

Smart Management of Retirement Income

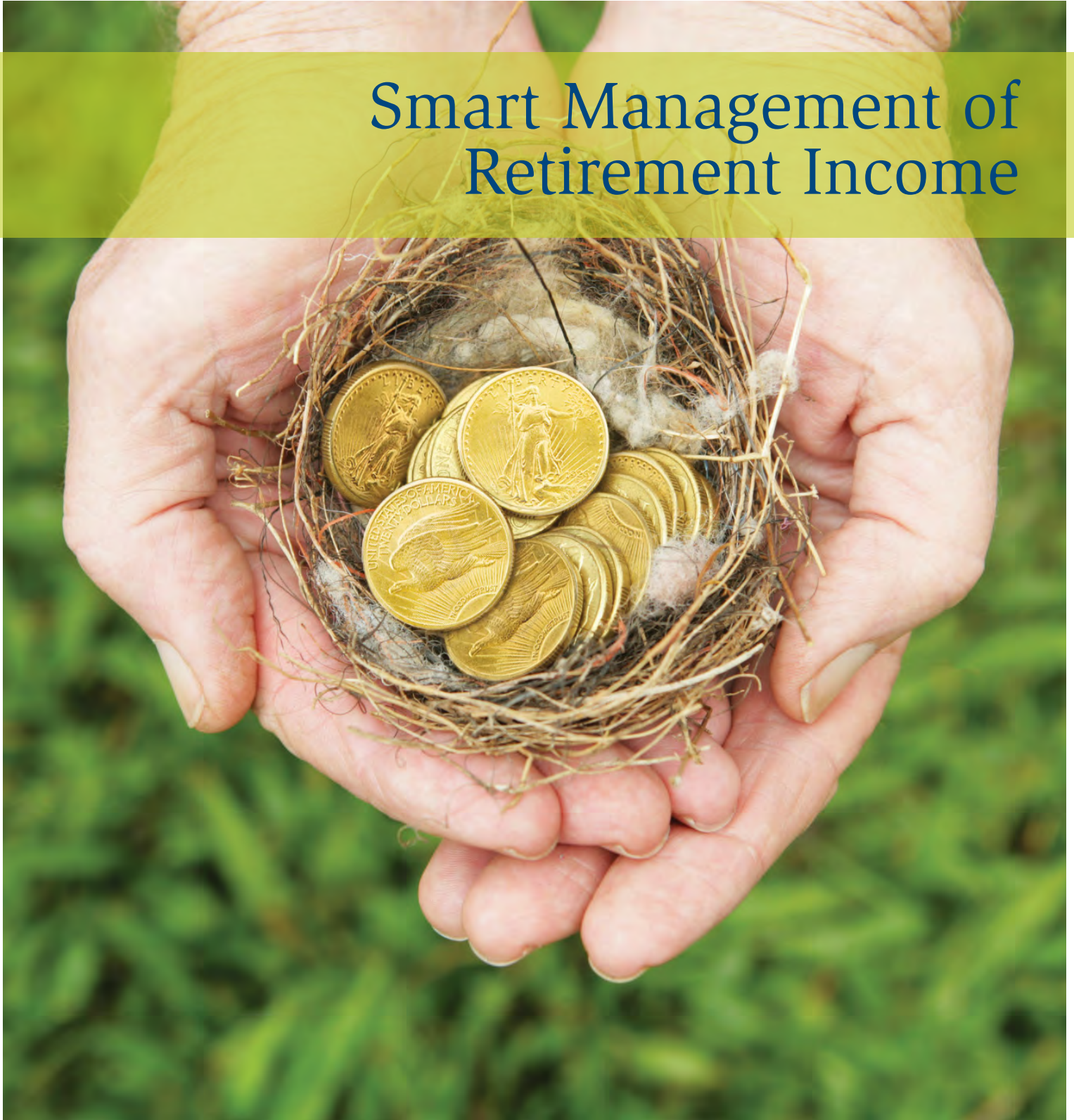


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Introduction



When you retire, you have more control over your time, and finally have enough leisure to do what you want. While taking control of your time may not require a lot of advance planning, taking control of your retirement finances does. You need income you can count on, year in and year out for a very long time. This brochure offers you tips on the subjects listed below to help you manage your retirement income.

Getting Ready for Retirement

Whether your retirement is fast approaching or years away, there are actions you can take now to maximize retirement when the time comes. It's never too early or too late to start.

Sources of Retirement Income

Managing retirement income starts with knowing what your sources of income will be—Social Security an employer-sponsored retirement savings account—and the rules that govern each income source.

Selecting Payout Methods

When you retire, you begin to take income from your defined benefit pension or defined contribution plan. You may also take income from a Social Security account. You should learn about the payout options from each source and what each means for your personal situation.

Managing Investment Portfolios

Retirement income management is all about making sure your retirement savings provide enough income for your needs, and that you don't outlive your assets. This starts with setting up and managing a portfolio that's right for you.

Taxation of Retirement Income

When you retire, you leave behind many things—the daily grind, commuting, maybe your old home—but one thing you keep is a tax bill. In fact, income taxes can be your single largest expense in retirement.

Working in Retirement

You're retired, but you may want to go back to work. You should, however, understand exactly how working after retirement might affect your Social Security, pension benefits, and other retirement income.

Long-Term Planning

Once retired, you may have questions about the future — particularly about how your spouse and family will cope financially if you become disabled or die and what will happen to the assets in your estate after your death. These valid concerns underscore the importance of solid long-term planning.

Health Care Costs

Your plans for the future shouldn't just be about what happens to your property or financial affairs. The longer you live in retirement, the greater the likelihood that you will need to use health insurance or arrange for long-term care.

Getting Ready for Retirement

Before you retire, you'll need to consider these questions:

- ▶ What sources of income are you confident you'll receive?
- ▶ How much income will these sources provide each year?
- ▶ How and when will the income be paid?
- ▶ How will you coordinate payments from different sources to create a steady stream of income so there's money for as long as you need it?

In most cases, the longer you work and the higher your salary, the more retirement income you can anticipate. If your employer offers a traditional pension, the pension income you receive will depend on the years of service, your salary and the age when you stop working. On the other hand, tax-deferred retirement plans—including employer-sponsored retirement plans such as 401(k)s, 403(b)s, individual retirement accounts (IRAs) and annuities—provide income based on the amounts you put in them, the investment choices you made and the way those investments performed.

Living Expenses in Retirement

Managing retirement income successfully starts with making sure your expectations for retirement are realistic. This requires that you have a clear picture of how much you'll spend both on the everyday costs of living and on any special activities you're planning.

Many retirement experts estimate you'll need between 70 and 85 percent of your pre-retirement income to maintain your standard of living after you stop working. But that formula might be too simple, and possibly too low, to account for what you'll actually spend. You'll need more if you have expensive hobbies or plan to travel extensively. You may also need more if you're in poor health and have substantial medical expenses. Start by tracking what you actually spend now.

Remember that many costs will go up over time—likely candidates include healthcare, food, property taxes and travel. Costs that could go down include your mortgage, commuting (including the need for a second car), clothing and financial expenditures for your children and your parents.

Retirement Timetable

Wherever you are on the retirement timetable, it's important to keep some critical ages in mind:

- 55:** You can retire early. If you retire, quit or are fired from your job beginning in the year you turn 55, you might be able to withdraw from tax-deferred savings plans without owing a 10 percent tax penalty, as long as you qualify for one of the [*exceptions spelled out in the federal tax code*](#). You may also be eligible for pension benefits from some employer plans if you have enough years of service.

Smart Tip: Create an Emergency Fund

You can't predict what might happen to your finances, but you can prepare by creating an investment or savings account equal to three to six months of living expenses, earmarked for emergencies. You probably will want to keep this rainy-day money in accounts that protect their value, such as savings or money market accounts, or U.S. Treasury bills.

- 59½:** You can generally withdraw money from your personal tax-deferred savings plans (IRAs, annuities) and from your employer-sponsored savings plans if you've retired from the job without owing a 10 percent tax penalty.
- 60:** You can receive Social Security benefits if you are a widow or widower.
- 62:** You may be eligible for full pension benefits from your employer, depending on the plan. You can begin to receive reduced Social Security benefits if you choose. Your Social Security benefits will increase, however, with every year you wait to collect them.
- 65:** You can receive full pension benefits from most employers, as well as full Social Security benefits if you were born in 1937 or earlier. If you are a widow or widower, you can receive full Social Security benefits if you were born before January 2, 1940. If you were born later than 1937, when you reach what's called full retirement age and are eligible for full benefits depends on the year of your birth. For those born between 1938 and 1942, it's during the year after you turn 65. For those born between 1943 and 1954, it's 66. For those born between 1955 and 1960, it increases annually from 66 and 2 months to 67. If you were born in 1961 or later, your full retirement age is 67. At 65, you normally also qualify for Medicare benefits.
- 70:** You should begin to collect your Social Security benefits if you haven't already, because your benefit has reached its maximum.
- 70½:** You must begin withdrawals from your traditional IRAs, but not from Roth IRAs. You must also begin withdrawals from employee-sponsored retirement plans, such as a 401(k), unless you're still working.

Working with Investment Professionals

Many people who are approaching retirement or have recently retired turn to a professional to seek help planning for that event and managing their income. If you're looking for that kind of help, you may need to shop around to find someone you like and trust. For information on different types of investment professionals and how to select them, read FINRA's [Selecting an Investment Professional](#). Always use [FINRA BrokerCheck](#) to learn about the licensing and background of the individuals you're considering. And if an investment professional says he or she has special credentials or designations, be sure to use FINRA's [Understanding Professional Designations](#) tool to see whether the issuing organization requires continuing education, takes complaints or has a way for you to confirm who holds the credential.

Caution: Look Before You Leave!

While early retirement is an alluring prospect, be advised that some early retirement strategies are in fact schemes designed to take your money. FINRA is aware of instances in which employees who had built up sizeable retirement savings have been misled—and financially harmed—by flawed, even fraudulent, early-retirement investment schemes. For more information about how to protect yourself, read the Investor Alert, [Look Before You Leave: Don't Be Misled By Early Retirement Investment Pitches That Promise Too Much](#).

Smart Tip: Allow Three-Months Lag Time When Applying for Social Security

The Social Security Administration (SSA) recommends applying for retirement benefits three months before you want your benefits to begin. You can get an estimate of your future benefits at any time. For more information, see the SSA's Web page [How should I prepare for retirement?](#)

Sources of Retirement Income

Social Security

For many, Social Security will be a vital—and significant—source of retirement income. Unlike most sources of retirement income, Social Security benefits are adjusted periodically for inflation through automatic cost-of-living adjustments, or COLAs.

Perhaps the biggest decision you'll make about Social Security is when to apply for your benefits. You can take reduced benefits at 62, wait until you're eligible to receive your full benefits—which will depend on the year in which you were born—or postpone your first payment to qualify for a larger amount.

The SSA offers many tools and resources to help you understand your Social Security benefits and how best to plan for the day when you will tap those benefits to help fund your retirement. Here are a few to explore:

[Find Your Full Retirement Age](#)

[When to Start Receiving Retirement Benefits](#)

[Social Security Retirement Planner](#)

[Life Expectancy Calculator](#)

Social Security Checklist

When you apply for benefits, you'll be asked to provide a number of documents. You must submit originals or copies certified by the issuing office, as the SSA does not accept photocopies. If you know what those documents are before you're ready to apply, you'll have a head start on getting them together.

Here's a checklist of some documents you may need when you sign up for Social Security:

- ✓ Your Social Security card (or a record of your number)
- ✓ Your birth certificate
- ✓ Proof of U.S. citizenship or lawful immigration status if you were not born in the U.S.
- ✓ Your spouse's birth certificate and Social Security number if he or she is applying for benefits based on your earnings
- ✓ Marriage certificate (if applying for spousal benefits)
- ✓ Your military discharge papers if you had military service
- ✓ Your most recent W-2 form, or, if you're self-employed, your tax return

Drawing Social Security Income

If you and your spouse are both eligible for Social Security benefits based on your work histories, you'll face a key choice. You must decide together whether to draw on your individual accounts or have one of you draw what are called spousal benefits.

If you and your spouse earned approximately equal amounts over your working lives, drawing on your individual accounts will provide the greatest benefits. But if one of you earned substantially more than the other, you'll want to compare your alternatives. If you are eligible for both your own retirement benefit and for benefits as a spouse, SSA will always pay you benefits based on your record first. If your benefit as a spouse is higher than your retirement benefit, you will receive a combination of benefits equaling the higher spouse's benefits.

If you have a minor child, you may be eligible for additional Social Security benefits.

Defined Benefit Plans

If you have a defined benefit pension, you should know before you retire about how much pension income you'll receive. This income is typically based on how long you worked at your company, what you earned and your age when you stopped working. But either way, as you approach retirement, you should check with your employer's human resources office on a number of pension eligibility questions. And after you retire, the office should still be a valuable resource.

Start with the most important thing: verify that you are fully vested—that is, eligible to collect a full pension. Many private company employees become vested after five years of service, or gradually between years three and seven.

You should also ask your employer what happens to your pension plan benefits if you retire sooner than 65 or work past that age. Some companies might decrease the amount of pension you would otherwise receive if you stop working earlier or later than 65.

If you're married and are part of a defined benefit plan, your employer is legally bound to pay some of your pension amount to your surviving spouse when you die. The amount may be set at 50 percent, but you may be able to increase it. If you don't want your spouse to get any of your pension, your spouse must sign a written consent waiving rights to this income.

Pensions can be a major attraction to people working in the public sector and armed services. Government pensions and military retired pay tend to differ from corporate pensions in several ways:

- ▶ Government employees may be required to contribute a percentage of their after-tax earnings to their pensions.
- ▶ Government employees and military service members may be able to receive their pensions after a set time—such as 20 or 30 years—no matter how old they are or how close they are to the more traditional retirement age of 65.
- ▶ Government pensions and military retired pay tend to be adjusted automatically for inflation using a cost of living index adjustment, or COLA.

Pension Plan Problems

A good place to start with general questions and problems related to your pension is the Department of Labor's [Employee Benefits Security Administration \(EBSA\)](#), which regulates retirement plans. You may contact EBSA toll-free: 866-444-EBSA (3272).

A pension plan is occasionally terminated if a company is bought, goes out of business or decides to freeze or change its employee benefits structure. If that happens, you will be notified in writing at least 60 days before the plan ends. Sometimes you'll also see a notice of a plan termination in local and national newspapers. You should later get a separate letter explaining what benefits, if any, you will receive.

Many company pensions are insured by the Pension Benefit Guaranty Corporation (PBGC). This federally run organization was set up to protect defined benefit pensions—including those that end because an employer terminates a plan. The benefits the PBGC pays when it takes over a pension plan are capped. In that case, highly paid individuals may lose part of their anticipated benefits. Also, if you lose track of your pension or your employer mismanages your plan, you can [ask for help](#) from the PBGC.

Smart Tip: Unclaimed Pension?

You can search for a pension you think you might have a right to on the PBGC's [website](#). All you need is your name and the name of your former employer.

Defined Contribution Plans

If you have a defined contribution plan, your employer may put money into the plan, allow you to contribute or sometimes contribute if you do. But, unlike a defined benefit pension, your employer doesn't make any promises about the income you'll receive when you stop working. Instead, that amount depends on how much money was invested, where it was invested and how long you've been in the plan.

Employer-sponsored retirement plans—such as 401(k)s, 403(b)s and 457s—are the best-known defined contribution plans. Other plans that generally cater to small businesses are SIMPLE IRAs and SIMPLE 401(k)s and Simplified Employee Pension (SEP) IRAs. These plans allow you to defer part of your current income into a retirement plan. In most cases, you also decide how your money is invested by choosing among options offered through the plan.

Defined contribution plans differ from defined benefit plans. For one thing, most defined contribution plans offer quicker, or even instant, vesting rights on any contributions your employer has made—and you are always automatically 100 percent vested in your own contributions and any earnings on those contributions.

One other very important feature of defined contribution plans is that when you switch jobs, you can usually move or roll over your accumulated assets to your new employer's plan or to an IRA. This way, you're starting with a balance to build on when you start a new job. If you can't move it, you can often leave your account with your former employer so it keeps growing until you retire.

! Don't Squander Your "Rollover Moment"

Too many older Americans spend an entire life accumulating retirement savings, only to make choices that harm their financial situation after they retire. When deciding whether to stay where you are, roll over to an IRA, or move to a new employer's plan (if you chose to work in "retirement"), these tips can help you avoid mistakes that can torpedo your retirement savings:

- ▶ Take time to comparison shop. In most cases, you do not need to make a snap decision with respect to your current employer's retirement savings plan.
- ▶ Compare fees and investment choices. Fees in particular are a key consideration. Small differences in cost can translate into big differences in the overall performance of your investments. The Department of Labor's [A Look at 401\(k\) Fees](#) provides answers to many common questions about fees and expenses. If you are considering an IRA, ask your broker how much it will cost to open the account and what ongoing costs are associated with your potential investments.
- ▶ Be wary of rollover sales pitches that make broad claims that brokerage accounts or IRAs are "free" or have "no fee." Certain types of fees might not be charged, but others might—such as fees for opening, maintaining or closing accounts or costs associated with particular investment products. For more information, read the Investor Alert.
- ▶ Use diversification and other strategies to *manage risk*. It was important to do so when you were saving for retirement (most 401(k)s offer mutual funds that offer "instant" diversification and help manage risk). It is equally important in retirement.
- ▶ *Ask and check* to be sure that both your investment professional and investments are registered.
- ▶ Make sure that some of your investments are liquid, meaning you are able to sell them quickly if you need to do so.
- ▶ Consider engaging an independent financial professional to review your rollover and other financial decisions at retirement.

Too Much Stock in Your Company

If you have an opportunity to accumulate retirement assets through the purchase of company stock, you don't want to overdo it. See FINRA's Investor Alert, [*Putting Too Much Stock in Your Company—A 401\(k\) Problem.*](#)

A Defined Contribution Checklist

When you're within a few months of retirement, it's a smart idea to review what's happening with your 401(k), 403(b) or other employer-sponsored savings plan. Here are some of the questions you'll want to ask yourself or the people in your employer's human resources department:

- ✓ What are my payout options?
- ✓ Will I be able to change my mind once I have made a decision?
- ✓ Could I postpone taking income from the account for a few years or until I turn 70½?
- ✓ Will I be able to change my allocation once I retire?
- ✓ For more information about 401(k) investing, see FINRA's [*Smart 401\(k\) Investing.*](#)

Home Equity

Your home is also a potential source of retirement income. If you own your residence outright, or have built up significant home equity, two of the most common ways to use your home to provide retirement income are to sell it or obtain a reverse mortgage.

If you decide to sell your home, the objective is to use some portion of the proceeds of the sale to fund your retirement. This assumes of course that the value of your house has gone up since you bought it. The Taxpayer Relief Act of 1997 allows you to sell your home and receive tax-free gains of up to \$250,000 if you are single and \$500,000 if you are married.

Since you need to live somewhere, an important decision will be whether to use the proceeds of the sale to downsize and purchase a less expensive home, or rent. If you decide to downsize and buy a less expensive home, you will need to consider one of two options, purchasing another home outright or obtaining a mortgage on the new home. The first option carries peace of mind (your house is paid for) but it will tie up more of your money, leaving less to generate income.

On the other hand, taking out a new mortgage means you must cover the cost of the mortgage month in and month out. If you go this route, it will be extremely important to manage your money to ensure it generates enough income to pay your mortgage.

! Caution: Using Home Equity Loans to Invest is Risky

Using a home equity loan to engage in speculative investing as a means to both cover the loan payment and generate additional income is extremely risky. This may result in the loss of your home if your investments go sour and you cannot repay your home equity loan. FINRA warns against this course of action in our Investor Alert, [*Betting the Ranch—Risking Your Home to Buy Securities.*](#)

Reverse Mortgages

If you're at least 62 and live on a fixed income, you might also get retirement income from a reverse mortgage. Officially called home equity conversion mortgages, they allow you to convert your home equity to a loan. You can take the proceeds as a lump sum, a series of regular payments or a line of credit. An appealing feature of a reverse mortgage is that no income tax is due on the money you receive, because it's a loan, not income.

But reverse mortgages are tricky—and definitely not for everyone. That's because once you take a reverse mortgage, your debt to your reverse mortgage lender grows with each payment you receive. That debt must be repaid when you die or move out of the home, usually by selling the property. The total amount that's owed can't be more than the value of the property, but it can equal the sale price. Plus, reverse mortgages come with closing costs, just like a regular mortgage—and these closing fees can be thousands of dollars.

The amount of income a reverse mortgage provides depends on your age, how much equity you have in your home and the interest rate the lender is charging. Some reverse mortgages are insured, which adds even more to the cost of borrowing but guarantees you'll receive your payments no matter what. Also, some reverse mortgages let you lock in your interest rate prior to closing just like with a regular mortgage, so you'll have a better idea of how much you can actually borrow beforehand.

THE SCORECARD FOR REVERSE MORTGAGES	
PROS:	CONS:
Ready source of cash	Loan must be repaid
No income taxes on payments because it's a loan, not income	Amount available to borrow may be small
No capital gains taxes, though loan amount is based on the current value of your property	Possibility of paying high interest rates and closing costs
No reduction of Social Security payments	Reduced estate to leave to your heirs

To help sort out the pros and cons of reverse mortgage in more detail, AARP provides an online seminar called [Homemade Money: A Consumer's Guide to Reverse Mortgages](#). For more information, you can check out what the Federal Trade Commission says about [reverse mortgages](#). The U.S. Department of Housing and Urban Development (HUD) also has a page on [reverse mortgages for seniors](#).

Smart Tip: Make Sure the Survivor Can Stay in the House

Both you and your spouse should be included in a reverse mortgage to ensure that, after one passes away, the survivor can stay in the house.

Selecting Payout Methods

One big change that retirement brings is you begin to take income from your defined benefit pension or defined contribution plan. You have to consider various payout methods, or the ways in which the income will come to you. The right alternative for you, or you and your spouse if you're married, depends on a variety of factors such as your other sources of income, your comfort level with investment risk and even your health.

When you retire from an organization that offers a pension, you generally have at least two options:

- ▶ taking a pension annuity and receiving a monthly check; or
- ▶ taking a lump-sum distribution, which you will need to invest or roll over to an IRA—and manage to ensure a secure retirement

Pension Payout Checklist

Many people wait until they are almost ready to retire before they start thinking about payout options. You may want to start planning earlier. Here's a checklist of questions to get you started:

- ✓ Is your health good enough to have a reasonable expectation of a long retirement? How about your spouse's health?
- ✓ Does your spouse have enough retirement income so that it would benefit you to select a single life annuity with a period certain for your payout? If so, how long should that period certain be?
- ✓ Are you concerned about the long-term financial health of your employer, so that taking a lump-sum payout, if available, might make sense?

Pension Payout Options

Annuity Options

An annuity, or stream payout, is the traditional way to receive income from a defined benefit pension plan. With this option, you get a check each month for the rest of your life or another fixed period. Your employer calculates the amount based on a number of factors including your age at retirement, your salary and the number of years you have worked. You know before you retire how much income you will receive.

With an annuity, you will not worry about outliving your pension payments. Because you know that the same amount is coming in on a regular basis, budgeting for both your everyday and unusual expenses may be easier. You also need to understand, however, that inflation can erode the purchasing power of most annuity payments over time.

Carefully evaluate the current and long-term financial condition of the entity that pays the annuity. Often it is an insurance company. One way to do so is [checking the credit rating](#) of the annuity provider.

Consider your payout options carefully. Once you have made your choice, you usually cannot change your mind.

Smart Tip:

Understand the Difference in Getting an Annuity from a Pension Plan and an Insurance Company

The life annuity you get from your company pension is based on the plan formula, which does not usually factor life expectancy or interest rates in the calculation of the payment you get. When you buy an annuity from an insurance company with a lump sum payment, the insurer will factor in your current age, life expectancy, prevailing interest rates and the profit it wants to make to determine the payment you will get. As a result, the annuity payments calculated from the pension plan and the insurance company will be different.

Single Life Option

You might choose a payout that lasts for your lifetime only, also called a single life or straight life annuity. With a single life annuity, when you die, the payments stop—even if you die soon after they start. To protect against that possibility, you might consider a single life with a period-certain payout. This method provides income to the beneficiary you name for a specified period, such as 10 or 20 years, if you die before that period ends. This option, however, results in a lower payment.

Joint and Survivor Option Protects Both

Alternately, you could choose an annuity to be paid out over your lifetime plus the lifetime of another person, usually your spouse, in what's called a joint and survivor payout. The amount of your monthly check is significantly less than what you'd receive with a single life annuity, with or without a period certain. But after you die, your survivor will get the percentage of your pension you specified up front every month for life. Depending on your distribution options, you may be able to select between 50 and 100 percent of the payment for the survivor. Some companies require married employees to select a joint annuity payout option or have the spouse sign a waiver if an individual annuity is selected. There's also the option of a period-certain payout with a joint and survivor annuity to provide income to a beneficiary you name for a specific period if both you and your spouse die before the period ends.

Lump-Sum Payment

A lump-sum distribution may be another option when you're ready to decide on a defined benefit payout. In this case, your employer will either make a cash payment or transfer the amount to an individual retirement account (IRA). Your employer calculates the amount you receive based on:

- ▶ what the plan would have paid you as an annuity over your projected life expectancy; and
- ▶ the current interest rate, which determines what the plan would have earned on the lump sum if it had been paid out in increments over your lifetime.

The lump-sum amount will vary with the prevailing interest rates. If interest rates are high, you'll receive a smaller lump sum than you would if rates were low.

Taking a lump sum could be a good choice if your spouse is significantly younger or you want to decide how to invest the money you get. You also have the option of working with a trusted and experienced investment professional. You'll get control over your assets—which could be important if you're concerned that the plan could be underfunded or that your employer could be acquired. A change in the ownership of your employer could result in major changes to the plan and to the pension you might qualify for after the acquisition. If you choose to have your lump sum pension distribution rolled over into an IRA, you can continue to defer taxes until you withdraw money later on.

Here's a quick comparison of annuities and lump-sum withdrawals:

	Pros	Cons
Fixed annuity	<ul style="list-style-type: none"> • Regular income on a regular schedule for life • No responsibility for making investment decisions • Protection against termination of plan or sale of employer 	<ul style="list-style-type: none"> • Income may be vulnerable to inflation • Income dependent on financial health of annuity provider
Lump-sum withdrawal	<ul style="list-style-type: none"> • Opportunity to make investment decisions • Ability to control assets • Continued tax deferral with rollover to IRA • Possibility of outpacing inflation • Protection against termination of plan or sale of employer 	<ul style="list-style-type: none"> • Responsibility for providing lifetime income • Taxes due immediately on cash-payouts and annual tax on investment earnings • Danger of spending assets too fast • Danger of significant investment losses

Defined Contribution Payout Options

When you retire with a defined contribution plan, you have some options about how to receive income. Your choices generally include taking a lump-sum distribution, keeping your savings in your existing account, annuitizing your assets and rolling them over into an IRA. Your plan administrator will be able to tell you which alternatives are available to you.

Lump-Sum Distribution

Taking all your money out of your defined contribution plan can seem attractive, but keep in mind that a lump-sum distribution is taxable in the year you take the money, unless you roll it over into an IRA. If your lump sum is substantial, it could be enough to bump you into a higher tax bracket than when you were working. While 20 percent of the total will be withheld to cover the federal income taxes that are due, you may still owe an additional amount. What's more, the money you withdraw is no longer tax deferred, which means that any future interest and dividends will be taxed in the year they are paid.

Take Stock of Your Company Stock

When you retire, you may want to take a lump-sum withdrawal of company stock from your 401(k) if it has increased in value. You can postpone taxes until you sell, preserving the tax advantages of your retirement account. And any capital gains when you eventually do sell qualify as long-term capital gains. You may want to get professional advice first so you can weigh the potential long-term advantages against possible drawbacks of withdrawing company stock from your 401(k).

Keep Your Defined Contribution Account

Keeping your savings in your defined contribution account is a second option. This is often the easiest and best choice for many employees, especially if your 401(k) has low expenses and offers adequate investment choices. While it might be the easiest option, it may not be right for you if your 401(k) investment choices are limited, expensive or if your account is heavily invested in your employer's own stock.

Annuitize Your Savings

Some employers allow you to annuitize all or a portion of your 401(k) or other defined contribution plan, which means converting all or a portion of the account value into a guaranteed stream of income for the rest of your life. The advantage of this type of annuity is that you cannot outlive your income. The disadvantage is that your payment may be fixed, so it gradually loses purchasing power due to inflation. When you choose an annuity, you also give up the right to make decisions about how your assets are invested just as you would when taking an annuity under a defined benefit plan.

IRA Rollover

Another choice is to roll over the assets of your 401(k) or other defined contribution plan into an individual retirement account (IRA) or individual retirement annuity. This way, you can protect your money's tax-deferred status, choose the way the assets are invested, and postpone income taxes until you withdraw. You also avoid the 10 percent early withdrawal penalty you would face if you're younger than 59½.

Smart Tip: Keep Track of Your Retirement Funds

You may want to maintain a separate investment account for any retirement funds you do roll over. That's because if you deposit rollover money into an existing tax-deferred account, you may complicate calculating the taxes you owe, especially if some of the contributions to the existing account weren't tax-deductible. Once the two sets of funds are mingled, you won't be able to separate them.

If you have leftover defined contribution plans floating around from former employers that you have not rolled over, you might consider consolidating them in your IRA. Among other things, it will simplify figuring out how much your required minimum distribution (RMD) must be once you reach 70½. Before you roll over any assets, make sure the IRA you are considering actually offers benefits and investment options that are more advantageous than your existing 401(k). For more information, see **Don't Squander your "Rollover Moment"** on page 6.

Required Minimum Distributions: Get Them Right!

The amount you must take from an IRA or defined contribution plan is called your minimum required distribution, or RMD. You calculate it using a distribution period provided in the Uniform Lifetime table found in Appendix C of Internal Revenue Service (IRS) Publication 590. It's important to get your RMD amount right. If you withdraw too little, you'll face a 50 percent penalty on the amount you should have taken out but didn't—on top of the income tax you'd owe. Use FINRA's [*RMD calculator*](#) to find out what your required withdrawal will be and the rate of return you'll need to earn to maintain your account balance.



Managing Investment Portfolios

The amount of money you have when you begin retirement is one of the most important factors in determining how to manage those assets during retirement.

If you have a large enough portfolio, it may generate enough income so that, with prudent spending, you never need to dip into your principal. If that is your situation, a combination of bank products such as CDs and Treasury bonds to preserve your principal, along with dividend-producing stocks and bonds may be the starting point for your investments in retirement.

On the other hand, if you're like the majority of retirees, you'll begin retirement with a more modest nest egg that will require you to tap your principal at some point. One important decision is how much to withdraw and from what account(s). Another is how much risk you want to incur, if any, in an attempt to grow your nest egg. You will also want to take into account whether your spouse is still working and how long it will be before he or she retires.

Unfortunately, there are no easy answers or failsafe ways to manage any investment portfolio. But there are some helpful concepts and general guidelines that can help you decide what is best for you, and also avoid serious mistakes that can jeopardize your financial wellbeing.

Reassessing Risk

As you head into retirement, you need to take a fresh look at the risk, or possibility of losing money from your investments. Your timeframe is one of the biggest factors in assessing risk. Because you no longer have time to recover from market downturns, you may need to reconsider whether the proportion of your assets in higher-risk securities is greater than it should be.

You also don't want to fall victim to inflation risk—the possibility that the change in prices will outgrow your purchasing power. Achieving the right balance isn't easy. That's why it's so important to take a big-picture view before you make major changes in the way you invest. If you're concerned about making your money last your entire lifetime, consider the following questions:

- ?** **What effect will taking money out of your various retirement accounts have on their ability to grow and provide income for life?** You will want to consider all of your assets and income sources, the effect of taxes and your unique circumstances when deciding what to do with any particular account.
- ?** **What sources of income can you count on for the duration of your retirement? And what are less predictable?** A growing number of Americans can no longer have pensions, leaving Social Security as the only “annuity” income they can count on for life. You need to have an idea of how long any one source will last so you can plan accordingly.
- ?** **How diversified are your sources of income?** You need to consider how vulnerable your sources are to major changes in the economy. If your investments would perform similarly during market swings, you need to diversify to protect your retirement income.

Asset Allocation

One strategic approach to investing during retirement is to maintain a particular mix of investments in your portfolio that you believe will provide the return you seek, at a level of risk you are willing to take. The process of creating such a portfolio and spreading out your risk is known as asset allocation.

Asset allocation is always important because each investment category, such as stocks, bonds or cash, tends to perform differently in different economic conditions. Although no one can predict any investment's behavior 100 percent of the time, there's lots of historical evidence that both stocks and bonds lose value in some periods and gain value in others. By spreading your investment principal among a number of different types of securities, you are often able to smooth out the ups and downs of your overall portfolio.

Throughout retirement, you may wish to adjust your asset allocation gradually. For instance, you might want to move money into less risky investments in response to a lifestyle change or to accommodate a change in economic conditions. Or, if you come into a sudden inheritance or other lump sum of money, you might want to invest that windfall with an eye toward growth rather than income generation. You can find asset allocation help from an experienced investment professional, such as your broker, a registered investment adviser or a financial planner.

Income Investments

At least some portion of your portfolio is likely to consist of income-producing investments, such as bonds and dividend-yielding stocks, and perhaps bank products, such as CDs. Income-producing investments are especially important in retirement, because once you stop working you typically need this money to live on.

Bonds are also known as “fixed-income investments” because when you buy and hold a bond, you receive a regular interest payment every six months or year. Assuming the bond does not default, with most bonds you also get your principal back when the bond matures.

Bonds aren't foolproof. Their market value can fall if interest rates rise or other factors undermine investor confidence in them. In that case, if you have to sell them before they mature, you will get less than you paid for them. But because bonds issued by the U.S. government, most state and local governments, and high-rated corporations have a low probability of default—that is, failure to pay what's due—these investments might appeal if you need steady income and don't want to risk your principal. Learn more about bond investing in [Smart Bond Investing](#).

Dividends are investment income you receive on preferred or common stock you own. Corporations may choose to pay out part of their earnings as dividends to you and other shareholders as a return on your investment. A company's board of directors decides how large a dividend the company will pay—or whether it will pay one at all.

If you're seeking income from stock, the advantage of preferred stock is that the dividends are often guaranteed and are paid before dividends on common stock. When the company's profits increase, however, the amount of preferred stock dividends you get may not increase because the company may declare a larger common stock dividend instead.

Growth Investments

Although you will probably shift many of your investment assets into income-producing products as you get older, many financial professionals emphasize the importance of continuing to own investments that offer growth potential, especially in the early years of what could be a long retirement.

There are several ways you can seek growth while avoiding some of the volatility that may make you uncomfortable. One approach is to reinvest the dividends from your stock investments and use some of the distributions from your mutual funds to buy additional shares. Owning more shares means you are increasing the base on which future earnings may accumulate. And, if the share price increases, you are in a position to realize a profit on those additional shares as well as your original shares if you sell.

You may also consider moving the equity investments you own into companies that pay regular dividends and into mutual funds that describe themselves as equity-income funds or growth-and-income funds.

Income from Selling Your Investments

Receiving investment income isn't the only way to draw retirement income from your investments. You can also get money by selling your investments if they are worth more than you paid for them.

While taxes shouldn't be the primary consideration in making an investment decision, you should consider the consequences of selling investments you hold in taxable accounts. You may have to pay capital gains taxes on the profit from the sale, as well as commissions to a broker for handling the transaction. If you have owned the investment for more than one year, you may owe capital gains tax. That rate can be 20 percent for people in the highest tax bracket or 0 percent for those in the lowest two tax brackets. That's likely lower than your regular income tax rate. But liquidating a lot of your holdings during any single year could drive up your tax bill if you don't have offsetting capital losses. So it's important to plan ahead if you'll be selling equities to provide current income. You should also be aware that as of January 1, 2013, the tax code imposes a Net Investment Income Tax of 3.8 percent on investors who meet certain income thresholds and other criteria. To learn more about the tax, who it applies to and how you calculate net investment income, be sure to talk with your tax professional or read the IRS's Net Investment Income Tax FAQs.

Of course, the situation is different if you're selling investments in a tax-deferred account. You pay transaction costs, but no capital gains tax. But when you withdraw from the account, you pay tax on the amount withdrawn at your regular tax rate.

Making Your Principal Last

Making your money last as long as you need it requires a disciplined approach to spending. Experts advise that you don't overspend your first few years of retirement. They also suggest that you be prepared to cut back on extras if your retirement portfolio suffers losses in a given year. The other key to stretching your retirement income is sound management of the yearly withdrawals you make from your retirement portfolio principal.

While there is no "one size fits all" percentage for how much of your nest egg you should withdraw each year, expert opinion tends to cluster in the 3 to 5 percent range. One thing most retirement planning specialists agree on is that you should start withdrawing as conservatively as possible at the beginning of your retirement. One of the arguments for starting off conservatively is that even a well-diversified investment portfolio can fluctuate—sometimes significantly—from year to year. You want to give your portfolio a chance to recover in the event the market takes a nosedive.

It's also a prudent strategy to take inflation into account as you withdraw. Consider building in an inflation rate to your yearly withdrawals. You should note that rising expenses and declining investment returns can take a toll on how long your money will last. Keep an eye on both, and be prepared to adjust your withdrawal rate, if necessary.

Selling Your Investments

A sound approach to take if you need to sell assets to generate retirement income is to start with long-term investments held in taxable accounts. This makes sense for two reasons. First, doing so allows the money in your tax-deferred account more time to grow, improving the potential for having income as long as you need it. That's perhaps the strongest argument for postponing taking money out of these accounts. Remember, though, that you are required to take RMDs after you turn 70½.

Second, starting with taxable accounts may also make sense because some of your taxable earnings may be taxed at your lower long-term capital gains rate. In contrast, all withdrawals from tax-deferred accounts (except Roth IRAs or Roth 401(k)s) are taxed at your regular income tax rate.

There may be, however, reasons to begin with your tax-deferred accounts. If you have large balances in accounts that require minimum distributions after you turn 70½, you may want to start taking income from those accounts sooner. That way, the amounts you'll be required to withdraw later are less likely to bump you into a higher tax bracket and increase what you owe in income tax.

Your heirs may have a lower tax burden if you leave them taxable rather than tax-deferred assets. That's because with taxable assets, no tax is due until they choose to sell. Or, if they do sell the assets immediately, they'll owe very little if any tax. In contrast, with tax-deferred assets, your heirs must take annual minimum required distributions and pay the tax that's due.

Fees & Expenses

As you consider various investment products, and re-evaluate the investments you already own, you'll need to take the fees and expenses of these products into account.

Fees and expenses generally tend to fall into two categories. Some you pay directly when you buy or sell an investment, such as a front- or back-end sales fee on a mutual fund or the commission on the purchase or sale of an individual security or exchange-traded fund. These fees are imposed only once. The other type is ongoing charges that you pay indirectly, such as a mutual fund's annual operating expenses, which are deducted from the fund's assets.

The reality is that the more you pay in various charges, the less you earn on your investment. Here are some common types of fees you may have to pay:

- ▶ **Commission**—a fee you pay to your broker for executing an order to buy or sell a security, such as a stock, bond or exchange-traded fund. The amount might be a set dollar amount per trade or it might be calculated on the total amount of the transaction.
- ▶ **Markup or markdown**—when a broker-dealer sells you a bond from its own inventory, it will add a markup to the price you pay. The markup is the equivalent of a commission to the broker. Similarly, when you sell a bond to a broker-dealer that the broker will hold in its own account, the broker will impose a markdown, which is a deduction from the bond's market price. When buying or selling bonds, be sure to confirm whether you will pay a commission, a markup or markdown.
- ▶ **Sales load**—a sales charge on mutual funds, which typically compensates the broker who sells the fund. Many mutual funds charge up-front loads, or sales charges, figured as a percentage of the amount you invest.
- ▶ **Surrender fees**—charges applied to annuities, products that are part of many peoples' investment and retirement plans. When you purchase these products, you sign a contract that gives you the option to convert your account balance to a stream of income at some point in the future. Along with most of these contracts come surrender fees—typically 7 percent or more of the amount you invest—that kick in if you decide to end the contract or withdraw funds during a surrender-charge period, typically six to eight years. For more information on surrender charges and other variable annuity fees, see the SEC's publication, [Variable Annuities: What You Should Know](#), which contains a section on Variable Annuity Charges.



Taxation of Retirement Income

Taxation of Social Security Benefits

Many older Americans are surprised to learn they might have to pay tax on part of the Social Security income they receive. Whether you have to pay such taxes will depend on how much overall retirement income you and your spouse receive, and whether you file joint or separate tax returns. Check the base income amounts in [IRS Publication 915, Social Security and Equivalent Railroad Retirement Benefits](#). Generally, the higher that total income amount, the greater the taxable part of your benefits. This can range from 50 to 85 percent depending on your income. There is no tax break at all if you're married and file separate returns.

The IRS also provides worksheets you can use to figure out what's taxable and how much you might owe in taxes on your retirement income. You can find these worksheets in [IRS Publication 554, Tax Guide for Seniors](#). If you do find that your income falls close to or within the limits that would trigger taxes on your Social Security income, you might be able to plan ahead so that some years you face the tax and some years you don't. For example, by timing when U.S. Treasury bills mature or postponing selling some stock, you might be able to bunch more of your income in one year—and thus pay the tax—while keeping the income just under the limits in another year. While most tax-exempt distributions count toward your total income, certain tax-exempt distributions, including those from a Roth IRA, do not affect your Social Security tax calculation.

Taxes on Tax-Deferred and Pension Income

You have to pay income tax on your pension and on withdrawals from any tax-deferred investments—such as IRAs, 401(k)s, 403(b)s and similar retirement plans, and tax-deferred annuities—in the year you take the money. The taxes that are due reduce the amount you have left to spend.

Smart Tip: Taxes on Pension Income Vary by State

The state where you live may not tax your pension—or you might consider moving to a state that doesn't. The rules are different in each state, so you'll have to check. But states can't tax pension money you earned within their borders if you've changed your legal residence to another state. For example, if you worked in New York but now live in Florida, you don't owe state income tax on the pension you receive from your former employer.

Pensions

You will owe federal income tax at your regular rate as you receive the money from pension annuities and periodic pension payments. But if you take a direct lump-sum payout from your pension instead, you must pay the total tax due when you file your return for the year you receive the money. In either case, your employer will withhold taxes as the payments are made, so at least some of what's due will have been prepaid. If you transfer a lump sum directly to an IRA, taxes will be deferred until you start withdrawing funds.

IRAs

Once you start taking out income from a traditional IRA, you owe tax on the earnings portion of those withdrawals at your regular income tax rate. If you deducted your contributions, you'll owe tax at the same rate on the full amount of each withdrawal. You can find instructions for calculating what you owe in [*IRS Publication 590, Individual Retirement Arrangements*](#).

Depending on your combined federal and state regular tax rate, you may want to consider holding investments that you expect may grow in value—such as certain stocks and mutual funds—in taxable accounts, not in traditional IRAs. This way, you won't owe tax on any increase in value until you sell them, and at that point the tax is based on the capital gains rate, not your income tax rate. The long-term capital gains rate for investments you've owned for more than a year is a maximum of 20 percent, depending on your tax bracket.

If you have a Roth IRA, you'll pay no tax at all on your earnings as they accumulate or when you withdraw following the rules. But you must have the account for at least five years before qualifying for tax-free provisions.

401(k)s and Other Salary Reduction Plans

When you receive income from your traditional 401(k), 403(b) or 457 salary reduction plans, you'll owe income tax on those amounts. This income, which is produced by the combination of your contributions, any employer contributions and earnings on the contributions, is taxed at your regular income tax rate. Withdrawals of employee contributions and earnings from [*Roth 401\(k\) accounts*](#) are not taxed provided the withdrawal meets IRS requirements. IRS rules, however, require that employer-contributed matching funds to your Roth 401(k) (and their earnings) reside in a pre-tax account and be taxed as ordinary income when you withdraw them.

Taxable Accounts

Interest paid on investments in taxable accounts is taxed at your regular rate. But other income—from both your capital gains and qualifying dividends—is taxed at the long-term capital gains rate of 20 percent or 0 percent, depending on your tax bracket. This is true when you have owned the investment for more than one year. This lower tax rate on most of your earnings is one of the major advantages of taxable accounts, though it's not the only one. There are no required withdrawals from taxable accounts and no tax penalty for taking income from these accounts before you turn 59½. This means you have greater flexibility in deciding which investments to tap for income and which to preserve for later needs.

There are also ways to minimize the taxes that may be due. You can use capital losses on some investments to offset capital gains on others. Your tax professional can explain how you can bunch or defer income to a single tax year or take advantage of tax deductions and credits. Or he or she may recommend investments that pay little current income but have strong growth potential. These could include index funds, exchange-traded funds, managed accounts and real estate as well as individual securities and mutual funds. Another approach a tax professional may suggest is to make charitable gifts of assets that have increased in value. This technique allows you to avoid capital gains taxes while taking a tax deduction for the current value of the asset.

You can't avoid income taxes during retirement. But once you stop working, you stop paying taxes for Social Security and Medicare, which can add several thousand dollars to your bottom line.

And you may find some other tax benefits. Once you turn 65, you may be able to take advantage of several tax laws that lower your bill. For instance, at age 65 you can take a larger standard tax deduction than a younger person can and you can take an even larger deduction if both you and your spouse are over 65. You'll also be able to make slightly more money than a younger person before you file a return at all, unless you have self-employment income. If you have limited income, you may also be eligible for a tax credit, which you can subtract directly from any tax that's due. You qualify if your adjusted gross income falls below the limits set by Congress for your filing status. [*IRS Publication 524, Credit for the Elderly or the Disabled*](#), provides the information and worksheets you need to figure out exactly where you stand.

Planning for Gifts and Bequests

As you look ahead, you may be thinking about giving some of your assets to family members or friends, which is often beneficial to both you and them as long as you can afford to live comfortably on your remaining retirement income.

Transferring wealth is often a good way to avoid incurring estate taxes—and that's in turn good because these taxes can take a larger bite of your assets than even the highest income tax rate. In addition, some states impose inheritance taxes at various rates on what your heirs receive from your estate.

But the good news is that prior to your death, you can make gifts to whomever you wish—and you can do so up to a certain amount without paying taxes. The ceiling changes from time to time. In 2014, you can make a gift of up to \$14,000 per year, or \$28,000 per year if you're married, to as many individuals as you like without ever owing federal gift taxes on the amount. If you do intend to split your gift with a spouse and give up to \$28,000 a year to any one individual, you'll need to file Form 709 with your taxes to be sure the IRS is notified.

In addition, you can make gifts larger than \$14,000 tax-free to your beneficiaries over the course of your lifetime. You have to follow IRS rules carefully to comply with the lifetime exclusion provisions. For more details, read the instructions for [*IRS Form 709*](#).

There are pros and cons to making tax-free gifts. On the upside, giving the money away reduces your taxable estate—that is, what will be subject to estate taxes when you die—while also helping your beneficiaries. But on the downside, once the gift is given, if you need access to that money later in your retirement, it's gone.

Keeping Up with Tax Changes

Tax rules change almost constantly—sometimes in relatively minor ways, sometimes through major reform—by acts of Congress and IRS rulings. To stay on top of the frequent changes in tax law, you might want to seek professional advice from a tax planner or tax adviser—typically a certified public accountant, or CPA. To make long-term plans with tax implications, you may also want to work with an attorney who specializes in tax and estate matters.

To be best prepared with ever-changing tax rules during retirement, you'll want to save anything related to your tax return for at least three years after filing and records on your investment gains and losses for at least six years. And because you'll most likely be paying estimated income taxes, you'll also need to keep excellent records of your income as well.

Smart Tip: Keep Records on Home Improvements

If you're a homeowner, keep any documents that deal with the value of your house and any improvements you have made to it for as long as you own the house. They may come in handy when dealing with taxes after you sell the house.



Working in Retirement

Whether working after retirement is financially necessary or personally rewarding, you should know that earning income during this stage of your life might affect your retirement benefits. Before you accept that first post-retirement paycheck, make sure you understand exactly how working could alter your Social Security, pension benefits and other retirement income.

Social Security and Limits on Earned Income

If you've already started withdrawing Social Security benefits, you might lose some of that income, depending on how much you earn and how old you are. That's because before you reach your full retirement age, there are caps on what you can earn before you begin to lose Social Security income. So if you think you will return to work after retirement, you might consider waiting to start your benefits. In fact, there may be an advantage to postponing Social Security if you don't need the income to live on. That's because your base benefit gradually increases until you reach 70. There's no advantage to postponing benefits after that age, however, since your base benefit doesn't get any bigger even if you continue to pay into the system because you're still earning income.

Alternatively, if you decide to return to work after you start taking Social Security benefits, you may have some options. For example, if you retire and start collecting benefits at age 62, but you're then offered a job that's too good to turn down, you can stop your Social Security payments using a document known as a withdrawal of application. As long as you repay any benefits you already received, you can start taking them again later on with a clean slate when you're ready to quit working for good. Whatever you earned in the period in which you returned to work can increase the amount you're eligible to receive later on. If you have questions about how to handle this application, you can call the Social Security Administration at (800) 772-1213.

If you work after you reach your full retirement age (FRA), there are no limits or penalties on your Social Security benefits, no matter how much you earn. And regardless of your age, the income caps apply only to earned income, not to income from your pensions, annuities, investments or other government benefits.

Impact on Pensions and Other Retirement Plans

If you have a pension, the pension benefits you get might be affected if you go back to work after retirement—but that depends on your individual pension plan. On the other hand, when you continue to work after you retire, you can still contribute to an employer-sponsored plan—such as a 401(k) or a 403(b). In this case, your age gives you an advantage. If you're over 50, you may make annual tax-deferred catch-up contributions to a salary deduction plan in addition to the regular maximum contribution. Similarly, you can also make catch-up contributions to IRAs. Once you're retired but still working, you can continue paying in to a traditional IRA up to age 70½, as long as you have earned income to put into it. And if you have a Roth IRA, there is no age limit on your contributions as long as they come from earned income.

Jobs and Required Minimum Distributions

Working in retirement might change many things in your life, but earned income doesn't get you off the hook for required minimum distributions (RMD), commonly known as your required withdrawal, from your tax-deferred retirement accounts.

You must start taking out at least the RMD from a traditional IRA in the year following the one in which you turn 70½ to avoid penalties whether you work or not. By the same token, you must take your required withdrawals from qualified pension annuities you might own if you rolled money into them from an employer plan.

You can use the [RMD calculator](#) to determine how much you are required to withdraw.

While you must adhere to regular RMD rules for IRAs and qualified rollover annuities even if you work after retirement, the situation is a little different for 401(k) plans and similar employer-sponsored retirement plans such as 403(b)s. If you have a 401(k) and continue to work after 70½, you may be able to delay your required withdrawals from that account until April 15 of the year following the year you retire—even if you don't retire until you're well into your 70s. Check with your plan administrator to see if this is the case.



Long-Term Planning

Now that you're retired, you may have many questions about the future—particularly about how your spouse and family will cope financially if you become disabled or die and what will happen to the assets in your estate after your death. These concerns underscore the importance of solid long-term planning.

? What's in Your Estate?

Your estate—the value of what you leave at your death—consists of everything you own individually and your share of anything you own with other people. This includes real estate, personal property, retirement plans, bank accounts, securities, life insurance policies and even income tax refunds you're entitled to.

As you look ahead, it's often a good idea to focus on putting your needs front and center in the plans. Although you probably want to take care of the people or institutions you love by making gifts, you should make sure you have enough resources to carry you through for the rest of your life.

You might also want to consider that no matter how carefully you prepare for retirement, circumstances that you can't predict often come along. So you should be realistic with your plans, which means taking precautionary steps to cushion yourself and those who depend on you from financial strain and emotional stress.

Choosing Pension and Insurance Beneficiaries

If you haven't already done so, by the time you start withdrawing retirement income, you should name beneficiaries. Your beneficiaries are the people or institutions who will receive the assets in your employer-sponsored retirement plans, IRAs and various insurance company products when you die. These assets, unlike your personal and real property or your taxable investment accounts, aren't transferred by will or trust.

Smart Tip: Do You Still Need Life Insurance?

When thinking about retirement, take the time to evaluate whether you still need life insurance, what coverage may be appropriate for your family needs and how much you can afford. [*The National Association of Insurance Commissioners*](#) has some questions to help you decide.

In many cases, your employer-sponsored plan will require that you name your spouse, if you have one, as beneficiary at the time you begin to participate. The only way to name someone else is if your spouse signs a waiver giving up his or her rights to those assets. But otherwise, there are usually no rules about who your beneficiaries may be. You can name family members, friends or an organization or institution. In fact, you can name more than one beneficiary for a single plan, a different beneficiary for each plan or the same beneficiary for several plans.

You also want to consider the possibility that the beneficiaries you name may no longer be alive when you die. To avoid this problem, you can name contingent beneficiaries in case your first choice dies before you do, can't be found or doesn't want your money. And you should check your documents from time to time to be sure that the beneficiary choices you made in the past still reflect your intentions. Unlike a will, which may become invalid if you marry or divorce, a person named as beneficiary continues to have a right to your assets if you don't change the designation.

Choosing IRA Beneficiaries

Anyone you choose—including your spouse, if you have one—can be the beneficiary of your traditional or Roth IRA. But if you roll over assets in your employer-sponsored plan to an IRA, the requirement for naming your spouse as beneficiary may persist unless he or she signs a waiver allowing you to name someone else. There are circumstances where this decision might be appropriate—if your spouse has substantial personal IRA assets, for example.

One reason to name the beneficiary is that you have greater control over what happens to your money. And, should you change your mind about the beneficiary you prefer, you can always change the designation.

Another Beneficiary Consideration: Younger Spouses

If your spouse is more than 10 years younger than you, you may want to name him or her as your IRA beneficiary before you begin required withdrawals. This will reduce your RMD and thus the income tax that's due.

The beneficiary of your traditional IRA will owe income tax on the withdrawals he or she will be required to make from your account, but in most cases the withdrawal period can be extended to cover the beneficiary's own lifetime. When your beneficiary is much younger than you are, the result can be a lengthy withdrawal period. In contrast, the beneficiary of a Roth IRA is not required to take withdrawals and no income tax is due on any withdrawals he or she does take—though like a traditional IRA, a Roth IRA is part of your estate and is included when the estate is valued.

A spouse is the only beneficiary of an IRA who can choose to roll over those assets into his or her own IRA, transfer the assets to a special beneficiary distribution account or even disclaim the assets so they pass on to the next eligible beneficiaries, such as your children. In this case, the withdrawal period that applies and the amount that must be withdrawn depends on which of these options he or she chooses.

If your beneficiary isn't your spouse, the amount of the first withdrawal is determined by the beneficiary's life expectancy in the year following the year of your death or, if the IRA owner dies on or after the date for required withdrawals, by your life expectancy, whichever is longer. You can find more information on how to calculate the withdrawal in [IRS Publication 590, Individual Retirement Arrangements](#).

Power of Attorney

As you look forward into your later retirement, you should probably think about how your personal affairs will be managed if you're not able to exercise control for one reason or another. One solution is to grant, or give, power of attorney to your spouse, sibling, adult child or close friend—someone you trust to act wisely and in your best interest. This attorney-in-fact, or agent, has the legal right to make the decisions you would make if you were able.

A lawyer can draw up the power of attorney for you, specifying the authority you are granting, and excluding anything you still want to control. An ordinary, or nondurable, power of attorney is revoked if you become physically or mentally disabled, so you may prefer to grant your agent durable power of attorney, which stays in effect even if you become incompetent. Not all states allow durable powers of attorney, so you should check with your legal adviser if you are planning this approach. An alternative may be to establish a springing power of attorney, which takes effect only at the point at which you're unable to act for yourself.

With either type, you have the right to revoke the authorization to act on your behalf at any time. You also have the right to choose a different agent if you wish.

Living Wills

Your plans for the future shouldn't just be about what happens to your property or financial affairs. You may wish to consider the medical decisions you want made if you're ill.

Just telling people what you would want in these cases isn't usually enough. Many state laws require written proof of your wishes. You can write a living will to make your wishes known. This is a document that describes the kind of medical treatment you want—or don't want—if you're terminally ill or in a permanent vegetative state, which means you're unconscious, unable to communicate and unlikely to recover. The laws of each state are a little different, so you want to be sure that your living will is drafted to meet the requirements in your state. If you sign a living will, you should also be sure your family and your doctor know where they can find a copy. You can get further information from the [*National Hospice and Palliative Care Organization*](#) at (800) 658-8898.

Health Care Costs

Health Insurance

Health care costs are likely to be one of the biggest expenses of retirement. Most individuals become eligible for Medicare at age 65. This means you need to get health insurance coverage somewhere else when you retire at an earlier age. Check whether your employer offers a retiree health insurance program as part of your retirement benefits, or if you can convert what you have to an individual policy.

You may also be eligible to get health insurance at group rates from your former employer under COBRA—a federal law that typically entitles you to continue your employer’s coverage for up to 18 months. You will, however, have to pay the full cost for coverage plus, possibly, an administrative fee. To be eligible for COBRA insurance, you must have been enrolled in your company’s health plan while employed. You must also elect to take COBRA coverage once you have been notified that you are eligible by the later of the 60th day after the written notice is sent or the day your health coverage ceases under the company’s health plan. If you fail to respond, you and your family will lose your right to COBRA benefits. To get COBRA coverage, you must pay the premium that you were already paying plus the amount paid by the company on time or risk losing your health insurance.

In addition to COBRA, you may have other options to get health insurance. For instance, if you are married and your spouse continues working after you retire, you may be able to get health insurance under your spouse’s company health plan, if one is available. You should also check your options under the 2010 Patient Protection and Affordable Care Act. Under that law, you may be able to obtain health coverage as you retire, even if you opt to get COBRA coverage for a period after you retire or when the COBRA benefit ends. You can find details on the [Health Insurance Marketplace](#) website. Compare the benefits and the cost of all available options so you can decide what health insurance works best for you.

Long-Term Care Insurance

Long-term care insurance is a risk-management product to help cushion the financial blow of prolonged and expensive elder care or custodial care. Medicare doesn’t cover long-term custodial care expenses. Most conventional health insurance doesn’t cover your long-term personal or custodial care either, and many policies have payment caps. This is where long-term care insurance comes into play.

Like other forms of insurance, most long-term care policies have caps, or maximum benefit amounts. That means almost no policy will pay for the total cost of your long-term care. But having this kind of insurance reduces the amount you’re responsible for paying—perhaps leaving more assets available for your spouse, if you have one, to live on in the meantime.

Be aware that all long-term care policies have a list of trigger events, which mark the point at which you qualify for benefits. These events may be a doctor’s order or a point at which you’re unable to perform a specified number of what insurers call your customary activities of daily life, or ADLs, by yourself. ADLs include tasks such as dressing or bathing yourself, being able to use the bathroom and feeding yourself. That said, not all long-term care policies cover cognitive impairments, such as Alzheimer’s disease, when you’re still able to perform most ADLs.

You may want to consider whether long-term care insurance should be part of your overall long-term retirement plan. Coverage and costs vary by provider. The insurance provider’s financial stability is also important: your policy is only as strong as the company that insures it.

Smart Tip:

Visit the National Association of Insurance Commissioners’ website for additional information on [health insurance options](#) and [long-term care insurance](#).



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