowing that any temporary loss of Social Security benefits will be made up later.

Another timing issue affects surviving spouses' Social Security benefits if the spouse who dies first has earned a higher Social Security benefit. That includes most couples, because the husband usually has higher career earnings, and he's the first to die in about 3 cases out of 4.

For example, Bill can start to get Social Security of \$1,600 a month at his normal retirement age (NRA) of 66, or at age 62 he can get the reduced amount of \$1,200. For a single worker in good health, both benefits are about equally valuable, but the widow's benefit changes things. His wife Mary can get \$1,300 of Social Security at her NRA of 66, or \$975 at age 62. If Bill dies after she's 66, here's what Mary gets as a widow, disregarding cost-of-living increases:

- If they both start Social Security at age 62, Bill's \$1,200 becomes a ceiling on Mary's benefit as a widow. After his death, Mary's benefit will increase by \$225, from \$975 to \$1,200.
- If they wait a few years and take Social Security at 66, Mary later gets his full \$1,600 benefit as a widow. That's a \$300 increase from the \$1,300 she was getting, and an extra \$400 compared to the \$1,200 available if they both had started Social Security at 62.

The extra value to the widow from waiting is even more if the difference in their benefits is greater, or if Mary is in much better health than Bill. Situations like this point up the need for a couple to gather accurate information about their benefits and finances, then jointly plan their retirement.

Comment, Action Needed

In thinking about life after retirement, you'll want to consider

- What you might do in a normal week
- Travel plans
- How your dreams compare with those of your spouse, and how you can meet both sets of dreams
- Whether you wish to work after retirement, on what basis, and whether this is realistic
- Where you want to live and whether to relocate
- Presence of grandchildren and other family members, and your interests in spending time with them.

All these issues are interconnected and highly personal. Financial planners or advisors can offer much help with the financial aspects of retirement, but they may have little good advice on these preferences. Individuals who love their jobs may want to keep working as long as possible, while others want to retire as soon as they can. People with preferences different from yours may not understand your views.

6. Post-Retirement Risks

Background

Although the focus of this paper is planning for your future retirement, we need to touch briefly on some post-retirement issues and risks that you'll want to know about in advance. The discussion of annuities here is useful if you're saving on your own or through an employer's DC plan and you may want to convert your nest egg into a steady source of retirement income. Much of this discussion also applies to employees retiring under a traditional DB plan that offers a choice between a lifetime pension or a lump sum of money.

Life-Cycle Issues and Retirement Focus

Although all these issues occur at or after retirement, some of them grow in importance very late in life, as you or your spouse may not be able to live a normal life without assistance.

Financial Issues

Managing your life savings after retirement is a major challenge with many uncertainties. This is discussed in detail in the WISER booklet "Making Your Money Last for a Lifetime: Why You Need to Know About Annuities."

Insurance companies sell several kinds of annuities and the terminology can be confusing. We'll discuss here only the kinds that are designed for retirees, sometimes called "lifetime payout annuities" or "immediate annuities." These are annuities that you buy with a lump sum of money when you want a guaranteed lifetime income. Insurance companies also sell "deferred annuities," which are used mainly to accumulate funds before retirement as discussed earlier.

If you use an annuity, the exact form you choose represents a trade-off between maximizing income and having income go to someone else in the event that you die early. Don't just look at 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 with a 10-year or 20-year guarantee.

Annuities that pay a fixed amount of monthly income will lose purchasing power with inflation. You may instead want to buy a variable annuity, where income varies with the stock market, but in a sense this is trading one kind of risk for another. Variable annuities have also been criticized for high expense charges that reduce their yield.

You probably don't want to put all your retirement savings into an annuity. But as you get into your 70s or beyond, it makes more sense to annuitize a substantial part of your savings for several reasons:

- Less concern about dying early
- Less desire and ability to control assets
- More concern about depleting funds

Risks

Among the uncertainties and risks after retirement are:

- Longevity, or living "too long"
- Death of a spouse, especially if you depend on your spouse for income or caregiving
- Inflation, which erodes the purchasing power of your retirement income
- Interest rates, which may cut your investment income from CDs or other fixed-income investments
- The stock market, which may fall when you can least afford it
- Business conditions, which may put your employer or life insurance company out of business. This can cut off some of your retirement income or health care, or eliminate your part-time job as a retiree
- Public policy, which may cost you money by raising your taxes or cutting government benefits
- Health care needs and costs, major uncertainties with no sure answers
- Loss of your or your spouse's ability to live independently. This may call for a move to different living facilities or to an area where outside help is available
- Change in marital status, as either divorce or marriage can change your whole financial picture

Comment, Action Needed

To some extent, these issues and risks are part of life as a retiree, though annuities or insurance can help cover some of them. They point up the need to expect the unexpected and to build a cushion into your retirement income.

F. Other Financial Issues and Decisions

Americans need to be more concerned that savings and investments meant to insure their future financial security may not last a lifetime. This concern is particularly acute for women, of whom 90% will be solely responsible for their finances at some point in their lives. Increased longevity, lower lifetime earnings, and volatile financial markets, combined with the need to care for family members, add to women's concerns about diminished financial circumstances later in life. Women often devote their time and money to helping others, and only later focus on helping themselves.

Several additional factors have tended to exacerbate women's financial vulnerability: women tend to be conservative investors; many women are inadequately insured against the death of their spouse or partner; and women tend to start saving through a diversified portfolio of investments later than men.

Traditionally, women have been careful, cautious investors, doing more research than men before investing their money. The flip side of this savings behavior is that many women are overly conservative, choosing investments with lower risk and their attendant lower returns. This conservative investing approach is evident early.

Older women at or near retirement are concerned about financial strategies for retirement income. They wonder what amount can be prudently withdrawn from an investment portfolio (often including pension plan accounts) without depleting their assets. Women ask: what asset mix and distribution strategy will provide them enough money to maintain a comfortable lifestyle, keep up with inflation, and not run out of money? They want to know what role should payout annuities play, and when should annuity payments begin? The previous section addressed such financial questions in a broad sense and this section has more details about

classes of investments. But this paper doesn't try to give detailed information on how to determine needs for insurance and investment products, or how to shop for these.

Finally, as caregivers to their families, many women know from first-hand experience that long-term care expenses can be catastrophic for retirees. In 1999 Americans spent over \$50 billion in non-government funds for nursing home care and home health care. Of this amount, over \$30 billion were out-of-pocket payments. Since women are more likely to incur long-term care, they want to know how to best insure care and prevent financial loss.

Financial strength of an insurance company is important if you intend to keep a policy many years, for example, life insurance, long-term care insurance, or an immediate annuity. You may want to find out about insurers' financial ratings and the guaranty fund in your state that protects policyholders of insurers that become insolvent. Your public library and state insurance department have more information.

1. Life Insurance

Background

Most people use life insurance to provide a source of income after their death to their family or other dependents. Benefits can be paid in a lump sum or as a series of monthly payments. The amount you need depends on your family situation and on the benefits available from Social Security plus group insurance where you work.

Term insurance pays a benefit if the insured dies during a specified number of years. Term insurance generally does not provide cash value if the policyholder surrenders the contract before the end of the term. These contracts are simple, and comparing prices between insurance companies is easy.

Permanent insurance pays a benefit if the insured dies before the contract matures (usually attained age 95 or 100). Permanent insurance contracts generally do provide cash value if the policyholder surrenders the contract. These contracts more complex and some benefits may not be guaranteed, so comparisons between companies are more difficult.

Life insurance **premiums** may be level, increasing, or decreasing.

Life insurance contracts often offer auxiliary benefits such as payment of an additional death benefit if death results from an accident. These additional benefits usually must be elected when the contract is originally issued.

Life-Cycle Issues and Retirement Focus

Before retirement:

- You might buy life insurance on yourself if your spouse or partner, children, aging parents or others depend financially on you.
- You might want your spouse, or someone else that you have an **insurable interest** in, to buy life insurance if you are dependent on them for funds.
- Some policyholders choose to buy contracts that allow them to change the death benefit after issue to accommodate life changes.
- Some life insurance contracts allow policyholders to borrow against the policy, using the cash value as collateral.
- A strategy to consider for supplementing retirement income is to purchase a life insurance contract that is designed to develop strong cash values at retirement age. These cash values may be available for withdrawing over a period of time on a tax-advantaged basis.
- You may want to re-designate your beneficiaries on your life insurance contracts if you are divorced. In some cases, you may want to remain the beneficiary of the life insurance contract on your ex-spouse if you depend on child support or alimony.

After retirement:

- Depending on other resources and survivor income, it may be important to continue life insurance on your spouse or partner after retirement. Life insurance benefits can be important to widows, who as a group tend to experience a major decline in their standard of living.
- On the other hand, if your death would leave your spouse with adequate resources from savings, Social Security and survivor options under pension plans, you may be able to cut back on life insurance premiums after retirement. After retirement, living too long is often a greater risk than dying too soon.

Financial Issues

The amount of life insurance you buy depends on many factors.

- The amount your dependents will need to live on in your absence
- The length of time you want the funds to last.
- Education of children
- Medical costs include care for aging parents.
- Your income and the standard of living that will need to be replaced in the event of your death.
- How much you can afford.
- Benefits may be available to survivors from Social Security, group life insurance, pension plans, etc. Some of these benefits may be substantial.

Risks

Life insurance tends to cost more as you age. Postponing the purchase of a life insurance contract may result in higher premiums.

Further, some individuals may become uninsurable due to health issues.

Comments, Actions Needed

Review life insurance needs whenever you have a major change in family or employment status. Such changes include getting married or divorced, gaining or losing a dependent, entering or leaving the work force. In each case, you estimate how much income your dependents would lose if you died, how much Social Security would pay and for how long. Be sure to include your value to others as a homemaker or caregiver, i.e., the cost of hiring someone to come in and perform those services.

Some term life insurance, usually based on your salary, may be available through your employer. You may be permitted to purchase additional life insurance, often expressed as a multiple of your salary, through your employer.

Additionally, some employers offer the chance to buy permanent life insurance at the work place.

2. Health Insurance

Background

Over 40 million Americans have no health insurance. Workers, retirees, and their families place a high value on health insurance, and employer premiums for health insurance are not subject to income tax or payroll tax. Yet the ever-increasing costs have made most employers search for ways to cut their health insurance costs, often by making employees pay higher contributions, bigger deductibles, etc.

Medicare, which covers people over 65 plus the long-term disabled, also has serious financial problems, and seems likely to change substantially in the next few years. Most people over 65 have “traditional Medicare,” but some use HMOs or other private coverage instead.

Long-term disability is sometimes called “the risk that everyone forgets.” Employer sick-leave practices usually cover only short-term illnesses or injuries. After a few weeks or months, your paychecks are likely

to stop while medical bills and other living expenses continue. Social Security pays disability benefits after a waiting period of at least five months, replacing part of your pay. To provide more income, you can buy long-term disability insurance through an employer's payroll-deduction plan or an individual policy. It's important to choose an adequate benefit amount and a long benefit period, protecting you and your family against the worst cases. If you need to hold down the cost, choose a longer waiting period before benefits begin.

Life-Cycle Issues and Retirement Focus

Workers who retire before age 65 sometimes have difficulty finding suitable health insurance coverage before they become eligible for Medicare.

After age 65, almost all Americans qualify for Medicare. Many of those people also purchase supplemental (Medigap) policies, or their employer continues some coverage into retirement.

Financial Issues

Medicare and other health insurance is extremely valuable to elderly people with high medical bills. But retirees' future costs are hard to estimate as they depend on health care cost inflation and the political process.

Doctors and hospitals usually ask for proof of Medicare or other coverage before agreeing to admit a new patient, regardless of age.

Risks

Anyone who defers buying health insurance because of the high cost risks incurring high medical bills without insurance, or Retirees whose employers continue health insurance into retirement can lose this coverage if the employer goes out of business or has retained the legal right to terminate coverage.

Comments, Actions Needed

Find out how much service is needed for the employer to continue health insurance after retirement. You may want to work a little longer to qualify for more benefits.

Before enrolling in Medicare, look into other options such as HMOs that may be available in the area where you intend to live after retirement.

3. Long-Term Care

Background

Long-term care (LTC) for those disabled by illness traditionally was provided by family members, but that is less common or feasible now.

Medicare does not pay for most long-term care. Failure to insure or set aside funds can lead to catastrophic costs for retirees and other family members.

For more information, see the section on Caring for Parents.

Life-Cycle Issues and Retirement Focus

People have a higher likelihood of incurring several years of long-term care as we live longer.

People shouldn't wait too long to purchase long-term care insurance: premiums rise rapidly, and older applicants may not be able to qualify for insurance due to poor health.

Financial Issues

Needs for LTC insurance vary with people's income and resources:

- Low-income people may qualify for free nursing home care under Medicaid. Medicaid may not provide the quality of care they would choose, but having it available can solve a major problem.
- Wealthy people often self-insure the risk of long-term care, paying for care out of pocket if the need should arise.
- “Middle-income” people (this term covers a wide range of resources) are the ones who may want to buy LTC insurance.

Sources of financing can include:

- Policies available through employer
- Children
- Other assets accumulated
- Wide variety of insurance products to choose from
- Cost of care varies depending on region

Risks

You may pay in amounts that will never be used if you (or other insured family member) never incur the need for long-term care.

Comments, Actions Needed

You need to inform yourself about what protection may best fit your (or, say, your parents’) needs before your family confronts disabling conditions.

- Some may not need coverage (have funds)
- Variety of policies offered today to fit individual needs; there is continual innovation
- Some policies allow for refunds if you do not incur the condition within a certain time

4. Bank Accounts and Certificates of Deposit (CDs)

Background

Banks, savings and loans, and credit unions offer a variety of deposit accounts.

With a savings account you can keep your money safe and close at hand. As with other accounts, institutions may assess various fees on savings accounts, such as minimum balance fees; and the number of withdrawals or transfers you can make each month is usually limited. Banks also sell certificates of deposit (CDs), which may be useful for retirement saving purposes as discussed in an Appendix.

U.S. Savings Bonds are bonds that are backed by the full faith and credit of the U.S. government.

Life-Cycle Issues and Retirement Focus

Savings accounts are among the most conservative investments, yielding very low rates of return.

At retirement:

- You will probably want to have your Social Security and pension distributions directly deposited into your principal checking account.
- You should periodically review the balance in your checking account, you should shift excess funds into a savings account or other investment vehicle.
- You may want to have a family member receive copies of your bank statements so they can help monitor your financial needs.

Financial Issues

Be sure to choose a bank that is financially stable, charges reasonable fees, and offers the services you need.

U.S. savings bonds are registered, noncallable, and nontransferable securities. They cannot be used as loan collateral. Series EE bonds are sold in face amounts of \$25 to \$10,000 and are issued at a discount, so they pay all interest at maturity. Series HH bonds are sold in ranges from \$500 to \$10,000, pay interest every six months, and may be redeemed after only six months.

Risks

Federal deposit insurance sets apart deposit accounts from other savings choices. Only deposit accounts at federally insured depository institutions are protected by federal deposit insurance. Generally, the government protects the money you have on deposit to a limit of \$100,000.

Inflation can seriously affect your rate of return on savings accounts and investments. When the inflation rate is higher than the interest rate on your savings account, it's a sure sign that your money is losing value.

Interest rates can decline. If you are living off the interest, you may have to dip into the principal, and that will mean even less income in the future.

Comments, Actions Needed

In shopping for a savings account, it is important to look closely and compare features especially the interest rate credited and any fees, although these will change from time to time.

The longer you put off saving for retirement, the greater the amount you will need to put aside each month to accumulate the same target savings goal at retirement age. The table below illustrates the monthly amount that must be invested into an account bearing an after-tax rate of return in order to have \$100,000 at age 65.

	After-Tax Nominal Interest Rate		
Age	4%	6%	8%
25	\$84.32	\$49.96	\$28.46
35	\$143.60	\$99.06	\$66.65
45	\$271.74	\$215.35	\$168.65
55	\$676.86	\$607.17	\$542.99

G. Outline of Lifetime Decisions

This section summarizes much of the information on decision-making that is presented throughout the paper. The outline is by life-cycle stage, an approximate measure that will not exactly fit all cases. While everyone ought to be aware of financial needs and resources throughout life, married couples will find it especially important for both partners to have a clear understanding and agreement about financial issues and decisions.

Age	Education & Career	Marriage & Family	Home & Other Property	Planning for Retirement	Other Financial Issues & Decisions
In your teens & 20s	<ul style="list-style-type: none"> • Invest in education, training, internships. Education is often a key to better job options. • Consider changing employment to obtain better experience. Early job choices can define long-term options. • Job changes may be frequent early on, but begin getting on a permanent career track. Recognize the type of health and retirement benefits in the organization (or industry) where you work. • Spare-time activities can give valuable clues about areas of interest. Volunteer to provide personal growth, lasting personal contacts, and achievements or skills to put on your resume. 	<ul style="list-style-type: none"> • Understand how getting married changes your financial circumstances. • Draft legal documents to clarify ownership of assets brought into marriage. • Draft a will, especially if you have children. 	<ul style="list-style-type: none"> • If you live together without marriage, have a clear understanding about finances or keep assets and debts separate. • Start to pay off any student loans, but start saving for a home and for retirement, too. • Begin building an emergency fund of 3 to 6 months of expenses. • Open savings accounts for children. • Consider when to stop renting and start owning a home. • Establish credit history. Don't run up credit card debts. 	<ul style="list-style-type: none"> • Participate in your company's 401(k) plan as soon as you can. Contribute at least up to the employer matching amount. 	
In your 30s & 40s	<ul style="list-style-type: none"> • Continue volunteer activities to avoid burnout on the job and at home. • Invest time in networking. Outside activities broaden your interests, skills, and personal contacts. • If you decide not to work outside the home, be sure the family's financial resources will support lifetime security even if one spouse dies, gets disabled or you divorce. • Obtain additional education for career change or return to employment. • If returning to employment, temporary employment may be a good initial strategy. • Avoid frequent job changes to keep from losing non-vested pension benefits. • When you leave a job, do it on the best basis possible. When termination is involuntary, you often can get severance pay plus support in transition to a new job. 	<ul style="list-style-type: none"> • Understand how getting married changes your financial circumstances. • If you marry, understand how family assets are being managed. • If you divorce, pay attention to retirement security. • Update wills and financial documents for children and step-children. 	<ul style="list-style-type: none"> • Increase 401(k) or IRA contributions to maximum permitted. • Finish paying back student loans. • Don't run up credit card debts. • Consider trade-offs of moving into a larger home vs. other savings goals. 	<ul style="list-style-type: none"> • Develop a retirement saving strategy and long-term plan. • Estimate what you need to save for a secure future. Build up your savings program and learn how you invest. • Measure year-by-year savings progress. Keep track of how you are doing compared to your plan 	<ul style="list-style-type: none"> • Obtain life insurance, especially if you have children. • Make sure you have adequate disability protection and consider long-term care insurance.

	<ul style="list-style-type: none"> • Make sure you understand health benefits at a new job. • Pension benefits and employer matching contributions may be lost unless you stay with the employer for 5 years. 				
In your 50s	<ul style="list-style-type: none"> • Stay involved in your community and in outside activities. Keep healthy. • Keep skills up-to-date to retain employment. • Consider working as a trainer and/or mentor to younger employees. 	<ul style="list-style-type: none"> • Start saving for and becoming knowledgeable about health care options for your parents. • Understand what spousal benefits you may be entitled to. • If you marry, understand how family assets are being managed. • If you divorce, pay attention to retirement security. 	<ul style="list-style-type: none"> • Consider downsizing to a smaller home. 	<ul style="list-style-type: none"> • Consider how long you want to work until retirement and how you can afford to retire then. Avoid job changes particularly if you have a DB plan. If you change jobs, look at the benefit implications of the change. • Consider early retirement packages carefully with respect to health benefits. If your employer downsizes, investigate pros and cons of buyouts and early retirement windows. Maybe start phasing into retirement. • Continue contributing to 401(k) plan and take advantage of expanded limit for ages 50 and older. Keep saving for retirement even as you pay for your children's education. • See how your assets compare to what you need. Start to build a detailed plan for retirement – when and where. Keep records of how you are doing compared to your plan. Measure year by year savings progress. Take corrective actions immediately. • If you must borrow, a home equity loan is better than credit cards. 	<ul style="list-style-type: none"> • Start to think seriously about retirement. • Decide how you'll get health protection in retirement. • Make sure you have adequate disability protection and consider long-term care insurance.
In your 60s	<ul style="list-style-type: none"> • After "retirement," consider working full-time, part-time, or as a volunteer. 	<ul style="list-style-type: none"> • Put an estate plan in place. • For second marriages, consider a prenuptial agreement. 	<ul style="list-style-type: none"> • Consider paying off mortgage. • Decide where to live in retirement years, considering location, cost, and living environment. 	<ul style="list-style-type: none"> • Keep contributing to DC plan and take advantage of expanded limit for ages 50 and older. • Consider phasing into retirement or post-retirement employment. Be sure to have adequate retirement benefits before commencing retirement. • Check your sources of retirement income, then retire according to your plan. Cut back or cease work and apply for retirement benefits. Look at how much regular income you have and if necessary, convert some assets to income. • Consider purchasing an immediate annuity to provide steady source of income. 	<ul style="list-style-type: none"> • Make sure your health and life insurance risk protection program is in place

Appendix A

Investing for Retirement

Here is information about using different kinds of investments to accomplish your retirement savings goals:

- Stocks
- Bonds and other fixed-income investments
- Mutual funds
- Stockbrokers and investment advisors

As explained earlier, you first need to decide on a long-term asset allocation (investment mix) among stocks vs. bonds or other investments. Then you choose specific investments or funds that fit into your asset allocation. After retirement, you may want to convert some of your savings to a lifetime annuity, as discussed earlier.

1. Stocks

Background

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 have a say in how the company is run. Perhaps more important, 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 much or all their value.

Compared to other securities, stocks have more risk of loss but also more potential reward. Employers and individuals with retirement funds usually consider stocks an excellent long-term investment. But as an investor in stocks, be prepared for the inevitable ups and downs of stock prices, and diversify your stock investments widely. “Don’t put all your eggs in one basket.”

Common shares typically: (1) share in the assets of the corporation when distributions are made or upon dissolution, and (2) vote for directors and on basic corporate matters.

Preferred shares have a preference over common shares either as to dividends or on liquidation or both.

The payment of dividends on common or preferred stock is usually in the discretion of the board of directors.

Life-Cycle Issues and Retirement Focus

In the early and middle parts of your career, you can afford to take more of the risks involved in stock investments because you have more time to make up losses. But as you get older, you may want to change your investment mix, allocating less to stocks and more to fixed-income investments.

At retirement, you may want to rebalance your portfolio of investments.

- Is your investment mix diversified enough? That is, would a substantial drop in stock prices force you to change your retirement plans?
- Is your portfolio liquid enough? That is, could you sell assets to get cash quickly if you needed to?

Financial Issues

You probably will want to invest in stocks through a tax-deferred fund such as a 401(k) plan, IRA, or variable annuity, so that any investment gains will accumulate tax-free until you take money out. Alternatively, you can buy stocks with your personal after-tax savings, with each year’s dividends or capital gains subject to income tax, and with losses deductible from taxable income within certain limits.

Instead of owning individual stocks directly, you may find mutual funds are a more convenient and effective way to diversify your stock investments.

Risks

Stocks are risky investments, and unlike savings accounts, stocks are not insured by the federal government.

A given company can go bankrupt, often rendering their stock worthless. On the other hand, a diversified portfolio will tend to hold its value, even if a company or two fails.

If the economy is doing poorly, the entire stock market will usually decline, and it can take years to recover.

Comments, Actions Needed

You can reduce your investment risks by diversifying, that is by spreading your investments among a number of investment vehicles. For example, rather than holding all your savings in the stock of your employer, you'll have far less risk if you own a mix of different stocks and bonds.

2. Bonds and Other Fixed-Income Investments

Background

Bonds are long-term debt securities issued by corporations and government agencies. When you buy a bond, you are lending money to a business or a government agency, which 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. Securities guaranteed by the U.S. Treasury are considered the safest investments available, in the sense that the federal government stands behind the promise to pay principal and interest, though the market value may vary depending on current interest rates and the time remaining before maturity.

Mortgages are long-term loans that are similar to bonds as an investment.

Stable-value funds are a special kind of fixed-income investment offered by many 401(k) plans. Stable-value funds pay an attractive rate of interest on your money with little risk of loss. These funds generally own guaranteed investment contracts (GICs) issued by life insurance companies, with the interest rates varying from year to year depending on market conditions.

Short-term fixed-income securities include Treasury bills, money market funds and bank certificates of deposit (CDs). These are generally the safest and lowest-yielding types of securities.

- Treasury bills are extremely safe, with a government guarantee and a very short duration to maturity, so their market value will not vary much when interest rates change.
- Money market funds are managed by mutual fund organizations and work much like savings accounts. Neither the principal nor interest rate is guaranteed, but in practice such funds are considered safe and convenient. You may be able to write checks against your balance in a money market fund.
- 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. Be careful to avoid having CDs from any one institution that exceed that amount. And before you invest in a CD, find out if you're allowed to withdraw your money before maturity, and what penalty will apply.

Life-Cycle Issues and Retirement Focus

As you approach retirement, you may want to rebalance your portfolio of investments to include less stock and more bonds. Retirees living off money from their investments often can't wait for the stock market to recover from a serious decline. One rule of thumb is that retirees should have enough fixed-income

investments so they won't need to sell stock to meet living expenses for at least 5 years, thus giving the stock market a good chance to recover during that time.

Financial Issues

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. Because of their tax-free feature, municipals pay substantially lower returns, and are attractive only to taxpayers in higher tax brackets. You should never have tax-free municipals in an IRA because you could invest the IRA in other bonds with higher yields and the same tax treatment.

When interest rates decrease, as in recent years, mortgage loans with high interest rates may get refinanced at lower rates. This saves money for the borrower but it can be frustrating for the original lender, who has taken the risk that rates may increase, reducing the value of the loan. The same is true for bonds which are "callable," meaning that the bondholder can be told to surrender the bond for cash. When investing in bonds or mortgages, you need to find out if the borrower has the right to pay them off before maturity.

Risks

Bonds are usually not very risky when held to maturity, but unlike savings accounts, bonds are not insured by the federal government. Bonds have two or three different kinds of risk:

- "Credit risk" recognizes that a borrower may get into financial trouble and be unable to make interest payments on time. Independent credit-rating firms assign ratings to companies or others who issue bonds to show how safe they are. U.S. Treasury bonds are considered risk-free. Next-safest are investment-grade bonds issued by strong borrowers, and last are "junk" bonds issued by weak borrowers. To compensate for such risk, Treasury bonds pay the lowest returns, while junk bonds are known as "high-yield" bonds.
- "Interest rate risk" recognizes that newly issued bonds are always competing with older bonds in the marketplace. If interest rates fall, older bonds that pay higher rates become more attractive, and their prices or values go up. But if interest rates rise, older bonds that pay lower rates will have their prices and values fall. This is why investors say that bond prices move in the opposite direction from interest rates – like the two ends of a seesaw, when one goes up the other goes down.
- "Inflation risk" recognizes that as prices increase over time, interest payable in future dollars will purchase less goods and services, and thus is less valuable than today's dollars. In a time of rising inflation, interest rates will go up and the value of existing bonds will fall. Some experts think of inflation risk and interest rate risk together as one kind of risk, because inflation and interest rates usually move up or down together. In other words, when lenders expect inflation rates to be high, they charge high rates of interest on loans or bonds, but they're always risking that inflation will be higher than expected so that market interest rates go up further.

Long-term bonds maturing in about 10 to 30 years are very sensitive to all 3 kinds of risk. These bonds also have greater rewards when the issuer and the economy are prospering, that is, their interest rates are usually the highest. Short-term bonds or money market funds have very stable values, but they usually pay low returns and so are not an attractive long-term investment.

3. Mutual Funds

Background

A mutual fund is a pool of money from many investors, invested on their behalf. Mutual funds typically invest in a diversified portfolio of stocks, bonds, or both.

By purchasing shares in a mutual fund, you own a piece of the fund and, in effect, in each of its underlying securities.

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 four basic types of mutual funds: equity (also called stock), bond, balanced, and money market funds. Equity funds invest primarily in stocks. Bond funds invest in corporate and/or government bonds. Balanced funds invest in a combination of stocks, bonds, and possibly other securities. These all are considered long-term funds. Money market funds are known as short-term funds because they invest in securities that mature in about one year or less.

Within these classes of mutual funds, we have many subgroups, for example index funds vs. actively managed funds, as discussed below, growth vs. value funds, and domestic vs. overseas funds.

Life-Cycle Issues and Retirement Focus

As you get older, you may want your investment mix to become less aggressive and risky, investing less in stocks and more in bonds. Some mutual funds now have a “life cycle” feature, intended for investors who expect to retire in a certain time period and want the fund manager to make the asset mix more conservative as they near retirement.

Financial Issues

An “actively managed” fund invests in stocks or bonds that are selected by the experts who work for that fund, and charges a small annual fee. 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. The underlying theory of index funds is along the lines of “You get what you pay for.” That is, the stocks of strong companies don’t usually have bargain prices, and the stocks of weak companies usually do. Opinions differ about whether actively managed funds are worth their additional fees. Not many actively managed funds have consistently outperformed index funds after figuring in their expense charges.

The level of expense charges (or management fees) that the fund managers deduct from your fund value is important. This is a cost you pay year-in and year-out, potentially holding down your investment performance, so you want to get your money’s worth. Sales expenses by some funds (front-end loads, back-end charges, or other fees) are another potential drag on performance that may or may not be justified by better performance. Another cost item is brokerage fees, which can vary greatly depending on how rapidly your fund buys and sells securities instead of holding on for the longer run. Because of their larger size, mutual funds pay lower brokerage fees for a given transaction than an individual would pay. This is an advantage of using mutual funds compared to trading on your own.

Risks

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.

Unlike savings accounts and certificates of deposit, mutual funds are not insured by the federal government.

Comments, Actions Needed

Mutual funds offer diversification, professional management, regulatory oversight, liquidity, convenience, and low costs.

Mutual funds also have their drawbacks. There is no guarantee that your fund will go up in value, and you must pay fees and sometimes commissions.

How do you choose one or more funds from the thousands that are available? There’s no easy answer, but here are a few ideas.

- Decide whether to use mainly index funds instead of managed funds with higher expense charges.

- Based on your desired asset allocation, look for a few index funds or managed funds whose investment objectives fit into your desired investment mix. Information on mutual funds is available on the internet and at the library.
- In choosing a fund, don't just take one with the most stars for its recent performance. Market conditions are constantly changing, and good or bad luck sometimes plays a large part. Past performance is a very unreliable guide to future performance. Look for a reasonable track record (average or better), good management, low expense charges, and good customer service.
- You may want to own funds that all are managed by the same organization. Advantages are that you get statements showing how your assets are allocated and how all your funds are doing, you can easily move money between funds, and you may get better service as a more valuable customer.
- One or two funds in each asset category will give you ample diversification. Owning many funds with overlapping objectives is just confusing, and may increase the total expense charges against your funds.

4. Stockbrokers and Investment Advisors

Background

Choosing a financial adviser can be complicated, simply because advisers vary widely. Some financial planners and investment advisers offer a complete financial plan, assessing every aspect of your financial life and developing a detailed strategy for meeting your financial goals. They may charge you a fixed fee or a percentage of your assets that they manage, or they may get commissions when you buy products or securities, or they may get fees that are offset by any commissions.

Brokers make recommendations about specific investments such as stocks, bonds, or mutual funds. While taking into account your overall financial goals, most brokers will not give you a detailed financial plan. Brokers are generally paid commissions when you buy or sell securities through them.

Life-Cycle Issues and Retirement Focus

At retirement, you may want to involve your children and other family members in your investments and introduce them to your investment advisors.

Financial Issues

In order to buy and sell stocks and bonds, you will usually have to pay brokerage fees. These are just a necessary part of acquiring and selling investments.

Fees for investment advice or for management of your investments are extra fees, which will reduce your investment income from the underlying assets.

Risks

Hidden fees are always a risk, and may lead to advice that isn't in your best interests. You may also receive bad investment advice from someone who is sincerely trying to help you. And there is some risk that an investment advisor may embezzle your funds or otherwise defraud you.

Some of the worst cases of fraud involve advisors who seemed very knowledgeable and trustworthy. No matter how much you personally like an advisor, 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. You also need a written agreement with your advisor about your investment objectives and how you want to achieve them.

Comments, Actions Needed

A key to choosing an adviser or broker 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 investment professional gets paid. If your employer brings in an outside firm to provide investment education, you have

less reason to worry about excessive fees or poor advice. But in all cases, you need to understand the reasons behind any advice before you follow it. Investments are not too complicated to explain, and you deserve clear answers to any questions or concerns.

Make sure you get frequent statements about your investment transactions, fees incurred, and asset allocation. Read the statements carefully and don't be afraid to ask questions.

Appendix B

Four Ways to Save for Retirement

This table briefly compares four ways a worker can save for retirement, supplementing or substituting for a traditional pension plan, based on the January 2003 tax rules. The numerical examples show that using an IRA or 401(k) plan will increase the amount of spendable money for retirement.

	Bank account or mutual fund	Roth IRA	Traditional IRA	401(k) with 50% employer match
Income tax treatment	<ul style="list-style-type: none"> You contribute after-tax money. You pay income tax each year on the investment earnings. No tax on money you take out. 	<ul style="list-style-type: none"> You contribute after-tax money. IRS rules limit the amount that may be contributed to an individual's account in a given year. No tax on investment earnings. No tax on money you take out. 	<ul style="list-style-type: none"> Contributions are deductible from taxable income. IRS rules limit the amount that may be contributed to an individual's account in a given year. No tax on investment earnings. Money you take out is fully taxable. 	
Penalties for early or late withdrawal	<ul style="list-style-type: none"> None 	<ul style="list-style-type: none"> 10% penalty for early withdrawal of earnings during the Roth IRA's first 5 years or before age 59 ½ with certain exceptions. No limit on withdrawals after the IRA's first 5 years if you are over age 59 ½ 	<ul style="list-style-type: none"> 10% penalty for early withdrawal before age 59 ½ with certain exceptions. 50% penalty for not taking minimum required withdrawals each year at age 70 ½ and over (this rule does not apply to a 401(k) plan where the employee is still working after age 70 ½). 	
Example based on contributing from \$3,000 of gross annual pay¹	<ul style="list-style-type: none"> Anne pays \$600 tax and contributes \$2,400 a year By age 65 her account has grown to \$186,805 Her spendable money is \$186,805 	<ul style="list-style-type: none"> Bob pays \$600 tax and contributes \$2,400 a year By age 65 his account has grown to \$242,575 His spendable money is \$242,575 	<ul style="list-style-type: none"> Carol contributes \$3,000 a year from before-tax income By age 65 her account has grown to \$303,219 After taxes, her spendable money is \$242,575 	<ul style="list-style-type: none"> Dave contributes \$3,000 a year from before-tax income, and employer makes \$1,500 matching contribution By age 65 his account has grown to \$454,829 After taxes, his spendable money is \$363,863
Advantages	<ul style="list-style-type: none"> No limit on how much you can put in or take out in any year. No tax on money you take out. 	<ul style="list-style-type: none"> Annual investment growth is not taxed, so fund grows more rapidly No tax on money you take out. After age 70 ½, you can leave all money in and contribute more 	<ul style="list-style-type: none"> Front-end tax deduction Annual investment growth is not taxed, so fund grows more rapidly 	<ul style="list-style-type: none"> Front-end tax deduction Annual investment growth is not taxed, so fund grows more rapidly "Free money" may be available from employer match
Disadvantages	<ul style="list-style-type: none"> No tax advantages to provide more spendable money for retirement. 	<ul style="list-style-type: none"> No front-end tax deduction Penalties for taking any money out before age 59 ½ or during the first 5 years, with certain exceptions 	<ul style="list-style-type: none"> Money you take out is fully taxable Penalties for taking any money out before age 59 ½, or for not taking some out after age 70 ½, with certain exceptions. 	<ul style="list-style-type: none"> Money you take out is fully taxable Penalties for taking any money out before age 59 ½, or for not taking some out after age 70 ½, with certain exceptions

¹ Each numerical example assumes that the individual uses \$3,000 of gross annual pay as a source of retirement savings, and pays tax either before or after contributing, depending on the Tax Code treatment. Individuals are 35 years old, retiring in 30 years, and in a 20% tax bracket (federal + state) both before and after retirement. The savings fund earns 7% a year before taxes.

Appendix C

Social Security Benefits

The Social Security program is the same for men and women. But in practice, women often face different situations than men do throughout their lives, and may depend more on Social Security:

- Working women, on average, earn less than men.
- Women usually are the primary caregivers, taking time out of careers to care for children or parents.
- More women than men stay out of the work force and rely heavily on Social Security spouse’s benefits.
- Women are much more likely than men to outlive their spouses.

www.ssa.gov/women is the Social Security Administration’s online web site for women. It’s a good source of Social Security information for women at different stages in their lives – as workers, caregivers, mothers, married or divorced spouses, retirees, or widows. The web site has links to details of Social Security features that apply to all workers, and features of special interest to women because of their employment patterns and family situations. Highlights of these features are outlined briefly below.

Provision	Basic Rules	Comments
Worker’s retirement benefit	<p>The amount paid is based on a worker’s 35 years of highest earnings, indexed for wage inflation.</p> <ul style="list-style-type: none"> • The amount is reduced if payments begin before the full retirement age. • The individual must have worked at least 10 years under Social Security. 	<p>Here is the approximate benefit paid to career workers who retire at the full retirement age, as a percentage of their pay just before retirement:</p> <ul style="list-style-type: none"> • “Low” earners – 56% • “Medium” earners – 42% • “Higher” earners – 34% • “Maximum” earners – 27%
Full retirement age	<ul style="list-style-type: none"> • The full retirement age is 65 for workers who were born before 1938. • For workers born in 1938 and after, this age gradually rises, reaching 66 for those born in 1943-1954, and 67 for workers born after 1959. 	<p>Benefits for future retirees can begin as early as age 62 the same as today. But they’ll have to retire a little later to get comparable benefits because the amount payable at any retirement age will gradually decrease as a percent of pay.</p>
Cost-of living increases	<p>After someone becomes eligible for benefits, the monthly payments go up each year in proportion to the Consumer Price Index.</p>	<p>This feature is very important, maintaining the value of Social Security benefit payments regardless of inflation.</p>
Children	<p>Benefits are paid to children of retired, disabled, or deceased workers until they are 18.</p>	<p>Children’s benefits continue to age 19 if they’re unmarried and attending high school.</p>
Surviving spouses	<p>Widows or widowers with children under age 16 can get benefits at any age. Widows or widowers without children can get benefits as early as age 60 (age 50 if disabled).</p>	<p>Widows’ or widowers’ benefits can be reduced or eliminated when they’re working in paid employment. When the spouse’s benefit as a retired worker is more, the greater benefit amount is paid.</p>
Spouses of retired workers	<p>Benefits are paid to spouses as early as age 62. The amount is one-half of the worker’s benefit if both are at the full retirement age, and is less if payable earlier.</p>	<p>When the spouse’s benefit as a retired worker is more, the greater benefit amount is paid.</p>
Former spouses	<p>Spouse’s benefits are paid as early as age 62 to a former spouse who was married to the worker for 10 years and has not remarried.</p>	<p>When the spouse’s benefit as a retired worker is more, the greater benefit amount is paid.</p>
Remarriage	<p>Benefit payments to a spouse usually end if--</p> <ul style="list-style-type: none"> • A surviving spouse remarries before age 60. • A former spouse remarries at any age 	
Disability benefits	<p>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.</p>	<p>Women who are out of the labor force more than 5 of the last 10 years won’t pass the recency-of-work test needed to get disability benefits.</p>
Benefit reductions for some non-covered workers	<p>Social Security benefits may be reduced for individuals with pensions from federal, state or local government who were not covered under Social Security while they were working.</p>	<ul style="list-style-type: none"> • The “windfall” rule may reduce a retired worker’s benefit by as much as one-half of the worker’s pension from noncovered employment. • The “government pension offset” rule reduces a spouse’s benefit by two-thirds of that person’s pension from noncovered employment.

Appendix D

Other References and Resources

Books about careers and employment:

Human Resource Management, Gaining a Competitive Advantage, Third Edition, 2000, by Raymond A. Noe, John R. Hollenbeck, Barry Gerhart, and Patrick M. Wright, published by Irwin, McGraw-Hill. Of particular interest are Chapter 6, *Selection and Placement*, Chapter 7, *Training*, Chapter 9, *Employee Development*, Chapter 10, *Employee Separation and Retention*, and Chapter 13, *Employee Benefits*.

Managing Human Resources, Second Edition, 1998, by Luis R. Gomez-Mejia, David B. Balkin, and Robert L. Cardy, published by Prentice Hall. Of particular interest are Chapter 5, *Recruiting, Selecting and Socializing Employees*, Chapter 6, *Managing Employee Separations, Downsizing and Outplacement*, Chapter 8, *Training the Work Force*, Chapter 9, *Developing Careers*, and Chapter 12, *Designing and Administering Benefits*.

Human Resources and Personnel Management, Fifth Edition, 1996, by William B. Werther, Jr. and Keith Davis, published by McGraw-Hill, Inc. Of particular interest are Chapter 7, *Recruitment*, Chapter 8, *Selection*, Chapter 9, *Orientation, Placement and Separation*, Chapter 11, *Training and Development*, Chapter 12, *Career Planning*, and Chapter 15, *Benefits and Services*.

Human Resources Management, Seventh Edition, 1994, by George T. Milkovich and John W. Boudreau, published by Richard D. Irwin, Inc. Of particular interest are Chapter 9, *External Employment Selection*, Chapter 10, *Employee Separations, Work Force Reduction and Retention*, Chapter 11, *Internal Staffing and Careers*, Chapter 12, *Training*, and Chapter 15, *Benefits*.

Books for consumers about money or retirement:

“Creating Retirement Income (2nd Edition)” by Virginia B. Morris in collaboration with NAVA (2002, Lightbulb Press)

“The Retirement Catch-Up Guide: 54 Real-Life Lessons to Boost Future Resources Now!” by Ellen Hoffman (2000, 2002, New York: Newmarket Press)

“The Savage Truth on Money” by Terry Savage (1999, John Wiley and Sons)

“Making the Most of Your Money (2nd Edition)” by Jane Bryant Quinn (1991, 1997, Simon & Schuster)

Reverse mortgages:

AARP (Washington DC) has an informative booklet “Home Made Money: A Consumer’s Guide to Reverse Mortgages.”

Other independent or governmental sources with websites and printed material on reverse mortgages:

- National Center for Home Equity Conversion (Apple Valley MN)
- Federal Trade Commission (Washington DC)
- Fannie Mae (Washington DC)

Banks and bank accounts:

Federal Reserve Board - www.pueblo.gsa.gov/cic_text/money/sense/sense

Retirement savings information:

Federal government:

- Employee Benefits Security Administration (formerly called the Pension and Welfare Benefits Administration), U.S. Department of Labor, 202-219-8776 - www.dol.gov/ebsa
- Savings Bond Operations Office, U.S. Department of the Treasury, 1-800-4US-BOND - www.savingsbonds.gov
- Securities and Exchange Commission: www.sec.gov/investor/pubs/inws (“Invest Wisely: Advice From Your Securities Industry Regulators”)

Independent organizations:

- AARP 202-434-3525 - www.aarp.org
(Formerly known as American Association of Retired Persons.)
- American Savings Education Council, 202-775-6364 - www.asec.org
- Employee Benefit Research Institute, 202-659-0670 - www.ebri.org
- Investment Company Institute, 202-326-5800 - www.ici.org
- Securities Industry Association, 202-296-9410 - www.sia.com

Retirement savings calculators:

- www.choosetosave.org/tools/fincalcs
- www.quicken.com/retirement
- www.investorguide.com/retirecalculators.html

Appendix E

Glossary of Financial Terms

401(k) plan – A type of retirement savings plan, used by private firms or non-profit employers. Also known as a cash-or-deferred arrangement.

403(b) plan – A type of retirement savings plan, used mainly by non-profit employers. Also known as a tax-deferred annuity.

457 plan – A type of retirement savings plan, used mainly by governmental employers. Also known as an eligible deferred compensation plan.

accumulation – The value of an individual's savings in an investment fund or deferred annuity until withdrawals or income payments begin.

Activities of Daily Living (ADLs) - Activities of Daily Living are terms used in long-term care insurance policies or programs to specify someone's ability to function independently. ADLs usually include eating, dressing, bathing, transferring in & out of bed, and using the toilet, though some definitions are more liberal than others. LTC insurance policies often base eligibility for benefits on inability to perform 2 or 3 ADLs.

adjustable -rate mortgage – A mortgage whose interest rate changes periodically based on the upward or downward movement of a specified benchmark, e.g., six-month or one-year Treasury bills.

after-tax – Describes funds on which an employee has already paid all income taxes, for example, amounts held outside a 401(k) plan or traditional IRA, or within a Roth IRA. Taxes on benefits derived from these funds, plus investment earnings in a Roth IRA, are not payable when they are received. See basis. Also known as post-tax.

amortization – The process of reducing a debt through installment payments of principal and interest.

annuitant – The named individual who is entitled to receive annuity payments for life under a life annuity.

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.

annuity certain – An annuity that is payable for a stated period of time, regardless of whether an individual lives or dies.

annuity form or option – A choice of payment methods available to an individual getting a pension or annuity.

annuity rate – The single-sum price that an insurance company or pension plan charges for an annuity contract or option of a standard amount such as \$1 per month. Annuity rates usually vary by age, and by sex if the annuity is outside a private pension plan, and are in addition to fixed expense charges. Also known as annuity purchase rate. See unisex annuity rate.

asset (and asset allocation) – Anything of value that you own that adds to your net worth; asset allocation refers to managing your finances by choosing or rejecting investments based on a specified strategy, such as aggressive growth, current income, minimizing taxes, etc.

back-end load – A sales charge or commission for an investment paid by the buyer at the time of sale.

balanced fund – A fund that invests in both stocks and bonds with the goal of reducing risk by investing in different markets

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

bear market – A period of declining prices in a financial market.

before-tax – Describes funds on which the employee has not yet paid income taxes, for example, amounts held in a qualified plan or traditional IRA. Taxes have been deferred, not waived, and are normally due when funds are paid out from the qualified plan or IRA. Also known as pre-tax.

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

bequest – Personal property left to another by the individual's will.

bond – A formal certificate of debt, issued by corporations or units of government.

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

bull market – A period of rising prices in a financial market.

capital appreciation – The rise in the value of an investment's principal.

cash refund annuity – A type of refund annuity under which the refund is paid in a lump sum. See refund annuity and installment refund annuity

cash withdrawal – The act of withdrawing some or all of an accumulation from an insurance contract or a deferred annuity.

certificate of deposit (CD) – A short-term debt security, which can have a maturity period of anything from a few weeks to several years; interest rates are established by market conditions and competitive environment.

commission – A fee charged for executing an investment transaction, such as buying or selling securities.

common stock – A share of ownership in a corporation; stockholders participate in the profits or losses of a company through dividends and changes in the stock's market price.

community property – In certain states, the property that a married couple has acquired over the course of their marriage; in the event of a divorce, the property would be equally divided between them.

compound interest – Interest that is credited on both principal and previously credited interest.

consumer price index (CPI) – A commonly used measure of the increase (or decrease) in costs of goods and services, published by the U.S. Bureau of Labor Statistics.

contract – A legally binding agreement between two or more parties.

cost-of-living adjustment (COLA) – An increase in a pension or annuity benefit to compensate for an increase in the cost of living.

coupon rate – The annual interest rate that an issuer promises to pay periodically over the life of a bond or other debt security, expressed as a percentage of the security's face value.

death benefit – The amount payable to a beneficiary at the death of the annuitant or insured (sometimes referred to as the survivor benefit).

deferred annuity – An annuity under which benefit payments do not begin when the annuity is purchased. In a typical deferred annuity, the individual accumulates money on a tax-deferred basis until retirement, then converts the accumulated value into income payments or withdraws it in a lump sum.

defined benefit plan – An employer pension plan with benefits based on formulas that recognize the individual's years of service and other factors such as pay.

defined contribution plan – An employer pension plan with benefits that equal the amounts contributed to employees' individual accounts plus actual investment earnings, plus forfeitures in some cases.

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

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

dividend – The amount distributed to stockholders from a company's net profit.

dollar-cost averaging – Systematically investing the same amount of money in the same stock or group of stocks.

early distribution – Payment of benefits from a qualified plan or IRA to an individual who has not reached age 59 ½, except as permitted by IRS rules, resulting in an excise tax.

equity – Ownership of stocks or real estate.

ERISA – The Employee Retirement Income Security Act of 1974, as amended. This federal law provides for regulation of private pension and employee benefit plans by the Department of Labor and Pension Benefit Guaranty Corporation. The IRS also regulates such plans under provisions of the Internal Revenue Code.

face value (of a bond) – The value that appears on the face of a bond that indicates the bond's value at its maturity date.

Federal Deposit Insurance Corporation (FDIC) – The federal corporation that insures bank deposits up to \$100,000 per Social Security number; not all banks participate.

fixed annuity – An annuity under which the insurer guarantees to pay at least a specified monthly benefit amount for each dollar applied to purchase the annuity. Also called fixed benefit annuity.

forfeiture – The non-vested part of a participant's account balance in a defined contribution plan which he or she loses upon termination of employment before attaining full vesting. Under IRS rules, some defined contribution plans credit forfeitures to the accounts of all other participants.

front-end load – A sales charge or commission paid for an investment at the time of purchase.

growth fund (or growth stocks) – A fund that invests in stocks with prices that are above average in relation to their current earnings because they are considered to have above-average growth prospects.

guaranty association – An organization that protects persons from losses suffered through the insolvency of an insurance company.

immediate annuity – An annuity under which income payments begin when the annuity is purchased.

impairment – Any aspect of the health, occupation, activities, or life-style of an individual that could increase his or her risk of dying or requiring medical care

income stock – A stock that pays regular and steady income, typically of well-established companies, such as utilities and others whose businesses generate steady cash flows.

income replacement ratio – The percentage of pre-retirement income that a retiree would need to receive after retirement in order to have a post-retirement standard of living equivalent to his or her pre-retirement standard of living. This ratio is generally less than 100 percent because some expenses (i.e., taxes, commuting costs, clothing expenditures, savings needs) decrease after retirement. Also known as a replacement ratio or rate.

indexing – Automatic adjustment of benefits to compensate for the effects of inflation after payments begin, generally in accordance with increases in the level of a price index such as the Consumer Price Index (CPI).

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.

inflation-indexed Treasury bond – A U.S. government security that increases the payments of interest and principal in proportion to the Consumer Price Index (CPI).

installment refund annuity – A type of refund annuity under which the refund is payable in a series of periodic payments. See refund annuity and cash refund annuity.

joint annuitant – The annuitant's spouse or other individual named to receive survivor annuity payments after the death of the annuitant.

joint and survivor annuity – An annuity that provides a series of payments to two or more individuals as long as one of them survives.

liability – Amounts owed by an individual or other entity.

life annuity – A series of payments that are made at regular intervals as long as a named individual, the annuitant, is then alive. Also known as a straight life annuity.

life annuity with period certain – A life annuity which promises that if the annuitant dies before the end of a designated period (usually 5, 10, or 20 years), the insurer will continue payments until the end of the designated period. Also called a life income with period certain annuity.

life expectancy – The average remaining years of lifetime for a group of people based on a specified mortality table or experience study.

life income with refund annuity — An annuity that pays benefits throughout the annuitant's lifetime and guarantees that total benefit payments will at least equal the purchase price of the annuity.

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 constant care in their own home or in a nursing home.

lump-sum distribution – A single-sum payment to a participant retiring or terminating employment in a pension or employee benefit plan.

maturity date – The date on which a bond, mortgage, loan, or other debt security is due to be repaid

Medicaid – A joint federal-state health insurance program that is run by the states, with eligibility limited to low-income or disabled people.

Medicare – A federally sponsored health insurance program of hospital insurance (Part A) and supplementary medical insurance (Part B), primarily for individuals aged 65 and older.

Medicare supplement (Medigap) insurance – Medical expense coverage that pays for certain expenses not covered under Medicare.

mortality charge – The cost of the insurance protection element of a variable annuity contract.

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.

net worth – Assets possessed by an individual or company in excess of liabilities.

no-load funds – Mutual funds that do not charge any sales load.

Pension Benefit Guaranty Corporation (PBGC) – The U.S. government agency that insures benefits in defined benefit pension plans.

pension plan – A plan set up by one or more employers to pay retirement benefits to employees. See defined benefit plan, defined contribution plan.

period certain – The stated period for which the insurer guarantees to make benefit payments under an annuity contract.

portfolio – A diversified pool of investments typically comprising stocks, bonds, or money-market instruments.

pre-existing condition – A physical or mental condition that was known to exist before a health insurance policy was issued; many policies specifically exclude certain pre-existing conditions from coverage.

premium – The fee paid to an insurance company in exchange for protection against a specified risk (for an insurance policy); the amount by which the sale price of a bond exceeds its face value.

qualified joint and survivor annuity – A form of annuity which provides for pension benefits from a qualified plan to continue to the spouse after a retired participant's death. The spouse's benefits are payable for life unless the participant (with consent of the spouse) has elected to forego it, and must be between 50 and 100 percent of the original benefits.

qualified plan – A pension plan or employee-benefit plan which meets a series of IRS requirements and is therefore eligible for income tax deferral.

qualified savings plan – A defined contribution plan with certain tax advantages offered by an employer or other plan sponsor to let employees invest for retirement or other needs. Many savings plans feature employer matching of employee contributions, with plan participation voluntary. Also known as a thrift savings plan, 401(k) plan, 403(b) plan, 457 plan, cash-or-deferred arrangement, tax-deferred annuity plan, or tax-sheltered annuity plan.

real estate – Property such as unimproved land, a home with surrounding property, or other larger investments in property.

real estate investment trust (REIT) – A pool of real properties marketed to individual investors, similar to a closed-end mutual fund.

refund annuity – A life annuity contract that guarantees total benefit payments will at least equal the purchase price of the annuity. See also cash refund annuity and installment refund annuity.

required minimum distribution – An amount that must be paid annually from a qualified plan or IRA to an individual who has reached age 70 ½ to comply with IRS rules.

reverse mortgage – A contract with a financial institution that allows a homeowner to get retirement income by borrowing against the equity in the home, with no repayment needed while the individual lives in the home.

risk – The possibility that an investment will lose or not gain value; also refers to a peril covered by an insurance contract.

rollover – The tax-free transfer of an account balance between an individual retirement account and a qualified retirement plan or another individual retirement account.

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.

sales charge – A transaction fee or commission paid for the purchase of an investment, such as a mutual fund.

securities – Investment instruments such as stocks or bonds issued by corporations, governmental units, or other entities that offer investors ownership shares or creditor relationships.

Social Security – A U.S. government program that provides retirement, survivors, and disability income benefits for eligible workers and their families. Formally known as Federal Old-Age and Survivors Insurance and Disability Insurance or OASDI.

surrender value – The amount that an insurance policyholder is entitled to receive when he or she discontinues coverage.

survivor benefits – Income payable to a beneficiary or beneficiaries from an annuity or insurance policy when the policyholder and/or insured dies; Social Security income payable to the family of a deceased worker.

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

term insurance – Life insurance that provides protection for a specific period of time and does not accrue any cash value; term insurance is the least expensive and simplest form of life insurance.

Treasury bills, notes, and bonds – Federal government-backed debt securities; bills range in maturity from 3 months to one year; notes mature in one to 10 years; bonds mature in 10 to 30 years.

underwriting – The process whereby insurers identify and quantify the amount of risk posed by an applicant for an insurance policy; the process whereby investment bankers arrange to distribute newly issued securities to the public.

unisex annuity rate – An annuity rate that is the same for men and women, as required by federal law governing benefits under public and private employee benefit plans. On the average, women tend to live longer than men and thus pay more than men for an annuity issued outside such a plan.

U.S. Savings Bonds –Registered, nontransferable securities issued by the U.S. government in amounts up to \$10,000.

value fund (or value stocks) – A fund that invests in stocks with prices that are below average in relation to their current earnings because they are considered to have below-average growth prospects.

variable annuity – An annuity under which monthly payments vary depending upon the value of the underlying investments, usually common stocks.

vesting – The right of an employee, earned over a specified period of time, to receive some retirement benefit, whether or not he or she remains with the employer.

whole life insurance – Individual life insurance protection which pays benefits to a beneficiary or beneficiaries when the insured dies; a savings amount, called the cash value, builds over time and can be used to accumulate wealth (and is available for loans).

will – A legal document whereby an individual declares his or her wishes regarding the disposal of personal property after death; may be changed by the individual at any time before death.