

FORMAN

INVESTMENT SERVICES

An Independent Firm

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Basic Retirement Planning

Retirement Planning--The Basics

You may have a very idealistic vision of retirement--doing all of the things that you never seem to have time to do now. But how do you pursue that vision?

Social Security may be around when you retire, but the benefit that you get from Uncle Sam may not provide enough income for your retirement years. To make matters worse, few employers today offer a traditional company pension plan that guarantees you a specific income at retirement. On top of that, people are living longer and must find ways to fund those additional years of retirement. Such eye-opening facts mean that today, sound retirement planning is critical.

But there's good news: Retirement planning is easier than it used to be, thanks to the many tools and resources available. Here are some basic steps to get you started.

Determine your retirement income needs

It's common to discuss desired annual retirement income as a percentage of your current income. Depending on who you're talking to, that percentage could be anywhere from 60% to 90%, or even more. The appeal of this approach lies in its simplicity. The problem, however, is that it doesn't account for your specific situation. To determine your specific needs, you may want to estimate your annual retirement expenses.

Use your current expenses as a starting point, but note that your expenses may change dramatically by the time you retire. If you're nearing retirement, the gap between your current expenses and your retirement expenses may be small. If retirement is many years away, the gap may be significant, and projecting your future expenses may be more difficult.

Remember to take inflation into account. The average annual rate of inflation over the past 20 years has been approximately 3 percent. (Source: Consumer price index (CPI-U) data published annually by the U.S. Department of Labor.)

And keep in mind that your annual expenses may fluctuate throughout retirement. For instance, if you own a home and are paying a mortgage, your expenses will drop if the mortgage is paid off by the time you retire. Other expenses, such as health-related expenses, may increase in your later retirement years. A realistic estimate of your expenses will tell



Calculate the gap

Once you have estimated your retirement income needs, take stock of your estimated future assets and income. These may come from Social Security, a retirement plan at work, a part-time job, and other sources. If estimates show that your future assets and income will fall short of what you need, the rest will have to come from additional personal retirement savings.

Figure out how much you'll need to save

By the time you retire, you'll need a nest egg that will provide you with enough income to fill the gap left by your other income sources. But exactly how much is enough? The following questions may help you find the answer:

- At what age do you plan to retire? The younger you retire, the longer your retirement will be, and the more money you'll need to carry you through it.
- What is your life expectancy? The longer you live, the more years of retirement you'll have to fund.
- What rate of growth can you expect from your savings now and during retirement? Be conservative when projecting rates of return.
- Do you expect to dip into your principal? If so, you may deplete your savings faster than if you just live off investment earnings. Build in a cushion to guard against these risks.

Build your retirement fund: Save, save, save

When you know roughly how much money you'll need, your next goal is to save that amount. First, you'll have to map out a savings plan that works for you. Assume a conservative rate of return (e.g., 5 to 6 percent), and then determine approximately how much you'll need to save every year between now and your retirement to reach your goal.

The next step is to put your savings plan into action. It's never too early to get started (ideally, begin saving in your 20s). To the extent possible, you may want to arrange to have certain amounts taken directly from your paycheck and automatically invested in accounts of your choice (e.g., 401(k) plans, payroll deduction savings). This arrangement reduces the risk of impulsive or unwise spending that will threaten your savings plan--out of sight, out of mind. If possible, save more than you think you'll need to provide a cushion.

Understand your investment options

You need to understand the types of investments that are available, and decide which ones are right for you.



If you don't have the time, energy, or inclination to do this yourself, hire a financial professional. He or she will explain the options that are available to you, and will assist you in selecting investments that are appropriate for your goals, risk tolerance, and time horizon.

Use the right savings tools

The following are among the most common retirement savings tools, but others are also available.

Employer-sponsored retirement plans that allow employee deferrals (like 401(k), 403(b), SIMPLE, and 457(b) plans) are powerful savings tools. Your contributions come out of your salary as pretax contributions (reducing your current taxable income) and any investment earnings are tax deferred until withdrawn. These plans often include employer-matching contributions and should be your first choice when it comes to saving for retirement. Both 401(k) and 403(b) plans can also allow after-tax Roth contributions. While Roth contributions don't offer an immediate tax benefit, qualified distributions from your Roth account are federal income tax free.

IRAs, like employer-sponsored retirement plans, feature tax-deferral of earnings. If you are eligible, traditional IRAs may enable you to lower your current taxable income through deductible contributions. Withdrawals, however, are taxable as ordinary income (unless you've made nondeductible contributions, in which case a portion of the withdrawals will not be taxable).

Roth IRAs don't permit tax-deductible contributions but allow you to make completely tax-free withdrawals under certain conditions. With both types, you can typically choose from a wide range of investments to fund your IRA.

Annuities are generally funded with after-tax dollars, but their earnings are tax deferred (you pay tax on the portion of distributions that represents earnings). There is generally no annual limit on contributions to an annuity. A typical annuity provides income payments beginning at some future time, usually retirement. The payments may last for your life, for the joint life of you and a beneficiary, or for a specified number of years (guarantees are subject to the claims-paying ability of the issuing insurance company).

Note: In addition to any income taxes owed, a 10 percent premature distribution penalty tax may apply to distributions made from employer-sponsored retirement plans, IRAs, and annuities prior to age 59½ (prior to age 55 for employer-sponsored retirement plans in some circumstances).

Investing for Retirement

Keep in mind...

- A well-diversified portfolio can help balance risk
- The earlier you start investing, the more you can contribute over the course of your working lifetime
- By starting early, your investments will have a longer period of time to compound
- With a longer time frame, you will have a larger choice of investment possibilities

What to do...

- Assess your risk tolerance
- Determine your investing time frame
- Determine the amount of money you can invest
- Choose investments that are appropriate for your risk tolerance and time horizon
- Seek professional management, if necessary

Why save for retirement?

Because people are living longer. According to the U.S. Administration on Aging, persons reaching age 65 have an average life expectancy of an additional 18.4 years. * And since Social Security accounts for only 37 percent of total aggregate income for aged persons,** Social Security alone may not be enough to see you through your retirement years.

*Source: *A Profile of Older Americans: 2006*, U.S. Administration on Aging

**Source: *Fast Facts & Figures About Social Security, 2007*, Social Security Administration

Estimating Your Retirement Income Needs

You know how important it is to plan for your retirement, but where do you begin? One of your first steps should be to estimate how much income you'll need to fund your retirement. That's not as easy as it sounds, because retirement planning is not an exact science. Your specific needs depend on your goals and many other factors. However, by doing a little homework, you'll be well on your way to a comfortable retirement.

Use your current income as a starting point

It's common to discuss desired annual retirement income as a percentage of your current income. Depending on who you're talking to, that percentage could be anywhere from 60% to 90%, or even more. The appeal of this approach lies in its simplicity, and the fact that there's a fairly common-sense analysis underlying it: Your current income sustains your present lifestyle, so taking that income and reducing it by a specific percentage to reflect the fact that there will be certain expenses you'll no longer be liable for (e.g., payroll taxes) will, theoretically, allow you to sustain your current life-style.

The problem with this approach is that it doesn't account for your specific situation. If you intend to travel extensively in retirement, for example, you might easily need 100 percent (or more) of your current income to get by. It's fine to use a percentage of your current income as a benchmark, but it's worth going through all of your current expenses in detail, and really thinking about how those expenses will change over time as you transition into retirement.

Project your retirement expenses

Your annual income during retirement should be enough (or more than enough) to meet your retirement expenses. That's why estimating those expenses is a big piece of the retirement planning puzzle. But you may have a hard time identifying all of your expenses and projecting how much you'll be spending in each area, especially if retirement is still far off. To help you get started, here are some common retirement expenses:

- Food and clothing
- Housing: Rent or mortgage payments, property taxes, homeowners insurance, property upkeep and repairs
- Utilities: Gas, electric, water, telephone, cable TV
- Transportation: Car payments, auto insurance,



gas, maintenance and repairs, public transportation

- Insurance: Medical, dental, life, disability, long-term care
- Health-care costs not covered by insurance: Deductibles, co-payments, prescription drugs
- Taxes: Federal and state income tax, capital gains tax
- Debts: Personal loans, business loans, credit card payments
- Education: Children's or grandchildren's college expenses
- Gifts: Charitable and personal
- Savings and investments: Contributions to IRAs, annuities, and other investment accounts
- Recreation: Travel, dining out, hobbies, leisure activities
- Care for yourself, your parents, or others: Costs for a nursing home, home health aide, or other type of assisted living
- Miscellaneous: Personal grooming, pets, club memberships

Don't forget that the cost of living will go up over time. The average annual rate of inflation over the past 20 years has been approximately 3 percent. (Source: Consumer price index (CPI-U) data published annually by the U.S. Department of Labor.) And keep in mind that your retirement expenses may change from year to year. For example, you may pay off your home mortgage or your children's education early in retirement.

Other expenses, such as health care and insurance, may increase as you age. To protect against these variables, build a comfortable cushion into your estimates (it's always best to be conservative). Finally, have a financial professional help you with your estimates to make sure they're as accurate and realistic as possible.

Decide when you'll retire

To determine your total retirement needs, you can't just estimate how much annual income you need. You also have to estimate how long you'll be retired.

Why? The longer your retirement, the more years of income you'll need to fund it. The length of your retirement will depend partly on when you plan to retire. This important decision typically revolves around your personal goals and financial situation. For example, you may see yourself retiring at 50 to get the most out of your retirement. Maybe a booming stock market or a generous early retirement package will make that possible. Although it's great to have the flexibility to choose when you'll retire, it's important to remember that retiring at 50 will end up costing you a lot more than retiring at 65.



Estimate your life expectancy

The age at which you retire isn't the only factor that determines how long you'll be retired. The other important factor is your lifespan. We all hope to live to an old age, but a longer life means that you'll have even more years of retirement to fund. You may even run the risk of outliving your savings and other income sources. To guard against that risk, you'll need to estimate your life expectancy. You can use government statistics, life insurance tables, or a life expectancy calculator to get a reasonable estimate of how long you'll live. Experts base these estimates on your age, gender, race, health, lifestyle, occupation, and family history. But remember, these are just estimates. There's no way to predict how long you'll actually live, but with life expectancies on the rise, it's probably best to assume you'll live longer than you expect.

Identify your sources of retirement income

Once you have an idea of your retirement income needs, your next step is to assess how prepared you are to meet those needs. In other words, what sources of retirement income will be available to you? Your employer may offer a traditional pension that will pay you monthly benefits. In addition, you can likely count on Social Security to provide a

portion of your retirement income. To get an estimate of your Social Security benefits, visit the Social Security Administration website (www.ssa.gov) and order a copy of your statement. Additional sources of retirement income may include a 401(k) or other retirement plan, IRAs, annuities, and other investments. The amount of income you receive from those sources will depend on the amount you invest, the rate of investment return, and other factors. Finally, if you plan to work during retirement, your job earnings will be another source of income.

Make up any income shortfall

If you're lucky, your expected income sources will be more than enough to fund even a lengthy retirement. But what if it looks like you'll come up short? Don't panic--there are probably steps that you can take to bridge the gap. A financial professional can help you figure out the best ways to do that, but here are a few suggestions:

- Try to cut current expenses so you'll have more money to save for retirement
- Shift your assets to investments that have the potential to substantially outpace inflation (but keep in mind that investments that offer higher potential returns may involve greater risk of loss)
- Lower your expectations for retirement so you won't need as much money (no beach house on the Riviera, for example)
- Work part-time during retirement for extra income
- Consider delaying your retirement for a few years (or longer)

Once you have an idea of your retirement income needs, your next step is to assess how prepared you are to meet those needs. In other words, what sources of retirement income will be available to you?

Saving for Your Retirement



START

You have several options for saving for your retirement. How do you know what to do? Here's one common approach:

Contribute money to employer-sponsored plan when employer matches your contribution - get maximum match possible



Employer match is free money



Match grows tax deferred until withdrawn



You may forfeit match if you don't work for a given length of time

Remaining money

Make voluntary contributions to employer-sponsored retirement plans



Dollars grow tax deferred until withdrawn*



Some plans allow pre-tax contributions resulting in an immediate tax savings



Systematic payments from your paycheck - you'll hardly notice



Investment choices might be limited

Remaining money

Contribute to IRAs



Many investment options



Dollars grow tax deferred until withdrawal (qualified withdrawals from Roth IRAs are federal income tax free)



May or may not be tax deductible



Can contribute up to \$5,000 in 2008 (\$4,000 in 2007)

Remaining money

Other options: Annuities, Stock plans, Life insurance, Other investments (e.g. stock, mutual funds), Nonqualified deferred compensation, Salary continuation plans



Annuities, life insurance, and other options have unique tax advantages



Lower capital gains tax rates make some equity investments more attractive for retirement planning



Some options may be complex, and timing of taxable events may be difficult to control

KEY



Definite plus



Need more info



Potential disadvantage

*Employers can allow employees to make after-tax "Roth" contributions to the employer's 401(k) or 403(b) plan. Qualified distributions of these contributions and related earnings are tax free.

**Individuals age 50 and over may make additional \$1,000 IRA catch-up contributions.

Traditional IRAs

Definition

A traditional individual retirement account or individual retirement annuity (IRA) is a personal savings plan that offers tax benefits to encourage retirement savings. You can contribute up to the lesser of \$5,000 (in 2008, \$4,000 in 2007) or 100 percent of your taxable compensation to a traditional IRA. In addition, individuals age 50 and older can make an extra "catch-up" contribution of \$1,000 in 2007 and 2008. Funds in a traditional IRA grow tax deferred until they are withdrawn. Contributions may be fully or partially tax deductible, depending on certain factors.



Prerequisites

- You have not reached age 70½ during the year of the contribution
- You have taxable compensation (i.e., wages, self-employment income) during the year
- You can deduct the full amount of your contribution provided that you are not covered by an employer-sponsored retirement plan
- If you are covered by an employer-sponsored retirement plan, your IRA deduction (if any) depends on your modified adjusted gross income (MAGI) and your federal income tax filing status. You will be entitled to a partial deduction in 2008 if your MAGI is less than:
 1. \$63,000 if your filing status is single or head of household (less than or equal to \$53,000 for a full deduction)
 2. \$105,000 if your filing status is married filing jointly (less than or equal to \$85,000 for a full deduction)
 3. \$10,000 if your filing status is married filing separately (full deduction not available)

Note: These income ranges are for the 2008 tax year, and are indexed for inflation.

Key strengths

- Deductible contributions are made on a pretax basis
- Funds in traditional IRAs grow tax deferred until they are withdrawn
- IRAs offer a wide range of investment choices

- \$1,095,000 (as of 4/1/07) (and in some cases more) of IRA assets are protected in the event of bankruptcy under federal law

Key tradeoffs

- Your ability to deduct contributions may be reduced or eliminated if you are covered by an employer-sponsored retirement plan
- Funds you withdraw from a traditional IRA are taxable income in the year received (to the extent that the withdrawal consists of deductible contributions and investment earnings)
- Withdrawals taken before age 59½ may be subject to a 10 percent premature distribution tax (subject to certain exceptions)
- Minimum annual withdrawals are required when you reach age 70½ (required minimum distributions)
- Taxable portion of distributions will be taxed at ordinary income rates even if funds represent long-term capital gains or dividends paid on stock held within the IRA

Variations from state to state

- States vary in their protection of IRAs from creditors
- States differ in their tax treatment of IRAs



How is it implemented?

- Open an IRA with a bank, financial institution, mutual fund company, life insurance company, or stockbroker
- Select types of investments to fund the IRA (e.g., CDs, mutual funds, annuities)
- Make contributions up to the due date of your federal income tax return for that year (usually April 15 of the following year), not including extensions

Roth IRAs

Definition

A Roth individual retirement account (IRA) is a personal savings plan that offers tax benefits to encourage retirement savings. You can contribute up to the lesser of \$5,000 (in 2008, \$4,000 in 2007)



or 100 percent of your taxable compensation to a Roth IRA. In addition, individuals age 50 or older can make an extra "catch-up" contribution of up to \$1,000 in 2007 and 2008. Contributions to a Roth IRA are not tax deductible, but the funds grow tax deferred and distributions are tax free under certain conditions.

Prerequisites

Comparison of Traditional IRAs and Roth IRAs

	Traditional IRA	Roth IRA
Maximum yearly contribution (2008)	Lesser of \$5,000 or 100% of earned income (\$6,000 if age 50 or older)	Lesser of \$5,000 or 100% of earned income (\$6,000 if age 50 or older)
Income limitation for contributions	No	Yes
Tax-deductible contributions	Yes. Fully deductible if neither you nor your spouse is covered by a retirement plan. Otherwise, your deduction depends on your income and filing status.	No. Contributions to a Roth IRA are never tax deductible.
Age restriction on contributions	Yes. You cannot make annual contributions beginning with the year you reach age 70½.	No
Tax-deferred growth	Yes	Yes; tax free if you meet the requirements for a qualified distribution.
Required minimum distributions during lifetime	Yes. Distributions must begin by April 1 following the year you reach age 70½.	No. Distributions are not required during your lifetime.
Federal income tax on distributions	Yes, to the extent that a distribution represents deductible contributions and investment earnings.	No, for qualified distributions. For nonqualified distributions, only the earnings portion is taxable.
10% penalty on early distributions	Yes, the penalty applies to taxable distributions if you are under age 59½ and do not qualify for an exception.	No, for qualified distributions. For nonqualified distributions, the penalty may apply to the earnings portion. (Special rules apply to amounts converted from a traditional IRA to a Roth IRA.)
Includable in taxable estate of IRA owner at death	Yes	Yes
Beneficiaries pay income tax on distributions after IRA owner's death	Yes, to the extent that a distribution represents deductible contributions and investment earnings.	Generally no, as long as the account has been in existence for at least five years.

401(k) Plans

Key strengths

- You receive "free" money if your contributions are matched by your employer (subject to your plan's vesting schedule)
- You decide how much to save (within federal limits) and how to invest your 401(k) money
- Your regular 401(k) contributions are made with pretax dollars
- Earnings accrue tax deferred until you start making withdrawals, usually after retirement
- Your Roth 401(k) contributions (if your plan allows them) are made with after-tax dollars; there's no up-front tax benefit, but distributions of your contributions are always tax free and, if you satisfy a five-year waiting period, distributions of earnings after age 59½, or upon your disability or death, are also tax free.
- You may qualify for a partial income tax credit
- Plan loans may be available to you
- Hardship withdrawals may be available to you, though income tax and perhaps an early withdrawal penalty will apply, and you may be suspended from participating for up to six months
- Your employer may provide full-service investment management
- Savings in a 401(k) are exempt from creditor claims in bankruptcy (but not from IRS claims)

Bear in mind...

- 401(k)s do not promise future benefits; if your plan investments perform badly, you could suffer a financial loss
- If you withdraw the funds prior to age 59½ (age 55 in certain circumstances) you may have to pay a 10 percent early withdrawal penalty (in addition to ordinary income tax)
- The IRS limits the amount of money you can contribute to your 401(k)
- Unless the plan is a SIMPLE 401(k) plan, you may have to work for your employer up to five years to fully own employer matching contributions

A 401(k) plan is a type of employer-sponsored retirement plan in which you can elect to defer receipt of some of your wages until retirement. If you make pretax contributions, your taxable income is reduced by the amount that you contribute to the plan each year, up to certain limits. The contributed amount and any investment earnings are taxed to you when withdrawn or distributed. If your plan allows after-tax Roth contributions, there's no immediate tax benefit, but qualified distributions are entirely tax free.

Most 401(k) plans offer an assortment of investment options, ranging from conservative to aggressive.



Differences Between a Roth 401(k) and a Roth IRA

	Roth 401(k)	Roth IRA
Maximum contribution (2008)	Lesser of \$15,500 or 100% of compensation	Lesser of \$5,000 or 100% of earned income
Catch-up contribution if age 50 or older (2008)	\$5,000	\$1,000
Who can contribute?	Any eligible employee	Only taxpayers who earn less than: Single/Head of household: \$116,000 Married (filing jointly): \$169,000 Married (filing separately): \$10,000
Lifetime required distributions after age 70½?	Yes	No
Potential employer matching contribution?	Yes ¹	No
Creditor protection in bankruptcy	Unlimited	At least \$1,095,000 (as of 4/1/07) (all IRAs aggregated) ²
Loans available?	Yes, if plan permits	No
Five-year waiting period for qualified distributions?	Yes, from time you contribute to the plan ³	Yes, from time you contribute to ANY Roth IRA
Distributions⁴	Upon termination of employment, age 59½, hardship, disability, and death	Any reason
Qualified tax-free distributions⁴	59½, disability, and death	59½, disability, death, first-time homebuyer (up to \$10,000)
Nonqualified distributions	Pro-rata distribution of tax-free contributions and taxable earnings	Tax-free contributions distributed first, then taxable earnings
Rollovers	To a Roth IRA, Roth 401(k), or Roth 403(b); From a Roth 401(k) or Roth 403(b)	To and from a Roth IRA; From a Roth 401(k) or Roth 403(b); From a traditional IRA ^{5,6}
Investment choices	Limited to investments offered by employer	Virtually unlimited

¹ Employer contributions and earnings are taxable when distributed.

² Amounts rolled over from an employer qualified plan or 403(b) plan, plus earnings on the amount rolled over, also have unlimited creditor protection.

³ Or from the time you contributed to a previous employer's Roth 401(k) plan, if you rolled over your balance from that plan to the current plan.

⁴ Depending on plan terms. Taxes and potential penalties apply to earnings paid in a nonqualified distribution.

⁵ Taxable conversion. Income limits apply.

⁶ Direct rollovers permitted from qualified (i.e., 401(k)), 403(b), and governmental 457(b) plans to Roth IRAs beginning in 2008 (subject to current law rules that generally apply to rollovers from traditional IRAs to Roth IRAs).

Annuities

Key strengths

- Interest and capital gains generated by an annuity accrue tax deferred until withdrawn
- You can receive payments from the annuity for your entire lifetime, regardless of how long you may live*
- There are normally no contribution limits
- There are many different types of annuities to choose from
- You pay taxes only on the earnings portion of annuity payments
- At death, proceeds from an annuity pass free from probate to your named beneficiary

Key tradeoffs

- Annuities carry fees and expenses
- May have surrender charges
- Contributions are not tax deductible
- There may be tax penalties for withdrawals prior to age 59½
- Once you elect a specific distribution plan, annuitize the annuity, and begin receiving payments, that election is usually irrevocable (with some exceptions)

An annuity is a contract between you and an issuer (usually an insurance company).

In its simplest form, you pay a premium in exchange for future periodic payments to begin immediately (an immediate annuity) or at some future date (a deferred annuity) and to continue for a period that can be as long as your lifetime.*



*Guarantees are subject to the claims-paying ability of the issuing insurance company.

Important: Annuities are long-term tax-deferred investment vehicles intended to be used for retirement purposes. Any gains in tax-deferred investment vehicles, including annuities, are taxable as ordinary income upon withdrawal. For variable annuities, investment returns and the principal value of the available sub-account portfolios will fluctuate so that the value of an investor's units, when redeemed, may be worth more or less than their original value.

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