WAEPA GUIDE

Saving for Retirement

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Saving for Retirement

Buying Your Retirement

Most of us know it's smart to save money for those big-ticket items we really want to buy – a new car, new home, or even a family vacation. You may not realize it yet, but the most expensive thing you will ever buy in your lifetime – is your retirement.

You might have never thought of it as "buying" your retirement. But that's exactly what you do when you put money into a retirement nest egg. You are paying today for the cost of your retirement tomorrow.

The cost of these future years is getting more expensive for most Americans, for two reasons. Firstly, we live longer after we retire – with many of us spending 15, 25, even 30 years in retirement. And secondly, we are much more active in our later years than previous generations.

In short, paying for the retirement you truly desire is ultimately *your* responsibility – and you must take charge.

That may sound like an impossible task – so many of us live paycheck to paycheck, barely making ends meet. You may have more pressing financial needs and goals than "buying" something so far in the future. Or you have waited until close to retirement before starting to save. But there's still time to buy the kind of retirement you want.

Steps Towards a More Secure Future

You may wonder how you can achieve your retirement dream when so many other financial issues have priority. Besides trying to pay for daily living expenses, you may need to buy a car, pay off debts, save for your children's education, take a vacation, or buy a home. You may have aging parents to support. You may be going through a major event in your life such as starting a new job, getting married or divorced, raising children, or coping with a death in the family.

Where to begin? You simply need to start by writing down what you need to do to accomplish each goal: When do you want to accomplish it, what will it cost (we'll tell you more about that later), what money have you set aside already, and what you are willing to do to reach the goal.

Look again at the order of priority. How hard are you willing to work and save to achieve a particular goal? Would you work extra hours, for example? How realistic is a goal when compared with other goals? Reorganize other priorities if necessary. Put those goals that are unrealistic into your wish list. Maybe you can turn them into reality too.

Beginning Your Savings Fitness Plan

Now look at your current financial resources. This is important because your financial resources affect your ability to reach your goals and protect them from potential financial crises. These are also the resources you will draw on to meet various life events.

Calculate Your Net Worth

This is not as difficult as it might sound. Your net worth is simply the total value of what you own (assets) minus what you owe (liabilities). It is a snapshot of your financial health.

First, add up the approximate value of all your assets. This includes your home (if you own one) and checking and savings accounts. Include the current value of investments, such as stocks, real estate, certificates of deposit, retirement accounts, IRAs, and any other retirement benefits you have.

Now add up your liabilities: the remaining mortgage on your home, credit card debt, auto loans, student loans, income taxes due, taxes due on the profits of your investments, if you cashed them in, and any other outstanding bills.

Subtract your liabilities from your assets. Do you have more assets than liabilities? Or the other way around?

Your aim is to create a positive net worth, and you want it to grow each year. Your net worth is part of what you will draw on to pay for financial goals and your retirement. A strong net worth also will help you through financial crises.

Recalculate your net worth once a year. It's a way to monitor your financial health.

Identify Other Financial Resources

You may have other financial resources that aren't included in your net worth but that can help you through tough times. These include the death benefits of your life insurance policies, Social Security survivor's benefits, health care coverage, disability insurance, liability insurance, and auto and home insurance. Although you may have to pay for some of these resources, they offer financial protection in case of illness, accidents, or other catastrophes.

Envision Your Retirement

Retirement is a state of mind as well as a financial issue. You are not so much retiring from work as you are moving into another stage of your life. Some people call retirement a "new career."

What do you want to do in that stage? Travel? Relax? Move to a retirement community or to be near grandchildren? Pursue a favorite hobby? Go fishing or join a country club? Work part time or do volunteer work? Go back to school? What is the outlook for your health? Do you expect your family to take care of you if you are unable to care for yourself? Do you want to enter this stage of your life earlier than normal retirement age or later?

The answers to these questions are crucial when determining how much money you will need for the retirement you desire – and how much you'll need to save between now and then. Let's say you plan to retire early, with no plans to work even part time. You'll need to build a larger nest egg than if you retire later because you'll have to depend on it far longer.

Planning for Retirement While Still Young

Retirement seems vague and far off at this stage of your life. Yet there are some crucial reasons to start preparing now for retirement. You will have to pay more for your own retirement than earlier generations. The sooner you get started, the better.

You have one huge ally – time.

You can start small and grow. Even setting aside a small portion of your paycheck each month will pay off in big dollars later. Company retirement plans are the easiest way to save. If you're not already in your employer's plan, sign up.

You can afford to invest more aggressively. You have years to overcome the inevitable ups and downs of the stock market.

Developing the habit of saving for retirement is easier when you are young.

Estimate How Much Money You Need to Save

Now that you have a clearer picture of your retirement goal, it is time to estimate how large your retirement nest egg will need to be and how much you need to save each month to buy that goal.

Most people never take this step, yet it is exceedingly difficult to save for retirement if you do not at least have an idea of how much you need to save every month.

There are numerous worksheets and software programs that can help you calculate how much you'll need to save.

Here are some of the basic questions and assumptions to keep in mind:

How much retirement income will I need?

An easy rule of thumb is that you'll need to replace about 80 percent of your pre-retirement income. If you are making $50,000 a year (before taxes), you might need about $40,000 a year in retirement income to enjoy the same standard of living you had before retirement. Think of this as your annual "cost" of retirement.

However, no rule of thumb fits everyone. Expenses typically decline for retirees: taxes are smaller (though not always) and work-related costs usually disappear. But overall expenses may not decline much if you still have a home and other debts to pay off. Large medical bills may keep your retirement costs high. Much will depend on the kind of retirement you want to enjoy. Someone who plans to live a quiet, modest retirement in a low-cost part of the country will need a lot less money than someone who plans to be active, take expensive vacations, and live in an expensive region.

For younger people in the early stages of their working life, estimating income needs that may be 30 to 40 years in the future is difficult. Every year or two, review your retirement plan and adjust your retirement savings estimate as your annual earnings increase, and your vision of retirement begins to come into focus.

How long will I live in retirement?

Based on current estimates, a male retiring at age 65 today can expect to live approximately 19 years in retirement. A female retiring today at age 65 can expect to live approximately 21 years.

These are average figures and how long you can expect to live will depend on factors such as

Estimate How Much Money You Need to Save *(continued)*

your general health and family history. But using today's average or past history may not give you a complete picture. People are living longer today than they did in the past, and virtually all expert opinions expect the trend toward living longer to continue.

What other sources of income will I have?

You can get your Social Security statement and an estimate of your retirement benefits on the Social Security Administration's website.

Will you have other sources of income?

For instance, will you receive retirement benefits that provide a specific amount of retirement income each month? Is the benefit adjusted for inflation?

What savings do I already have for retirement?

You'll need to build a nest egg sufficient to make up the gap between the total amount of income you will need each year and the amount provided annually by Social Security and any retirement income. This nest egg will come from your retirement plan accounts at work, IRAs, annuities, and personal savings. What adjustments must be made for inflation? The cost of retirement will likely go up every year due to inflation – that is, $40,000 won't buy as much in year five of your retirement as it will the first year because the cost of living usually rises. Although Social Security benefits are adjusted for inflation, any other estimates of how much income you need each year – and how much you'll need to save to provide that income – must be adjusted for inflation.

What will my investments return?

Any calculation must consider what annual rate of return you expect to earn on the savings you've accumulated, and on the savings you intend to make in the future. You also need to determine the rate of return on your savings after you retire. These rates of return will depend in part on whether the money is inside or outside a tax-deferred account.

It's important to choose realistic annual returns when making your estimates. Most financial planners recommend that you stick with the historical rates of return based on the types of investments you choose or even those that are slightly lower.

How many years do I have left until I retire?

The more years you have, the less you'll have to save each month to reach your goal.

How much should I save each month?

Once you determine the number of years until you retire and the size of the nest egg you need to "buy" to provide the income not provided by other sources, you can estimate how much you need to save.

It's a good idea to revisit this worksheet at least every year or two. Your vision of retirement, your earnings, and your financial circumstances may change. You'll also want to check periodically to be sure you are achieving your objectives along the way.

How to Prepare When There's Little Time Left

What if retirement is just around the corner and you haven't saved enough? Here are some tips. Some are painful, but they will help you toward your goal.

- **It's never too late to start.** It's only too late if you don't start at all.
- **Sock it away.** Pump everything you can into your tax-sheltered retirement plans and personal savings. Try to put away at least 20 percent of your income.
- **Reduce expenses.** Funnel the savings into your nest egg.
- **Take a second job** or work extra hours.
- **Make sure your investments are part of the solution,** not part of the problem. To boost your returns, diversify your holdings and keep an eye on fees. But don't take risks you can't afford and refrain from trading too much.
- **Retire later.** You may not need to work full time beyond your planned retirement age. Part time may be enough.
- **Refine your goal.** You may have to live a less expensive lifestyle in retirement.
- **Delay taking Social Security.** Benefits will be higher when you start taking them.
- **Make use of your home.** Rent out a room or move to a less expensive home and save the profits.
- **Sell assets that are not producing much income or growth,** such as undeveloped land or a vacation home, and invest in income-producing assets.

"Spend" for Your Retirement

Now comes the tough part. You have an idea of how much you need to save each month to reach your retirement goal. But how do you find that money? Where does it come from?

There's one simple trick for saving for any goal: spend less than you earn. That's not easy if you have trouble making ends meet or if you find it difficult to resist spending whatever money you have in hand. Even people who have high incomes often have difficulty saving.

Here are some ideas to help you:

Start with a "spending plan": a guide for how you want to spend your money. Some people call this a budget, but since we are thinking of retirement as something to buy, a spending plan seems more appropriate.

A spending plan is simple to set up. Consider the following steps:

Income. Add up your monthly income: wages, average tips or bonuses, alimony payments, investment income, and so on. Don't include anything you can't count on, such as lottery winnings or a bonus that's not definite.

Expenses. Add up monthly expenses: mortgage or rent, car payments, average food bills, medical expenses, entertainment, and so on. Determine an average for expenses that vary each month, such as clothing, or that don't occur every month, such as car insurance or self-employment taxes. Review your checkbook, credit and

“Spend” for Your Retirement *(continued)*

debit card records, and receipts to estimate expenses. You will need to track how you spend cash for a month or two. Most of us are surprised to find out where and how much cash “disappears” each month.

Include Savings as an Expense. Better yet, put it at the top of your expense list. Here’s where you add in the total of the amounts you need to save each month to accomplish the goals you wrote down earlier.

Subtract Expenses from Income. What if you have more expenses (including savings) than you have income? Not an uncommon problem. You have three choices: cut expenses, increase income, or both.

Cut Expenses. There are hundreds of ways to reduce expenses, from clipping grocery coupons and bargain hunting to comparison shopping for insurance and buying new cars less often.

The section that follows debt and credit card problems will help. You also can find lots of expense-cutting ideas in books, magazine articles, and financial newsletters.

Increase Income. Take a second job, improve your job skills or education to get a raise or a better paying job, make money from a hobby, or jointly decide that another family member will work.

A Few Tips

Even after you’ve tried to cut expenses and increase income, you may still have trouble saving enough for retirement and your other goals. Here are some tips.

- **Pay yourself first.** First put away the money you want to set aside for goals. Have money automatically withdrawn from your checking account and put into savings or an investment. Join a retirement plan at work that deducts money from your paycheck. Or deposit your retirement savings yourself, the first thing. What you don’t see, you don’t miss.
- **Put bonuses and raises toward savings.**
- **Make saving a habit.** It’s not difficult once you start.
- **Revisit your spending plan every few months** to be sure you are on track. Income and expenses change over time.

Avoiding Financial Setbacks

Avoid Debt and Credit Problems. High debt and misuse of credit cards make it tough to save for retirement. Money that goes to pay interest, late fees, and old bills is money that could earn money for retirement and other goals.

How Much Debt is Too Much Debt? Debt is not necessarily bad, but too much debt is. Add up what you pay monthly in car loans, student loans, credit card and charge card loans, personal loans – everything but your mortgage. Divide that total by the money you bring home each month. The result is your "debt ratio." Try to keep that ratio to 10 percent or less. Total mortgage and nonmortgage debt payments should be no more than 36 percent of your take-home pay.

What's the Difference Between "Good Debt" and "Bad Debt"? Yes, there is such a thing as good debt. That's debt that can provide a financial pay off. Borrowing to buy or remodel a home, pay for a child's education, advance your own career skills, or buy a car for getting to work can provide long-term financial benefits.

Bad debt is when you borrow for things that don't provide financial benefits or that don't last as long as the loan. This includes borrowing for vacations, clothing, furniture, or dining out.

Do You Have Debt Problems?

Here are some warning signs:

- Borrowing to pay off other loans.
- Creditors calling for payment.
- Paying only the minimum on credit cards.
- Maxing out credit cards.
- Borrowing to pay regular bills.
- Being turned down for credit.

Avoid High-Interest Rate Loans

Loan solicitations that come in the mail, pawning items for cash, or "payday" loans in which people write postdated checks to check-cashing services are usually extremely expensive. For example, rolling over a payday loan every two weeks for a year can run up interest charges of over 600 percent! While the Truth-in-Lending Act requires lenders to disclose the cost of your loan expressed as an annual percentage rate (APR), it is up to you to read the fine print telling you exactly what the details of your loan and its costs are.

The key to recognizing just how expensive these loans can be is to focus on the total cost of the loan – principal and interest.

Avoid High-Interest Rate Loans *(continued)*

Don't just look at the monthly payment, which may be small, but adds up over time.

Handle Credit Cards Wisely. Credit cards can serve many useful purposes, but people often misuse them. Take, for example, the habit of making only the 2 percent minimum payment each month. On a $2,000 balance with a credit card charging 18 percent interest, it would take 30 years to pay off the amount owed. Then imagine how fast you would run up your debts if you did this with several credit cards at the same time.

Additional Tips:

- **Keep only one or two cards**, not the usual eight or nine.
- **Don't charge big-ticket items**. Find less expensive loan alternatives.
- **Shop around** for the best interest rates, annual fees, service fees, and grace periods.
- **Pay off the card** each month, or at least pay more than the minimum.
- Or **just leave the cards at home** – or cut them up!

How to Climb Out of Debt.

Despite your best efforts, you may find yourself in severe debt. A credit counseling service can help you set up a plan to work with your creditors and reduce your debts. Or you can work with your creditors directly to try and work out payment arrangements.

Strengthening Your Financial Plan

Saving for Retirement. Once you've reduced unnecessary debt and created a workable spending plan that frees up money, you're ready to begin saving toward retirement. You may do this through a company retirement plan or on your own. First, let's look at a few of the places where you might put your money for retirement.

- **Savings accounts, money market mutual funds, certificates of deposit, and U.S. Treasury bills.** These are sometimes referred to as cash or cash equivalents because you can get to them quickly and there is a minor risk of losing the money you put in.
- **Domestic bonds.** You loan money to a U.S. company or a government body in return for its promise to pay back what you loaned, with interest.
- **Domestic stocks.** You own part of a U.S. company.
- **Mutual funds.** Instead of investing directly in stocks, bonds, or real estate, for example, you can use mutual funds. These pool your money with money of other shareholders and invest it for you. A stock mutual fund, for example, would invest in stocks on behalf of all the fund's shareholders. This makes it easier to invest and to diversify your money.

Choosing Where to Put Your Money

How do you decide where to put your money? Look back at the short-term goals you wrote down earlier – a family vacation or the down payment for a home. Remember, you should always be saving for retirement. But, for goals you want to happen soon – say, within a year – it's best to put your money into one or more of the cash equivalents – a bank account or CD, for example. You'll earn a little interest, and the money will be there when you need it.

For goals that are at least five years in the future, however, such as retirement, you may want to put some of your money into stocks, bonds, real estate, foreign investments, mutual funds, or other assets. Unlike savings accounts or bank CDs, these types of investments typically are not insured by the federal government. There is the risk that you can lose some of your money. How much risk depends on the type of investment. The longer you have until retirement and the greater your other sources of income, the more risk you can afford. For those who will be retiring soon and who will depend on their investment for income during their retirement years, a low-risk investment strategy is more prudent. Only you can decide how much risk to take.

Why take any risk at all? Because the greater the risk, the greater the potential reward. By investing carefully in such things as stocks and bonds, you are likely to earn much more money than by keeping all your retirement money in a savings account, for example.

The differences in the average annual returns of various types of investments over time are dramatic. Over the last 50 years, the compound annual rate of return of short-term U.S. Treasury bills, which

Choosing Where to Put Your Money *(continued)*

roughly equals the return of other cash equivalents such as savings accounts, has been 4.5 percent. The compound annual rate of return of long-term government bonds over the same period has been 6.9 percent. Large-company stocks, on the other hand, while riskier, have averaged an annual return of 10.8 percent.

Many financial experts feel it is important to save at least a portion of your retirement money in higher risk – but potentially higher return – assets. These higher risk assets can help you stay ahead of inflation, which eats away at your nest egg over time.

Which assets you want to invest in, of course, is your decision. Never invest in anything you don't thoroughly understand or feel comfortable about.

Personal Financial Fitness

Reducing Investment Risk. Diversification lets you manage your risk in a particular investment or category of investments and decreases your chances of losing money.

There are two main ways to reduce risk:

- **First,** diversify within each category of investment. You can do this by investing in pooled arrangements, such as mutual funds, index funds, and bank products offered by reliable professionals. These investments typically give you a small share of different individual investments and will allow you to spread your money among many stocks, bonds, and other financial instruments, even if you don't have a lot of money to invest. Your risk of losing money is less than if you buy shares in only a few individual companies. Distributing your investments in this way is called diversification.
- **Second,** you can reduce risk by investing among categories of investments. You should put some of your money in cash, bonds, stocks, and other investment vehicles. Studies show that once you have diversified your investments within each category, the choices you make about how much to put in these major categories is the most important decision you will make and should define your investment strategy.

Why Diversify? Because at any given time one investment or type of investment might do better than another. Diversification lets you manage your risk in a particular investment or category of investments and decreases your chances of losing money. In fact, the factors that can cause one investment to do poorly may cause another to do well. Bond prices, for example, often go down when stock prices are up. When stock prices go down, bonds often increase in value. Over a long time – the time you have to save for retirement – the risk of losing money or earning less than you would in a savings account tends to decline.

By diversifying into several types of assets, you are more likely to reduce risk and improve return than by putting all your money into one investment or one type of investment. The familiar adage "Don't put all your eggs in one basket" applies to investing.

Deciding on an Investment Mix

How you diversify – that is, how much you decide to put into each type of investment – is called asset allocation. For example, if you decide to invest in stocks, how much of your retirement nest egg should you put into stocks: 10 percent ... 30 percent ... 75 percent? How much into bonds and cash? Your decision will depend on many factors: how much time you have until retirement, your life expectancy, the size of your current nest egg, other sources of retirement income, how much risk you are willing to take, and how healthy your current financial picture is, among others.

Your asset allocation also may change over time. When you are younger, you might invest more heavily in stocks than bonds and cash. As you get older and enter retirement, you may reduce your exposure to stocks and hold more in bonds and cash. You also might change your asset allocation because your goals, risk tolerance, or financial circumstances have changed.

Rebalancing Your Portfolio

Once you've decided on your investment mix and invested your money, over time some of your investments will go up and others will go down. If this continues, you may eventually have a different investment mix than you intended. Reassessing your mix, or rebalancing, as it is commonly called, brings your portfolio back to your original plan. Rebalancing also helps you to make logical, not emotional, investment decisions.

For instance, instead of selling investments in a sector that is declining, you would sell an investment that has made gains and, with that money, purchase more in the declining investment sector. This way, you rebalance your portfolio mix, lessen your risk of loss, and increase your chance for greater returns in the long run.

Here's how rebalancing works: Let's say your original investment called for 10 percent in U.S. small company stocks. Because of a stock market decline, they now represent 6 percent of your portfolio. You would sell assets that had increased and purchase enough U.S. small company stocks so they again represent 10 percent of your portfolio.

How do you know when to rebalance? There are two methods of rebalancing: calendar and conditional.

- Calendar rebalancing means that once a quarter or once a year you will reduce the investments that have gone up and will add to investments that have gone down.
- Conditional rebalancing is done whenever an asset class goes up or down more than some percentage, such as 25 percent. This method lets the markets tell you when it is time to rebalance.

Tips on How to Save Smart for Retirement

- Start now. Don't wait. Time is critical.
- Start small, if necessary. Money may be tight, but even small amounts can make a significant difference given enough time, the right kind of investments, and tax-favored vehicles such as company retirement plans and IRAs.
- Use automatic deductions from your payroll or your checking account for deposit in mutual funds, IRAs, or other investment vehicles.
- Save regularly. Make saving for retirement a habit.
- Be realistic about investment returns. Never assume that a year or two of high market returns will continue indefinitely. The same goes for market declines.
- If you change jobs, keep your retirement account money in your former employer's plan or roll it over into your new employer's plan or an IRA.
- Don't dip into retirement savings.

Using Employer-Based Retirement Plans

Does your employer provide a retirement plan? If so, say retirement experts... grab it! Employer-based plans are the most effective way to save for your future. What's more, you'll gain certain tax benefits.

Employer-based plans come in one of two varieties (some employers provide both):

Defined Benefit Plans. These plans pay a lump sum upon retirement or a guaranteed monthly benefit. The amount of payout is typically based on a set formula, such as the number of years you have worked for the employer times a percentage of your highest earnings on the job. Usually the employer funds the plan – commonly called a traditional pension plan – though in some plans workers also contribute. Most defined benefit plans are insured by the federal government.

Defined Contribution Plans. The popular 401(k) plan is one type of defined contribution plan. Unlike a defined benefit plan, this type of savings arrangement does not guarantee a specified amount for retirement. Instead, the amount you have available in the plan to help fund your retirement will depend on how long you participate in the plan, how much is invested, and how well the investments do over the years. The federal government does not guarantee how much you accumulate in your account, but it does protect the account assets from misuse by the employer.

In the past 20 years, defined contribution plans have become more common than traditional defined benefit retirement plans. Employers fund most types of defined contribution plans, though the amount of their contributions is not necessarily guaranteed.

Workers with a retirement plan are more likely to be covered by a defined contribution plan, usually a 401(k) plan, rather than the traditional

Using Employer-Based Retirement Plans *(continued)*

defined benefit plan. In many defined contribution plans, you are offered a choice of investment options, and you must decide where to invest your contributions. This shifts much of the responsibility for retirement planning to workers. Thus, it is critical that you choose to contribute to the plan once you become eligible (usually after working full time for a minimum period) and, even if you are automatically enrolled in the plan, to contribute as much as possible. Invest wisely – review your plan investment options and revisit your choices at least once a year.

Tax Breaks

Even though you may be responsible for funding a defined contribution plan, you receive important tax breaks. The money you invest in the plan and the earnings on those contributions are deferred from income tax until you withdraw the money (hopefully not until retirement). Why is that important? Because postponing taxes on what you earn allows your nest egg to grow faster.

Remember the power of compounding? The larger the amount you have to compound, the faster it grows. Even after the withdrawals are taxed, you typically come out ahead.

The tax deduction also means that the decline in your take-home pay, because of your contribution, won't be as large as you might think. For example, let's assume you are thinking about putting $100 into a retirement plan each month and that the rate you pay on income taxes is 15 percent. If you don't put that $100 into a retirement plan, you'll pay $15 in taxes on it. If you put in $100, you postpone the taxes. Thus, your $100 retirement plan contribution would reduce your take-home pay by only $85. If you are in the 25 percent tax bracket, the cost of the $100 contribution is only $75. This is like buying your retirement at a discount.

Vesting Rules

Any money you put into a retirement plan out of your pay, and earnings on those contributions, always belong to you. However, contrary to popular belief, employees don't always have immediate access to the money their employer puts into their pension fund or their defined contribution plan. Under some plans, such as a 401(k) or a traditional pension plan, you have to work for a certain number of years – say, three – before you become "vested" and can receive benefits. Some plans vest in stages. Other defined contribution plans, such as the SEP and the SIMPLE IRA, vest immediately. You have access to the employer's contributions the day the money is deposited. No employer can require you to work longer than seven years before you become vested in your retirement benefit.

Be aware of the vesting rules in your employer's plan.

Make sure you know when you're vested. Changing jobs too quickly can mean losing part or all of your retirement benefits or, at the very least, your employer's matching contributions.

Types of Defined Contribution Plans

The following are some of the most common types of defined contribution plans:

401(k) Plan | This is the most popular of the defined contribution plans and is most offered by larger employers. Employers often match employee contributions.

403(b) Plan | Think of this as a 401(k) plan for employees of school systems and certain nonprofit organizations. Investments are made in tax-sheltered annuities or mutual funds.

SIMPLE IRA | The Savings Incentive Match Plan for Employees of Small Employers is a simpler type of employer-based retirement plan. There is also a 401(k) version of the SIMPLE.

Profit Sharing Plan | The employer shares company profits with employees, usually based on the level of each employee's wages.

ESOP | Employee stock ownership plans are similar to profit sharing plans, except that an ESOP must invest primarily in company stock. Under an ESOP, the employees share in the ownership of the company.

SEP | Simplified employee pension plans are used by both small employers and the self-employed.

Other retirement plans you may want to learn more about include 457 plans, which cover state and local government workers, and the **Federal Thrift Savings Plan,** which covers federal employees. If you are eligible, you may also want to open a Roth IRA.

How to Make the Most of a Defined Contribution Plan

- Study your employee handbook and talk to your benefits administrator to see what plan is offered and what its rules are. Read the summary plan description for specifics. Plans must follow federal law, but they can still vary widely in contribution limitations, investment options, employer matches, and other features.
- Join as soon as you become eligible.
- Put in the maximum amount allowed.
- If you can't afford the maximum, try to contribute enough to maximize any employer matching funds.
- Study carefully the menu of investment choices. Some plans offer only a few choices, others may offer hundreds. The more you know about the choices, investing, and your investment goals, the more likely you will choose wisely.
- Many companies match employee contributions with stock instead of cash. Financial experts often recommend that you don't let your account get overloaded with company stock, particularly if the account makes up most of your retirement nest egg. Too much of a single stock increases risk.
- Plan fees and expenses reduce the amount of retirement benefits you receive from plans where you direct the investments. It's in your interest to learn as much as you can about your plan's administrative fees, investment fees, and service fees. Read the plan documents carefully.

Borrowing from Retirement Plans

- Don't borrow from your retirement plan or permanently withdraw funds before retirement unless necessary.
- Your retirement plan may allow you to borrow from your account, often at very attractive rates. However, borrowing reduces the account's earnings, leaving you with a smaller nest egg. Also, if you fail to pay back the loan, you could end up paying income taxes and penalties. As an alternative, consider budgeting to save the needed money or pursue other affordable loan options.
- Also avoid permanently withdrawing funds before retirement. This often happens when people change jobs. It's estimated that between 19 and 29 percent of workers leaving their jobs rolled over at least some of the money they received from their former employer's retirement plan to an IRA or another employer-sponsored plan.
- Pre-retirement withdrawals reduce the ultimate size of your nest egg. In addition, you'll pay federal income taxes on the amount you withdraw (10 percent to as high as 37 percent) and a 10 percent penalty may be tacked on if you're younger than age 59.5. In

Borrowing from Retirement Plans *(continued)*

addition, you may have to pay state taxes. If you're in a SIMPLE IRA plan, that early withdrawal penalty climbs to 25 percent if you take out money during the first two years you're in the plan.

- Finally, reduce the cybersecurity risk of fraud or loss to your retirement account by taking basic steps including routinely monitoring your online account, using strong and unique passwords, keeping personal contact information updated, being wary of public Wi-Fi, and knowing how to report cybersecurity incidents.

Managing for a Lifetime of Financial Growth

As mentioned earlier, you will experience several major events in your life that can make it more difficult to start or keep saving toward retirement and other goals. The key is to have a clear plan, to stay focused on your goals, and to manage your money so that life events don't prevent you from keeping on target.

Here are some suggestions for saving while managing some common life events:

Marriage. Getting married creates new financial demands that compete for retirement dollars, such as changing life insurance needs and saving to buy a home. But it's usually less expensive for two people to live together, thus freeing up dollars. Also, you probably still have time on your side. A spending plan is essential. Remember, every little bit helps.

Raising Children. The Department of Agriculture estimates that it costs the average American middle-income, married family approximately $284,570 to raise a child through age 17 (though these costs may be reduced somewhat by the Child Tax Credit). Furthermore, in some cases a spouse may stay out of the workforce to raise children, thus cutting into income and the opportunity to fund retirement. Having a child may alter your major financial goals but it should never eliminate them. Make the best effort you can. Also, many financial planners stress that saving for retirement should have priority over saving for a child's college education. There are financial aid programs for college-bound students but not for retirement.

Changing Jobs. It's estimated that the average worker changes jobs more than 12 times in a working lifetime. Changing jobs often puts you at risk of not vesting in your current job, or a new job may not offer a retirement plan. Consider keeping your money in your former employer's retirement plan or rolling it into a new company plan or an individual retirement account (IRA). Don't cash out and spend the money, however small the amount.

Divorce. It's important that you know the laws regarding your spousal rights to Social Security and retirement benefits. Under current law, spouses and dependents have specific rights. Remember, retirement assets may well be the biggest financial asset in marriage. Be sure to divide those assets carefully. It's also critical to review your overall financial situation before and after your divorce. Income typically drops for partners in the wake of a divorce, particularly for women.

Disability. A severe or long-lasting disability can undermine efforts to save for retirement. Although Social Security Disability benefits can help sustain a family if severe disability strikes, you may wish to explore the availability and cost of other forms of disability insurance.

Managing for a Lifetime of Financial Growth *(continued)*

Death. The premature death of a spouse can undermine efforts for the partner to save for retirement, particularly if there are dependent children. That's why it's important to check your Social Security statement to find out how much children will receive if a parent dies. Maintaining adequate life insurance is also important. Be sure that you have properly named the beneficiaries for any insurance policies, retirement plans, IRAs, and other retirement vehicles.

Coping with Financial Crises

Life has a way of throwing unexpected financial roadblocks, detours, and potholes in our path. These might be large medical bills, car or home repairs, a death in the family, loss of a job, or expensive legal problems. Such financial emergencies can derail your efforts to save for retirement or other goals.

Here are some strategies for managing financial crises:

Establish an Emergency Fund

This can lessen the need to dip into retirement savings for a financial emergency. Building an emergency fund is tough if income is tight, but every few dollars help. Fund it with pay from extra working hours or a temporary job, a tax refund, or a raise. Put the money into a low-risk, accessible account such as a savings account or a money market fund.

Insure Yourself

Insurance protects your financial assets, such as your retirement funds, by helping take care of the big financial disasters.

Here's a list of insurance coverage you should consider buying:

- **Health.** If you and your family aren't covered under an employer's policy, consider a health plan through the Health Insurance Marketplace. At least try to buy catastrophic medical coverage on your own.
- **Disability.** Did you know you are more likely before age 67 to miss work because of a disability than to die? Social Security Disability Insurance can pay you and your family benefits if you are severely disabled and are expected to be so for at least 12 months. (Worker's compensation only helps if the disability is work-related.) In addition, your employer may offer some disability coverage, but you may need to supplement it with private coverage.
- **Renters.** Homeowners are insured against hazards like fire, theft, and liability, but most renters aren't. Renter's insurance is inexpensive.
- **Automobile.** Don't drive "bare." It's usually against the law to drive without auto coverage, to say nothing of being costly if you are in an accident.
- **Umbrella.** This provides additional liability coverage, usually through your home or auto insurance policies, in the event you face a lawsuit.
- **Life.** Having life insurance can help you or your spouse continue to save if either one of you dies before retirement. Social Security may be able to pay benefits to your spouse and/or minor children. On the other hand, you may not need life insurance if no one depends financially on you. There are many types of life insurance, with a variety of fees and commissions attached.

Coping with Financial Crises *(continued)*

- **Long-term care.** This insurance can help pay for costly long-term health care either at home or in a health care facility or nursing home. It protects you from draining savings and assets you otherwise could use for retirement.

Borrow

If you must borrow because of a financial emergency, carefully compare the costs of all options available to you.

Sell Investments

It's usually advisable to sell taxable investments first. Try not to touch your faster growing retirement accounts. Taking money out of your retirement accounts could trigger income taxes and penalties.

Monitor Your Progress

Financial planning is not a one-time process. Life, your goals, tax laws, and your financial world have a way of changing, sometimes dramatically.

- Periodically review your spending plan.
- Monitor the performance of investments – adjust if necessary.
- Make sure you contribute more toward your retirement as you earn more.
- Update your various insurance safety nets to reflect changes in income or personal circumstances.
- Keep your finances in order.

Where to Go from Here

You now realize that saving for your own retirement is critical and that it is primarily your responsibility. You may get help along the way, but most of the work is going to rest on your shoulders. No one will work harder or care more about your retirement and your other financial goals than you.

Look back at your goals you outlined. Perhaps they seem more realistic now. Even if you can't do as much as you would like to right away, you can do something.

Think of this as a starting point. Continue to educate yourself about managing your money and investing. Consider professional resources as well, such as your benefits department, financial planners, and other financial experts who can help you not only with your financial questions, but, more importantly, can help motivate you into action.

Finally, there is only one real key to "buying" that retirement you've dreamed of. It doesn't matter whether you are still young or whether retirement is just around the corner. It doesn't matter whether you're in your first job, trying to save for a home, or putting a child through college.

ALL THAT MATTERS IS THAT YOU START SAVING...NOW!