Developing a Money-Smart Retirement Plan

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HOW DO YOU GET STARTED?

Being able to retire when and how you want is probably one of your most important financial objectives. Many factors shape your ability to retire on your own terms, and the landscape is constantly in flux because of tax law changes, the economy and possibly your personal situation.

To ensure you'll have the necessary financial resources, you need to develop a plan. Even if you can't follow it to the letter, your plan will provide you with a target to aim at. By reviewing the plan periodically and revising it as appropriate, you'll dramatically increase your chances of meeting — or exceeding — your retirement objectives.

This guide describes the fundamentals of developing or reviewing a retirement plan. Because so many complex and fluctuating factors go into creating a plan, this is just a start. After you digest the information, call

your financial advisor to discuss your goals. He or she can help you design, monitor and refine your plan as you find the way to your ultimate destination — financial security.

The best thing you can do for yourself is to start *now*. The sooner you start, the easier it will be to accumulate funds. Why?

- You'll have more years to build a retirement nest egg.
- Your savings program will become a habit.
- Most important, time can magnify the effects of compounding, as illustrated in Chart 1.

These three themes are central to your financial success and, as you'll see, will be discussed throughout this guide.

In the time it will take you to read this guide, you'll learn how to begin mapping out your retirement plan, gain ideas of where to go along the way and, perhaps most important, discover how to avoid potential pitfalls on your path. Don't worry if you haven't had a chance to start retirement planning yet: You've missed some opportunities, but it's never too late.

Chart 1

Power of compounding

For every $100,000 you wish to accumulate by age 65, here is how much you'd need to save, after taxes, on an annual basis starting at different ages[1]:

Age	6% return	8% return	10% return
35	$ 1,194	$ 819	$ 553
45	$ 2,565	$ 2,024	$ 1,588
55	$ 7,158	$ 6,392	$ 5,705

[1] *The investment returns shown are purely hypothetical. Your actual returns will vary, and the possibility of investment losses is inherent with investing in securities.*

WHERE WILL THE MONEY COME FROM?

Traditionally, Americans have relied on two primary sources for retirement income: Social Security and employer pensions. But most people working today won't be able to rely on these sources alone to provide the income they'll need; Social Security benefits will likely be too small — if the system is still operating at all — and fewer employers are providing pensions.

So, for almost everyone, personal savings (both inside and outside retirement accounts) have become an essential component of retirement income.

SOCIAL SECURITY

To be eligible for Social Security benefits, you must contribute to the system for the equivalent of at least 10 years. Your benefits are determined by your earnings before retirement and the age at which you choose to begin receiving benefits.

The good news is that benefits are indexed to rise with inflation; the bad news is that the earnings used to determine the benefits are capped. Although this amount is also indexed for inflation, the cap means that people earning a higher income will receive proportionately less of their preretirement earnings than people whose income is below the cap.

Upon reaching your full retirement age, you're eligible to receive your full benefits. Full retirement age used to be 65. However, for people born in 1938 or later, that age is gradually increasing until it reaches 67 for people born after 1959. (See Chart 2 on page 4.)

To estimate your benefits, go to the Social Security Administration (SSA) Web site at www.ssa.gov. Or review the annual statement the SSA sends out about three months before your birthday. If you haven't received your statement, go online and request one.

Taking benefits early vs. late

You may elect to start receiving benefits as early as age 62. Your benefits, though, will be less than what you would have received had you waited until your full retirement age.

If, for example, your full retirement age is 66 and you elect to take benefits at age 62, you'll receive only 75% of the amount you would otherwise receive. For each month that you wait after attaining age 62, your monthly benefit will increase. For example, if you wait until age 63, you'll receive 80% of the full amount.

Alternatively, you can choose to delay taking your retirement benefits until a year or more after your full retirement age and increase the eventual monthly amount you'll receive. For those whose full retirement age is 66, for example, each year beyond age 66 will bring an additional 8% per month. Waiting until age 70 means you'll get 132% of the monthly benefit that would have been payable had you started taking benefits at age 66.

Keep in mind that, even though choosing early benefits means the payments will be smaller, you'll receive more payments over your lifetime. And the opposite is true if you choose to delay benefits. So deciding when to take benefits requires an analysis of your total expected benefit throughout your lifetime. Which alternative turns out better will ultimately depend on how long you live. Check the SSA Web site to help determine benefits received at different age levels.

Chart 2

Age to receive full Social Security benefits

Year of birth	Full retirement age
1937 or earlier	65
1938	65 and 2 months
1939	65 and 4 months
1940	65 and 6 months
1941	65 and 8 months
1942	65 and 10 months
1943 – 1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

Note: *If you were born on Jan. 1 of any year, you should refer to the previous year. If you qualify for benefits as a survivor, your full retirement age may be different.*

Source: *Social Security Administration*

Remember spousal benefits

Your spouse, even if he or she has never had earnings under Social Security, will be entitled to a benefit under your record. Your dependent children also may be eligible, depending on their ages.

Your spouse's benefit will generally be equal to 50% of your benefit if you start receiving benefits at your full retirement age. If you take an early benefit, your spouse's benefit also will be reduced. The reduction percentage will depend on when you begin taking benefits.

Bear in mind that your spouse might be entitled to his or her own benefit. If so, your spouse will be paid the higher of the two amounts.

RETIREMENT PLANS

Retirement plans benefit from special tax advantages but also are subject to special restrictions. For instance, there are rules that allow tax breaks for contributing to retirement plans and rules that allow retirement plan income to grow on a tax-deferred basis, but there also are rules that limit annual contributions and rules that dictate the timing and amount of distributions you take from those plans.

Before you can start planning, review the retirement plans that are currently available to you. Generally, there are two categories into which all plans can be sorted — IRAs and employer-sponsored plans.

IRAs

IRAs are perhaps the most widely used retirement plans because they're easy to set up and maintain. You can open up one yourself — it doesn't have to be sponsored by your employer — and you can contribute as much (or as little) as you want, whenever you want, provided you don't exceed applicable annual limits. Following are descriptions of the three main types of IRAs:

1. Traditional IRA. IRA assets grow tax-deferred, meaning that you owe no tax on the earnings until you withdraw funds.

Your eligibility to make a contribution depends on statutory limits, your earned income and your age. Your contribution is limited to the amount of earned income — income from wages and self-employment income — that you have for the year. It doesn't include investment income. Those age 50 and older may be able to make additional "catch-up" contributions. Plus, your spouse may use your earned income to make a contribution of his or her own. However, you (and your spouse) are eligible to make contributions only if you're under age $70\frac{1}{2}$ at the end of the year for which you're making the contribution.

Before contributing to a traditional IRA, be sure you wouldn't be better served by contributing to another IRA type, such as a Roth IRA (see "Roth IRA" on page 6), or to an employer's 401(k) plan.

One factor that may affect your decision is the deductibility of your contribution. Your income level and other factors will determine if your contribution to a traditional IRA will be fully deductible. If neither you nor your spouse is eligible to participate in an employer-sponsored plan, your contribution is deductible no matter how much income you earn. But if you or your spouse *is* eligible, your tax deduction for making an IRA contribution may be reduced or completely eliminated depending on your adjusted gross income (AGI).

If you aren't eligible to make a deductible contribution (or a Roth IRA contribution), you may wish to make a nondeductible one — you'll still enjoy the benefit of

Case study I

TO CONVERT OR NOT TO CONVERT

If you have a traditional IRA, you may wish to convert it to a Roth IRA. To be eligible, however, your adjusted gross income (AGI) must not exceed $100,000 (not counting the conversion amount), and your filing status must not be married, filing separately. Starting in 2010, though, the AGI limit no longer applies. Regardless of your income level, therefore, you'll be able to convert to a Roth IRA at that time.

Converting may make sense if you can afford it on the front end. Before doing the conversion, though, analyze your situation and calculate whether it will work for you.

For example, suppose Joe is deciding whether to convert his $50,000 traditional IRA to a Roth IRA. He wonders why he would want to pay the tax today at his 25% tax rate. After all, he reasons, that's $12,500 he'd be out of pocket now.

Joe is 40 years old and anticipates not having to use his IRA funds in retirement. Given the fact that he doesn't expect to fund his retirement with his IRA money and the Roth isn't subject to minimum distribution requirements (unless inherited), Joe is a good candidate for a Roth conversion. Over the years, his $50,000 account could grow to become a much larger amount, and all qualified distributions would be tax free.

If Joe were 60 years old, the Roth conversion might still make sense, especially if his primary objective were to find a way to transfer his IRA to his children and grandchildren without their being subject to income tax on the distributions.

tax-deferred growth. And, when you withdraw the funds after age 59½, only the earnings will be taxed. You can withdraw your nondeductible contribution without tax.

2. Roth IRA. You may contribute the same amount to a Roth IRA as you can to a traditional IRA, but there are different eligibility rules, such as no age limit with respect to contributions, so long as you meet the earned income requirement.

Note that the total annual contribution to IRAs can't exceed the limit. So, if you're eligible, you can contribute all to a traditional IRA or all to a Roth IRA, or split your contribution between the traditional and the Roth.

The Roth IRA also differs from a traditional IRA in that you won't be able to claim a deduction for your contributions. But all Roth IRA earnings can be withdrawn tax free after age 59½, provided you've had the account for at least five years. (You can withdraw amounts up to your total contributions tax free at any time.)

There are other differences as well. Traditional IRAs have required minimum distribution rules that must be strictly followed. (See page 22.) Roth IRAs have no distribution requirements during your lifetime.

If a Roth IRA sounds like a better place to park your retirement funds but you already have a traditional IRA, you may be able to elect to convert some or all of it to a Roth IRA. In so doing, you'll be creating taxable income, but you'll also be getting the benefit of future tax-free withdrawals. (See Case study I at left.)

3. Simplified Employee Pension (SEP) IRA. A SEP IRA provides self-employed individuals a way to make more significant retirement contributions than would be available to them through a traditional or Roth IRA. Funds are treated, for tax purposes, the same as IRA funds; you may claim a deduction for your contributions, and distributions will be taxed. But the contribution limits can be much higher.

While the formula for determining how much you can contribute each year is fairly complex, 20% of your net self-employment earnings is a rough estimate.

Employer-sponsored plans

If your employer sponsors a retirement plan, be sure you take advantage of it. Which one is appropriate for you will depend on your situation and what your employer offers. Following are some of the most popular plans:

401(k). The 401(k), 403(b) and 457 plans take their name from the Internal Revenue Code sections from which they are derived. 403(b) plans are a 401(k) equivalent for tax-exempt organizations, while 457 plans are for governmental units. They all allow employers a way to provide employees with an opportunity to defer tax on a portion of their income by contributing it to a retirement account set up under the plan. Employers providing 401(k) or 403(b) plans may also offer a Roth version. (See Planning tip 1 at right.)

The statutory annual contribution limits for these plans are considerably higher than those for IRAs — and employees age 50 and older also may be able to make catch-up contributions. Some employers even match a portion of the amounts contributed by employees. That's free money!

Planning tip 1

ROTH 401(K) ADDS NEW DIMENSION TO RETIREMENT PLANNING

The Roth 401(k), which became available in 2006, is similar to a Roth IRA in that there is no tax deduction when funds are contributed, but no taxes are due on qualified distributions. The contribution limits are the same as for traditional 401(k) plans. The limit applies in total to all 401(k) contributions. For example, you can contribute the annual maximum amount to either a traditional 401(k) or a Roth 401(k) or to a combination of the two, but you can't contribute the full amount to both. Employer contributions, however, can't be deposited into a Roth 401(k) account.

A Roth 401(k) may be especially beneficial for high-income individuals because contributions can be made regardless of income level, unlike Roth IRA contributions, which are phased out or completely eliminated as income exceeds certain amounts. A quirky difference between the Roth 401(k) and the Roth IRA is that Roth 401(k) funds must be distributed beginning no later than age 70½, whereas Roth IRAs have no lifetime distribution requirement. Fortunately, you may roll over a Roth 401(k) into a Roth IRA if you desire.

Roth 403(b)s are also permissible, but Roth 457 plans are not.

As with traditional IRAs, distributions from 401(k), 403(b) and 457 plans must follow required minimum distribution rules. One difference, though, is that you may, under certain circumstances, continue to contribute to these plans after you turn 70½.

Solo 401(k) plans. If you have self-employment income, the solo 401(k) is custom made for you. Traditional 401(k)s have historically been unavailable to self-employed individuals. But now, by combining the features of 401(k)s with

Case study II

AN ESOP BENEFITS OWNERS AND EMPLOYEES ALIKE

An Employee Stock Ownership Plan (ESOP) is a complex qualified retirement plan that is created primarily to purchase the company's stock. Typically, the owner will at least initially retain control of the company because the company controls the trust.

Here's how it worked for Beth, who had much of her net worth tied up in the business she started 25 years ago. She sold half of her business to an ESOP. Because Beth invested the proceeds in "qualified replacement securities" and held those securities for the requisite time period, special rules allowed her to defer her gain on the sale. Qualified replacement securities are generally securities issued by publicly traded domestic companies.

Beth was excited by the prospect of being able to diversify her holdings, but she was even happier to be able to sell her company without having to relinquish control. Another benefit that she may yet realize is that the securities she acquired can be used for estate planning strategies.

An ESOP can be a great way for a business owner to have his or her cake and eat it too: He or she can sell the company without giving up control. It also is beneficial to the employees who participate in the plan, because they have an opportunity to share in the success of the business.

other plans, the self-employed individual can save more for retirement.

The solo 401(k) is, in essence, a way to double dip on the available retirement contribution. You can contribute the 401(k) limit, including the catch-up amount (if applicable), plus the amount that you could contribute to a SEP IRA. This means you may be able to more than triple your retirement contribution. There's a downside, however. Nearly all retirement plans require you to contribute on behalf of employees. However, solo 401(k)s are intended for businesses whose only employees are the owners — so, if you have employees, you may prefer to offer an alternative, such as a conventional 401(k). Plus, you need to have the cash to make the contribution, or the administration and cost of creating the plan will be wasted. The bottom line, though, is that the solo 401(k) is worth investigating.

SIMPLE IRA. Savings Incentive Match Plans for Employees (SIMPLEs) are for employers with no more than 100 employees. The employer is required to make contributions either by agreeing to match employee contributions dollar for dollar up to a certain percentage (generally 3%) or by making contributions of a flat 2% regardless of how much an employee contributes.

Statutory contribution limits, including those for catch-up contributions, are a little lower than for 401(k)s. There are also SIMPLE 401(k)s with rules that largely parallel SIMPLE IRAs. Subtle differences, however, generally make SIMPLE IRAs preferable for the employer. For example, discrimination testing isn't required with SIMPLE IRAs, but limited testing is necessary with SIMPLE 401(k)s.

Defined contribution plans. Defined contribution plans include profit sharing and money purchase plans. The rules that limit employee contributions and those that limit employer contributions are different. For those employer plans that are combined with employee plans, the employee's annual contribution limit (not including any catch-up amount) reduces what the employer can contribute.

An Employee Stock Ownership Plan (ESOP) is one type of defined contribution plan that may be especially helpful for owners of closely held businesses. (See Case study II on page 8 for more on ESOPs.)

Defined benefit plans. While much less common than they once were, these traditional pensions are still around. Employees can't contribute to defined benefit plans, and the investment risk is generally borne by the company because the annual retirement benefit is guaranteed. Whereas defined contribution plan funds are segregated by employee, defined benefit plan funds are often pooled.

Though properly designed defined benefit plans will be more costly to create, they may allow business owners to contribute significantly more than the established defined contribution limits. That's because the amount contributed is driven by how much is needed to generate the benefit.

It's important to know what you're expected to receive, but it's equally important to know what factors may affect your future benefits. Being armed with such knowledge can help you make the best decisions in regard to your retirement plans.

OTHER SAVINGS AND INVESTMENTS

Retirement plans are just one piece of your retirement puzzle. Your investments may also be a significant source of funds for retirement.

Personal assets

Fortunately, there are a wide variety of places you can put your money outside tax-advantaged retirement accounts. You may already have many of them; others you may want to consider. Here's an overview of some of the most common:

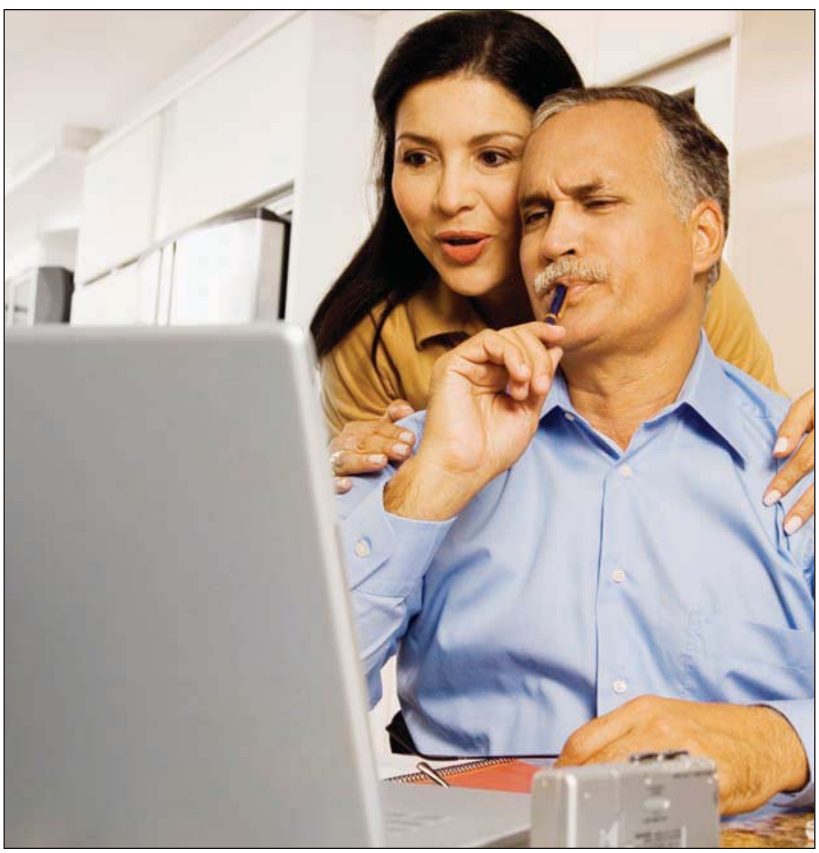
Savings accounts, money market accounts and CDs. These are the bread and butter savings vehicles for most people. Generally, they are insured up to $100,000 on a per bank basis, not on a per account basis. Interest earned is currently taxable.

Mutual funds, stocks and bonds. These are fairly traditional investment vehicles that can be found in most investors' holdings. (See page 13 for information on tax treatment.)

Life insurance and annuities. Although both are typically a contract with life insurance companies, the insurance policy provides a death benefit, whereas the annuity provides a guaranteed income stream for a predetermined period of time or for life. Generally, these are tax advantaged in that earnings can build up without being currently taxable.

Real estate. Your home is probably one of your more substantial assets, but unless you plan to sell it and downsize significantly, you shouldn't consider it an asset for retirement purposes. Investment property, on the other hand, can be a good source of revenue for retirement purposes, either as cash flow from net rental income or funds generated at sale.

Business interests. Although often illiquid, a valuable business can help pave the way to a comfortable retirement. You can sell all or a portion when the time comes, the business can continue, your involvement can be pared back and you can be paid a salary for your management, or you can receive a retirement benefit from a plan you established years before.



Employer-provided assets

You may be getting more from your employer that you can use to save for retirement than just a salary and 401(k) match, and it's important to take these assets into account when developing your retirement plan:

Nonqualified deferred compensation. This is a compensation arrangement set up by your employer that allows you to forgo some current salary (and the tax on it) until retirement or some other designated time in the future, and that continues to build up value during the intervening period. (For more on these plans, go to page 16.)

Restricted stock. Your company may give you shares at no cost to you, but with strings attached. For example, you may have to remain with the company for a certain period of time or the company may need to meet certain performance goals before you get access to the shares. Though the shares are technically yours, you can't do anything with them until the restrictions lapse.

Stock options. Here, the company provides you the opportunity to purchase shares at a predetermined price. Usually, the options don't vest until sometime in the future, either based on time or when the stock achieves a target price.

HOW DO YOU BUILD YOUR RETIREMENT SAVINGS?

Once you've taken inventory of all your sources of retirement income, you can consider ways to build up your savings. This may mean simply starting to participate in your employer's 401(k) plan or opening an IRA. Or it may mean increasing contributions to existing accounts or changing your asset allocation within them. If you're already making the maximum contributions allowed, it may mean exploring new investment opportunities.

FUNDAMENTAL TACTICS

So how do you find the strategy that's best for you? First consider the retirement planning fundamentals. These tactics can help you save for retirement, regardless of when you want to retire or how much you need to save.

Don't delay

The sooner you start saving, the more opportunity your funds will have to grow. If you're getting close to retirement and haven't started planning for it, you can't afford to wait any longer. Saving even a little bit extra can make a big difference. Fortunately, if you're 50 or older, catch-up contributions to your retirement accounts can help you make up for lost time. Suppose you're able to contribute $20,500 at the beginning of each of the next 10 years. At a 6% rate of return, your account will be worth nearly $287,000 at the end of the period. And, if you can take advantage of an employer match, you'll have even more.

Planning also will help you strike a balance between having fun today and being forced to work late in life because you're financially unable to retire. By forgoing $20,500 per year (less when you factor in the tax benefit) your lifestyle today might not be significantly affected. Having the extra $287,000 in your retirement account, though, might have a major impact on how things go in your golden years.

Find a comfortable risk level

All investment choices involve a trade-off between risk and reward. A certain amount of risk is inevitable if you want your money to grow. The key is determining how much risk you can accept.

Understanding your risk tolerance will help you create a plan you feel comfortable with and, perhaps more important, help you stick with the plan through good times and bad. (See Planning tip 2 on page 12.)

Although your personality influences how much risk you can tolerate, your stage of life and current wealth also affect it. As you move closer to retirement and have less time to recover from a market downturn, you may be better off forgoing the highest potential returns and putting the majority of your money in more secure investments, such as bonds. But if you have a large amount of disposable income available for investing, you may be able to afford more risk — even under a shorter time frame.

Planning tip 2

ASSESS YOUR RISK TOLERANCE

If you're not sure what your risk tolerance is, consider these questions:

- If you had $10,000 to invest, would you prefer an investment with a potential annual gain or loss of up to $2,000 to one with a potential annual gain of only $500 but no potential loss?
- Can you resist selling an investment that's losing money over the course of one year?
- Are you willing to accept a greater amount of fluctuation in your investments to potentially achieve long-term returns much higher than inflation?

The more of these questions you answered "yes" to, and the more emphatic each "yes," the higher your risk tolerance. But you also need to keep in mind your time frame and current wealth.

Diversify your investments

Investment choices are perhaps the single biggest factor with respect to building funds for retirement. While you'll probably have some missteps along the way, you can minimize your risks by having a properly diversified portfolio. (See Case study III at right.) That's why asset allocation — how much of your money you put into various investment types — is so important. The objective of any asset allocation plan is to find the appropriate mix of expected risk and expected return to achieve your goals.

Diversifying your funds among the three broad investment classes — stocks, bonds and cash — is an important way to help minimize your investment risks. The first step is to decide how to allocate your resources among those main classes. Then, within each asset class, you face additional choices. Here is a closer look at each class:

1. Stocks. You can choose among various categories of stocks, such as by size (large cap, mid cap and small cap), function (growth, value, income), geography (domestic, international) and market sector (technology, energy, financial services, basic materials) — each of which may respond differently to economic changes. Over the short term, stocks can be a risky investment. But over the long term, they have earned higher and more consistently positive returns than any other financial investment.

2. Bonds. As with stocks, you can choose among various categories of bonds, such as by taxability (taxable, tax free), issuer (private, federal government, state or municipal government), or time frame (short, intermediate or long term). Bonds, though generally less volatile than stocks, also respond to economic changes. In particular, bonds are sensitive to market interest rate changes.

3. Cash and cash equivalents. These generally include short-term liquid instruments such as Treasury bills, commercial paper and money market funds.* This class is typically allocated the smallest percentage of resources, because, though you face minimal risk, you also generally reap lower rewards. You may want to maintain sufficient funds to cover cash needs in an emergency — say, three to six months' worth.

** An investment in a money market or mutual fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although these funds seek to preserve the value of an investment at $1 per share, it is possible to lose money by investing in them.*

Ease diversification with mutual funds

You don't have to invest in these asset classes directly. For example, if you want to invest in stocks and bonds but don't have a large enough portfolio to achieve the diversity you want through individual purchases, mutual funds may provide the solution you're looking for.

Mutual funds are a collection of stocks or bonds designed to meet a stated investment objective or strategy. Most 401(k) plans are invested primarily in mutual funds.

Rebalance regularly

Asset allocation isn't something you do once and then forget about. Be diligent when it comes to rebalancing your portfolio and, as necessary, readjusting your focus.

As you near retirement age you'll have a clearer picture of what your retirement spending needs will be. And it's likely you'll find that the portfolio you started out with is allocated quite differently than how it needs to be at retirement. As you begin to withdraw your funds to cover your retirement spending, your focus will shift to the best way to make the retirement dollars work for you.

Consider tax consequences

Diversification also includes having the right kinds of investments for the accounts in which they're held. View your portfolio in total — not just on an account-by-account basis.

So consider the tax consequences when making asset allocation decisions. If, for example, you want to invest in bonds, you'll have a choice between taxable and nontaxable bonds. All else being equal, taxable bonds usually pay a bit more interest because you're subject to tax on the income. But that doesn't mean you should choose them.

Suppose your choice is between a taxable bond that pays 5% and a municipal (nontaxable) bond that pays 4%. At first blush, you

Case study III

DON'T PUT ALL YOUR EGGS IN ONE BASKET

Diversification is a lesson that, unfortunately, a great many would-be retirees have learned the hard way. They invested nearly all their retirement savings in company stock — and then the value of their stock disappeared. Don't let that happen to you. It may be tempting to turn your back on diversification while your company stock price is shooting skyward. Decisions on potential risks like this depend not only on your belief in the future of the company but also where you are in your retirement planning timeline.

For example, Lucy and Vicki were employed at a company whose stock had risen dramatically throughout their careers and then dropped precipitously as they were about to retire. Lucy never really paid much attention to her 401(k) account. All she knew was that, with every paycheck, she put more into the account, which was 100% invested in her company stock. Vicki also paid little attention to her account. But, she had invested only 20% of her 401(k) money in the company stock and the rest in a variety of mutual funds offered by the plan.

While Lucy's account zoomed ahead like the hare, Vicki's crawled forward like the tortoise. Then one day the company experienced a major setback and its stock price dropped. And dropped. And dropped. When the dust settled, Lucy was left with next to nothing in her 401(k) and her plans for retiring at age 65 were suddenly on hold. Vicki was also stunned. However, although her 401(k) was damaged compared to where it had been, she was still able to retire as planned.

might think that the 5% bond is better. But you must focus on your actual after-tax return. In this case, if you're in a tax bracket that's higher than 20%, you'll be better off with the municipal bond. After all, a 5% bond subject to a 20% tax is the same as a 4% bond not subject to tax.

It follows, then, that tax-free investments, such as municipal bonds, don't generally belong in IRAs or other tax-deferred vehicles. If you can invest in the same quality taxable bond and get a higher rate, you'll be doing yourself a disservice by holding municipal bonds in your IRA. On the other hand, an IRA may be an ideal place to hold your *taxable* bonds, because you defer the tax and get a better return.

Keep in mind that this is an example. Making decisions based on today's tax laws is fine for now, but laws and tax rates are highly likely to change, so be diligent about monitoring your investments.

Dictating the best allocation

The most appropriate way to allocate your funds between tax-advantaged retirement accounts and other investments, and within each category, will depend on your individual circumstances and preferences. Ideally, you'll be able to maximize your retirement saving opportunities and still have enough money to meet your day-to-day expenses. Perhaps, though, you won't be able to contribute the maximum, so you'll need to avail yourself of those vehicles that will provide the maximum benefit from the amount you're able to contribute.

TACTICS FOR YOUR SAVINGS STAGE

With the fundamental tactics in mind, you can further develop your retirement savings strategy based on where you are in the savings process.

Take advantage of free money first

If your employer offers a 401(k) match, it's giving you a great chance to receive free money. So, even if you have limited funds available to put away for retirement, at minimum you should contribute enough to your 401(k) (or other employer-sponsored plan that offers matching) to get the maximum employer match.

Assume, for example, that your company offers a match equal to 50% of your contribution, until your contribution reaches 6% of your salary. For every dollar you contribute to the 401(k) — up to 6% of your salary — the company will put in 50 cents.

In this case, if you earn $50,000 annually but don't take advantage of the match, you'll be forgoing $1,500 per year of free money. True, you must contribute $3,000 (6% of $50,000) of your own money to get $1,500 of theirs. But don't be so quick to dismiss the idea.

Remember, your contribution also reduces your taxable income. So, if you're in a combined 25% federal and state income tax rate, your real cost — after the tax benefit — is just $2,250 per year, which translates to $187.50 per month. Still too much? Consider that, if you're 35 years old and you pass up the opportunity to get a $1,500 match *just one time*, you're losing out on accumulating more than $8,600 inside the plan by age 65, assuming an average return of 6%. And that's only on the match portion. If you consider you would have also contributed $3,000 to get the match, you can triple the amount.

Bottom line: You're losing out on having nearly $26,000 accumulated by age 65. And if you pass up the opportunity to get the $1,500 match for *five* years, you're losing out on almost $38,500 of free money and more than $115,000 in total.

Contribute more

Once you've maxed out your employer match, you can continue to benefit from tax-advantaged savings opportunities. But putting more in your 401(k) may not be the best next step. Instead, consider making retirement account contributions in this order:

1. Roth IRA. If your income level doesn't prohibit you from contributing to a Roth IRA, consider making the maximum allowable contribution. Again, the theory here is that the tax deduction you forgo today will allow you to potentially reap a greater benefit at retirement. (However, if you think you'll be in a lower tax bracket after retirement, you may be better off first contributing more to your employer-sponsored plan, especially if you're close to retirement.)

A Roth IRA may also be a better choice for your next retirement dollars because of its virtually unlimited investment options. With a 401(k) or other employer-sponsored plan, your choices are limited to the investments offered by the plan. (For more on Roth IRAs, return to page 6.)

2. 401(k) or other employer-sponsored plan. If you aren't eligible to make a Roth IRA contribution due to your income level, or you've contributed the maximum and can

Planning tip 3

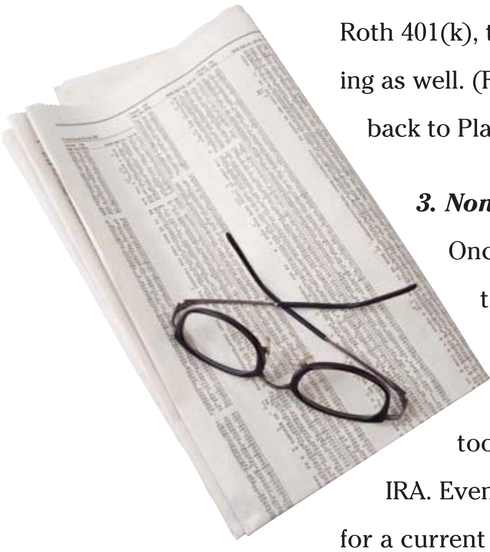
NO EMPLOYER-SPONSORED PLAN? OPEN YOUR OWN RETIREMENT ACCOUNT

If your employer doesn't offer a retirement plan, your first savings step probably should be opening an IRA so you can still enjoy the benefits of tax-advantaged savings. Remember, traditional IRAs offer a current tax deduction and tax-deferred growth. Roth IRAs don't offer a tax deduction, but any growth is tax free (as long as you take only qualified withdrawals).

Whether you should open a traditional or Roth IRA depends on a variety of factors, such as whether you need a tax deduction today to be able to afford the contribution and whether you expect to be in a higher or lower tax bracket after you retire. For more on the ins and outs of IRAs, return to page 5.

If you're self-employed, you have an even better option: Set up a solo 401(k) or other plan for the self-employed. Such plans allow you to make much larger contributions than you can make to an IRA. For more on these types of plans, go back to page 7.

afford to put away more, the next logical step is to continue to fund your 401(k) or other employer account to take advantage of tax-deferred savings. If your employer offers a Roth 401(k), that's an option worth considering as well. (For more on Roth 401(k)s, go back to Planning tip 1 on page 7.)



3. Nondeductible traditional IRA. Once you've reached the contribution limit for the 401(k) (and if you don't have a Roth IRA because your income is too high), consider a traditional IRA. Even though you won't be eligible for a current tax deduction because of your income level, you can still defer tax on any earnings and growth in the funds.

Starting in 2010, you'll be able to convert from a traditional to a Roth IRA regardless of your income level. So consider making nondeductible contributions through 2010 and then converting to a Roth. Depending on your circumstances, you may be able to convert with minimal tax consequences because the nondeductible contributions aren't subject to tax at conversion. This idea won't work as well, however, if you have other traditional IRA balances at the time of conversion.

Look at compensation

Retirement plans aren't the only options available to you: Take a look at other types of compensation your employer may offer you that also have some potential tax benefits:

Nonqualified deferred compensation. Certain highly compensated employees may be offered an opportunity to defer some salary. So long as the agreement is properly worded, including setting forth a predetermined date or event when the employee is eligible to receive the money, he or she won't be currently taxed on the earnings. The downside for the company is that, until the employee is eligible to receive the money, the company doesn't get a tax deduction.

The downside for the employee is that the funds that are set aside aren't protected from the creditors of the company. If the company goes bankrupt, the employee may never get a penny of the deferred compensation.

Stock options and other employee stock plans. For some people, stock options can be a golden ticket to great wealth, but they can also cause you to fall into an alternative minimum tax (AMT) trap. Essentially, stock options are rights to purchase company shares at a set price.

Once stock options vest, you can decide when to "exercise" the options — purchase the stock — so there's a measure of control with respect to income recognition, especially if you decide to exercise the options without immediately selling the shares. For qualified incentive stock options, there are AMT considerations at the time the options are exercised.

Restricted stock is simply a bonus at the time they become unrestricted. But you can elect to recognize the income when you receive the stock. If you have options, restricted stock or other related benefits, *Planning tip 4*

EARLY WITHDRAWALS MAY MEAN LATER RETIREMENT

Even the best-laid plans can go astray at times. If you face a situation where you're forced to access some of your retirement plan savings, do so with caution. Consider other assets or borrowing power first. If you make a withdrawal before you reach age 59½, you'll most likely face a penalty equal to 10% of the amount withdrawn, unless you meet an exception. Further complicating the issue, some of the exceptions apply to both 401(k)-type plans and IRAs, and some to just IRAs.

Among the more common exceptions:

Distributions upon the death or disability of the participant. If you need to access funds as a result of a disability, you can do so free of the penalty. Similarly, distributions due to the death of the participant are paid without penalty regardless of the beneficiary's age.

Distributions pursuant to a qualified domestic relations order. If you're ordered, as part of divorce proceedings, to distribute a portion of your funds to your former spouse, the amounts aren't subject to penalty.

Exceptions that apply just to IRAs include:

First-time homebuyer. You can avoid the penalty on the first $10,000 of amounts used to pay certain expenses related to buying a home. Note that any purchase of a home can qualify so long as you didn't have ownership of a personal residence at any time in the previous two years.

Education expenses. You'll avoid the penalty if you're using the funds to pay for qualified higher education expenses, including postsecondary tuition, fees, books, supplies and equipment.

Medical insurance premiums. Amounts used by certain unemployed individuals to pay for medical insurance premiums will also be exempt from the penalty.

Return of nondeductible contributions. Withdrawing nondeductible contributions (such as those to a Roth or nondeductible traditional IRA) won't subject you to the penalty, but calculating what portion of your withdrawal is considered a return of nondeductible contributions is complex, so seek guidance first.

There are myriad exceptions to the exceptions, particularly when dealing with Roth IRAs. Even without the penalty, in many cases you're subject to income tax on the withdrawal.

If you have a short-term need, consider "borrowing" the funds from your IRA. Tax law permits you to take a tax- and penalty-free distribution so long as the funds are returned within the specified 60-day time period. If you need more time to pay back the funds, you may be allowed to borrow funds from your 401(k). This is akin to making a loan to yourself, because you must pay interest and you'll have a set repayment schedule. Another source of funding — such as a home equity loan — may be more palatable.

Case study IV

A CRT AS A RETIREMENT FUNDING TOOL

Roger holds $500,000 of stock that has appreciated significantly since he purchased it years ago. His dilemma: He'd like to sell the stock to diversify his portfolio and have some extra cash for retirement, but he'll owe considerable capital gains tax on the sale.

The solution? He sets up a charitable remainder unitrust (CRUT) to benefit his favorite charity and funds it with the appreciated stock. The trust can sell the stock and reinvest the proceeds in diverse, income-producing investments. Because the trust is charitable, no capital gains tax is owed on the sale. The trust pays Roger a percentage of the trust's annual value for the rest of his life. His payments vary from year to year depending on how the CRUT investments perform. After Roger's death, the remaining assets pass to the charity.

Roger reports his annual payments from the CRT (to the extent they represent income) on his personal income tax return. They are taxed to him based on the manner in which the trust earned the money — ordinary income is distributed first, then any accumulated capital gains, then tax-exempt income and finally principal.

Roger may also benefit from a charitable deduction. His gift's value is determined using IRS tables that factor in his life expectancy, current interest rates and the payout rate. Based on these factors, Roger's lifetime interest is worth $300,000. That leaves $200,000 ($500,000 – $300,000) for him to deduct the year he sets up the trust. Depending on his income for the year, he may not be allowed to deduct the entire amount currently. But he can carry forward the excess for up to five years.

it's important that you understand your rights and the potential tax consequences so you can plan for how and when to exercise the options or sell the stock.

Consider other investments

Once you've contributed to retirement plans as much as legally permitted and taken into account other types of compensation that can be used in your retirement strategy, look at some other investments that can be retirement oriented:

Annuities. You enter into an annuity contract with an insurance company that provides you with a stream of income — an annuity — that's guaranteed, subject, that is, to the claims-paying ability of the issuing insurance company. You can design the annuity with a lot of flexibility. The income can, for instance, start at your retirement — or whenever you determine — and can last the rest of your life. The annuity can also be designed to be paid for your life and your spouse's life, and, if you so designate, others as well. The payments are subject to income tax, based on a complex formula.

Life insurance. Life insurance purchased for investment purposes differs from life insurance that's primarily for death benefit purposes. When used for investment purposes, your objective is to put as much money as possible into the policy to pump up its cash value.

At retirement, or whenever you determine to be the right time, you can begin to withdraw funds from the policy. So long as the policy and your withdrawals are structured properly, all the money you receive is completely free of income tax.

Charitable remainder trust (CRT). The CRT is most often considered an estate planning tool. But because it can be structured to provide a lifelong income stream similar to an annuity, you may also view it as a retirement planning tool. Whatever is left in the trust at the end of the term goes to the designated charity. When you fund the trust, you receive an income tax deduction for the current value of the amount expected to eventually go to charity, based on IRS tables.

Note that the amount isn't equal to the full amount contributed to the CRT. Rather, the deduction is the calculated remainder value; depending on your income and the deduction calculated, you may not be able to get a full tax benefit in the year of the contribution.

A CRT can be especially advantageous if you hold a large amount of a highly appreciated stock. The CRT can sell the stock and replace it with more diversified investments. CRTs don't pay taxes, so you avoid current capital gains tax while diversifying your portfolio. (See Case study IV at left.)

Taxable investments. Even though income and growth from investments in mutual funds, stocks and bonds held outside retirement accounts are taxable, there still are tax advantages to these types of investments. First, tax on growth is deferred until you sell the investment (though mutual funds may make taxable distributions of growth). Second, qualified dividends and long-term capital gains are taxed at a lower rate than ordinary income (15% through 2010, and Congress may extend this low rate).

POTENTIAL PITFALLS

You must be careful on your retirement planning journey, because there are many pitfalls along the way. By preparing for potential pitfalls now, you can lessen their impact later.

Inflation

Although we may grumble about inflation, most Americans have become somewhat desensitized to its impact because incomes typically rise to keep pace with, or stay ahead of, the increased cost of living. But when you retire, your income probably won't rise as fast as inflation. Assuming an inflation rate of 4%, for example, for every $1 of cost today you'll need more than $2.19

Planning tip 5

PROTECT YOUR ASSETS

Assets in employer-sponsored retirement plans are typically safe from creditors, and IRA assets may be protected depending on state law and the specific circumstances.

But creditors may be able to access other assets, such as if you're on the losing end of a lawsuit. And, of course, there's also the risk your personal property could be stolen, damaged or destroyed. So asset protection planning is another important aspect of retirement planning.

First be sure you have sufficient insurance, including property and casualty, to cover your home and its contents, automobiles, and other personal property. Excess liability coverage, commonly referred to as "umbrella" coverage, kicks in where other coverage leaves off. Usually you can't buy excess liability coverage unless both your homeowner and auto coverage meet certain criteria. If you serve on corporate or nonprofit organization boards of directors, you should also consider insurance to cover associated liability.

Next, depending on your wealth and vulnerability to lawsuits, you may want to consider more sophisticated strategies, such as a family limited partnership or a domestic or offshore asset protection trust. Transferring assets to your spouse also can offer protection in some situations.

in 20 years. Thus, the $50,000 item you want today will cost nearly $110,000 at that time.

Inflation isn't to be feared; rather, it's simply something to be taken into consideration. That is, if you've determined your retirement needs to be $5,000 per month in today's dollars, your monthly need 20 years from now will be much greater than $60,000 per year. Figuring that your $2 million nest egg only has to generate a 3% after-tax return ($60,000) will lead to unpleasant surprises when you realize that the same $60,000 doesn't go as far as it used to go.

Loss of income-earning ability

The success of your retirement savings strategy likely depends on your continued ability to earn income. But what if you become disabled and unable to work, even temporarily, before you retire? That could put a huge dent in your ability to save for retirement.

That's why long-term disability insurance is critical. It pays a percentage of your salary for the length of your inability to work or until retirement. Your employer may provide some long-term disability insurance coverage, but it may not be enough. So look into your current coverage and, if it seems insufficient, consider buying additional coverage.

Long-term health care costs

Of all the wild cards involved in planning for your retirement, perhaps the biggest unknown and most difficult to control is your future health care costs. It's unlikely that soaring health care costs will abate anytime soon. Even now, elderly people typically spend thousands of dollars each month for health care, especially if nursing care is needed. Remember, long-term care isn't covered by Medicare, and to be eligible for Medicaid, you must have virtually no assets left.

Consider, therefore, purchasing long-term care (LTC) insurance. In fact, LTC insurance could be as valuable to you as having a sizable 401(k) plan balance.

With LTC insurance, you pay for coverage today, before you need it. Premiums are based on your age, your health and the coverage you choose. So if you purchase the insurance now, you can lock in more reasonable rates than if you wait — plus you'll avoid the risk that you may become uninsurable later if you develop health problems. And you may even be able to get a tax benefit for paying your premiums. But LTC insurance isn't right for everyone. So be sure to consult your financial advisor before purchasing coverage.

YOU'RE READY TO RETIRE ... NOW WHAT?

Retirement planning isn't something you do once and forget about. The closer you get to retirement, the more important it is for you to know where you stand. That way, you can make adjustments as needed to help you reach your destination safely.

Fast forward 10, 20, 30, maybe even 40 years. Fortunately, as your retirement draws near, you should have a clearer picture of your assets, your retirement income sources and your spending requirements. Whether you feel you've got more money than you'll ever need or you've got more expenses than you can afford, monitoring where you stand is essential. During retirement, it's even more vital to be conscious of the impact that your spending has on your future.

For example, presume that, by the time you reach age 70, you've accumulated $1 million for retirement. If you expect to spend $5,000 a month over and above the income you get from Social Security and pensions, you'll need to earn a 6% after-tax return — before considering inflation — to generate the $60,000 you wish to spend in a year.

Chart 3 shows when your $1 million nest egg would be exhausted under various assumptions. Naturally, if all else is equal, as your annual spending increases, you're accelerating how quickly the funds will be exhausted.

Chart 3

How long will your $1 million nest egg at age 70 last?

At various inflation rates and rates of return[1], here is the age by which a $1 million nest egg would be exhausted if you withdrew $60,000 per year:

	Inflation rate		
After-tax annual rate of return	**2%**	**3%**	**4%**
6%	97	93	90
5%	93	90	88
4%	90	88	86

[1] *Investment returns and inflation rates shown are purely hypothetical. Your actual returns will vary, as will the actual inflation rate and your spending. The possibility of investment losses is inherent with investing in securities.*

CONSIDER TAX CONSEQUENCES

You've accumulated a significant amount of wealth and you have a variety of account types — a 401(k) plan, a Roth IRA and various taxable accounts. You've done well for yourself in that you have a diversified portfolio and are poised to achieve your retirement goals. What else can you do to ensure you continue to live well and perhaps even leave a sizable inheritance for your heirs?

This is when making the best choices with respect to funding your retirement needs

Chart 4

Applicable divisors for required minimum distributions

Age	Divisor	Age	Divisor	Age	Divisor
70	27.4	86	14.1	102	5.5
71	26.5	87	13.4	103	5.2
72	25.6	88	12.7	104	4.9
73	24.7	89	12.0	105	4.5
74	23.8	90	11.4	106	4.2
75	22.9	91	10.8	107	3.9
76	22.0	92	10.2	108	3.7
77	21.2	93	9.6	109	3.4
78	20.3	94	9.1	110	3.1
79	19.5	95	8.6	111	2.9
80	18.7	96	8.1	112	2.6
81	17.9	97	7.6	113	2.4
82	17.1	98	7.1	114	2.1
83	16.3	99	6.7	115 and up	1.9
84	15.5	100	6.3		
85	14.8	101	5.9		

Note: *Taxpayers must use a different table if a beneficiary is a spouse and more than 10 years younger than the account owner.*

Source: *U.S. Internal Revenue Code*

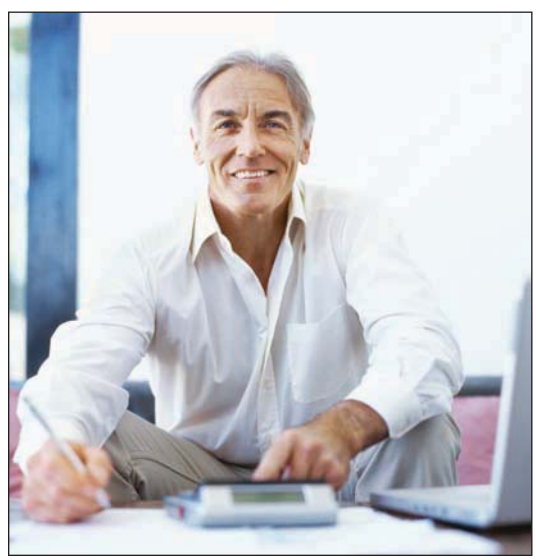
matters. Because every situation differs, it's important to know what will be best for you.

For example, if all else is equal, you'll generally be better served by deferring the tax on your retirement savings as long as possible and using money from your taxable accounts first. However, there are other factors, such as how the accounts are invested and rules that govern how long you're able to defer tax.

Though taxable accounts are currently taxed on income, tax on any investment growth is deferred until you sell the assets. If the investment has been held for more than one year, the gain is taxed at the lower long-term capital gains rate. With traditional IRAs and 401(k) assets (and most other employer-sponsored plans), you defer tax until you actually make withdrawals. But the withdrawals are taxed at your higher, ordinary-income rate. In most situations, you're required to start taking retirement plan distributions after age $70\frac{1}{2}$. Roth IRAs grow on a tax-free basis (so long as certain requirements are met), and they aren't subject to any distribution requirements during your lifetime.

WORK WITHIN MINIMUM DISTRIBUTION REQUIREMENTS

Once you reach age $70\frac{1}{2}$, be careful to take the required minimum distributions (RMDs) from your traditional IRA and 401(k) because there are significant penalties — 50% of the shortfall — for not withdrawing enough. To calculate your RMD at any given age, divide your projected retirement account balance by the divisor for that age shown in Chart 4. For example, if you



have $1 million in your account and you're 70, you simply divide $1 million by 27.4 and get an RMD of $36,496.35.

The RMD rules for inherited IRAs are complex and depend on a variety of factors. So if you have inherited such an account, it's important that you understand the rules to avoid potential penalties. Also be aware that, if you have inherited an IRA from someone other than your spouse, you'll likely have to take RMDs even before you reach age 70½ — even if it's a Roth IRA. If the IRA used to belong to your spouse, though, there's a special exception that allows you to treat the IRA as your own, and thus apply the distribution rules as if it were your own.

CHOOSE CAREFULLY

Deciding which accounts to tap into and whether you should take more than any RMDs can be quite an exercise. While, generally speaking, you'll want to defer any income tax as long as possible, that won't always be the case.

Gauge the benefit of tax deferral against the income tax impact of any current and future money you withdraw. For example, if you're in a low tax bracket for a particular year and expect to be in a higher tax bracket in future years, you may want to accelerate a taxable distribution to take advantage of the lower tax rate. Because you need to preserve your retirement funds as long as possible, however, you must consider all the factors before making a decision.

ENJOY TRULY GOLDEN YEARS

Once you reach retirement age, you may think it's easy sailing from there on. The reality is, however, that you need to continue to be as diligent about how you spend your money as you were in accumulating it. Indeed, because your time horizon is more limited after retirement, you may need more help than ever before.

Wherever you are along the journey to retirement, be sure to keep your financial advisor apprised of your situation. He or she can help give you a more precise estimate of your needs and your resources, and develop and monitor a retirement plan that fits your goals and circumstances.

RETIREMENT PLANNING CHECKLIST

Now that you realize the importance of planning for your later years, it's time to get started. Use this worksheet to identify your goals and areas you need to work on to achieve them. After you complete the form, send it to your financial advisor. He or she can use it as a starting point to help you create a plan to realize your retirement dreams.

Please check all boxes that apply to your situation.

Do you have a retirement plan in place?

- ❑ Yes (date last reviewed: ______________________)
- ❑ No, but I would like to develop one

My primary retirement goals are to:

- ❑ Live independently where I want
- ❑ Travel frequently
- ❑ Buy and enjoy the things I want
- ❑ Cover health care expenses
- ❑ Minimize taxes
- ❑ Help my children and heirs
- ❑ Pursue hobbies and other interests
- ❑ Other ______________________________________

My current retirement resources include:

- ❑ IRAs
- ❑ 401(k) plans
- ❑ Profit sharing or other defined contribution plans
- ❑ Stocks and bonds, including mutual funds
- ❑ Family or other businesses owned
- ❑ Real estate or intellectual property
- ❑ Savings
- ❑ Art, jewelry, precious metals and other valuables
- ❑ Other assets ________________________________

I need help with:

- ❑ Determining my retirement expenses
- ❑ Determining my retirement income and resources
- ❑ Accounting for inflation
- ❑ Establishing my future income needs
- ❑ Choosing among retirement plan options
- ❑ Implementing a personal action plan

My greatest retirement concern/need is:

____

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____

____

Send this form to your financial advisor or call him or her to discuss your retirement planning needs.

____
NAME

____
TITLE

____
ORGANIZATION

____
ADDRESS

____
CITY STATE ZIP

____
PHONE FAX

____
E-MAIL