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21st century retirement

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Pension Payout Options—What's Right for You?

When you think of retirement, you probably envision the enjoyable ways you will spend your free time. But, you may also want to give some thought to receiving your funds while in retirement. If you participate in a **company pension plan**, you will have to decide *how* you want to receive your pension proceeds. Consider your payout options, so when the time comes, you can make the choice that is most appropriate for you.

Typically, most pension plans offer the following:

1. Income for the rest of your life (**single life option**).
2. Income for the lives of both you and your spouse (**joint and survivorship option**).
3. A **lump-sum distribution**.

Both single life and joint and survivorship options provide you with a fixed income (usually in monthly installments) in exchange for your pension balance. The third option (lump sum) allows you to take your entire pension balance and manage it yourself.

If you are concerned about outliving your assets, regardless of your marital status, take one of the two "income" options, which may ease your fear of running out of money. If you are single, the choice is easy because you can only select the single life option. On the other hand, if you are married, you can choose either income option.

The single life option pays a higher monthly income, but payments cease at *your* death. While the joint and survivorship option pays a lower monthly income, payments continue until the death of both you *and* your spouse. If you have other substantial retirement assets or your spouse has his or her own pension, taking the larger income offered by the single life option may be your best bet. By contrast, if your pension is all you and your spouse have, the spousal security offered by the joint and survivorship option may be more appropriate.

As you carefully review these two income options, keep in mind that there may actually be a "third" income option, which is really a combination of the single life option and **life insurance**. By taking the higher income

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Planning Retirement: Making the Numbers Add Up

Americans are living longer, healthier lives than ever before. As a result, for many people, retirement may last 20 years or more. So, if "time is money," how many years do you have in the bank? Because inflation will most likely decrease the purchasing power of your money over time, your dollars may buy less during your retirement than they do today. For example, at 3.5% inflation, $100 today would be worth only $42.31 in 25 years, and this amount would be further reduced to $30.00 in 35 years.

The sooner you start building your nest egg, the longer it has to grow. Consider the following examples that assume no taxes or inflation. Suppose, at age 25, you save $100 per month for 20 years and earn 6% interest. If you make no additional contributions after the age of 45 and your savings continue to earn 6% interest, at age 65 your savings will be worth $148,182. However, if you don't begin until age 45 (saving $100 per month for 20 years at 6% interest), at age 65 your savings will be worth *only* $46,204. In order to achieve savings of $148,182 over 20 years, you would need to earn interest at a rate of approximately 15% per year—or save significantly more than $100 per month!

While both scenarios illustrate the same amount of money being saved per month, the additional 20 years and the **compound interest** factor make a big difference. If you are in your prime earning years and start setting money aside *now,* you may have a better chance of meeting your retirement funding goals.

Identify Your Goals

The first step in preparing for your retirement is to determine your objectives. How do you envision your "golden years"? Spend some time thinking about what is really important to you, and consider what you want your future to look like. For example, at what age do you want to retire? Where do you see yourself living? Do you expect to travel frequently? Would you like to continue to work on a part-time basis? Do you see yourself playing golf every day? These questions and others can help you shape a vision for your retirement.

Once you have a sense of your goals, estimate your financial needs. Generally, a retiree's living expenses are roughly 30% less than his or her expenses during working years. While some costs may increase, such as health care and leisure activities, others may decrease. For example, retirees tend to spend less on mortgages and education.

Know Your Resources

The second step in preparing for your retirement is to determine from where you will attain your retirement money. Most people draw on three main sources of income during retirement: Social Security, employer-sponsored plans, and personal retirement savings. Each offers important resources that can add to your overall retirement savings.

With Social Security, the benefits received are based on the income you have earned over the course of your life, subject to a maximum amount. It offers, for most, only a base level of income. Therefore, many retirees supplement Social Security benefits with savings from employer-sponsored plans, such as pension plans, 401(k) plans, 403(b) plans, Simplified Employee Pensions (SEPs), and Savings Incentive Match Plans for Employees (SIMPLEs). The tax advantages and, in many instances, matching contributions from employers make these savings vehicles popular complements to personal retirement savings, which often include traditional Individual Retirement Accounts (IRAs) and Roth IRAs.

Make a Plan

Now that you've thought about your retirement objectives and your potential sources of income, the last step is to develop a plan that helps you address any potential shortfall in your retirement savings. Analyze your current spending habits to find out where your money is actually going and how much you have available to put aside for retirement savings. It may be worthwhile to investigate ways in which you can adjust your lifestyle to decrease spending, and thus increase the amount available for savings. Can you "nip and tuck" without detracting from your quality of life? Are there short-term sacrifices you are willing to make for long-term gain?

When it comes to preparing for retirement, stick to your plan, but be sure to monitor it regularly, as your needs may change over time. Make sure your disciplined approach to saving continues to meet your current and future goals. It's never too late to start saving. Put yourself in a position of working toward your retirement goals, as soon as you can. ■

Retirement Plan Sponsors Increasingly Use Automatic Features

The majority of sponsors of 401(k) or similar defined contribution retirement plans now have automatic features in their plans to help ensure that workers are saving enough to receive full company matching contributions over time, according to the results of a recent survey conducted by human resource consultancy Aon Hewitt in the 4th quarter of 2014.

The survey of approximately 100 companies with defined contribution (DC) plans showed that 70% of respondents have some form of automatic enrollment for new hires. The findings further indicated that 29% of the employers polled automatically enroll participants in the plan at a savings rate that is at or above the company match threshold; while another 27% of employers automatically enroll employees below the full match rate, but automatically escalate contributions over time so that workers will eventually be saving enough to receive the full company match. The survey also showed that 8% automatically enroll participants below the full match threshold and have contribution escalation as an opt-in feature.

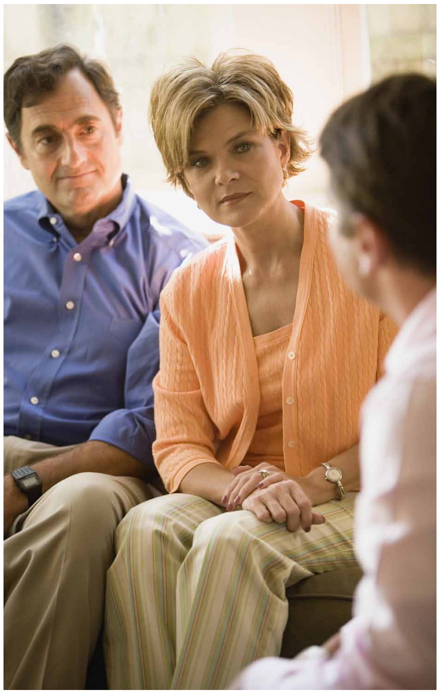
In addition, the survey found that, among the respondents who sponsor plans with automatic enrollment, 7% have default savings rates above the full company match level, 34% have default rates at the full company match level, and 59% have default rates below the full company match level. Moreover, 62% reported that they have embedded contribution escalation, 22% said they have optional escalation, and 16% indicated they have no escalation.

The survey also asked the respondents who reported that their company has not yet implemented automatic enrollment and why they had not done so. More than two-thirds (67%) cited the increased cost of the match as the biggest barrier, 37% said they are concerned about the reaction from employees, and 30% said they do not want small account balances in the plan. ■

Early Retirement: Is It Still Viable?

Many people may plan to take an early retirement or circumstances out of their control may force them to make that decision. Either way, with life expectancies steadily increasing for Americans, it's possible that an individual could spend at least one-third of his or her lifetime in retirement. So, the sooner you begin planning for your exit from the labor force, the greater your chances of taking a comfortable, early retirement.

To maintain your quality of life during your non-working years, you should plan to supplement your qualified retirement plans and Social Security benefits with personal savings. With a disciplined long-term savings plan, you may help increase the likelihood of reaching your retirement goals.



There are important planning considerations specific to early retirees. For example, individuals who retire before the age of 59½ may incur certain penalties on early withdrawals from retirement plans. Also, the pace of inflation will have a direct impact on how long you can live comfortably on your retirement income. Remember that over time, the purchasing power of the dollar typically decreases. Due to financial necessity, or sometimes just an overabundance of leisure time, part-time work while in retirement may be worth your serious consideration as an important part of your overall financial plan.

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with the single life option and using some of that income to pay the premiums on a life insurance policy, you may be able to "net" more income than with the joint and survivorship option. Meanwhile, your spouse will be protected with a potentially significant life insurance death benefit. After your death, the death benefit proceeds will be received income tax free by your spouse and can be used to help fund his or her retirement.

The success of this strategy, often called "pension maximization," depends on your age, health, the type of insurance policy, and schedule of premium payments. The issuance of a life insurance policy is subject to underwriting approval, and the issuance of a policy at a reasonable premium is not guaranteed. Therefore, it is important to apply and verify that you qualify for an appropriate amount of life insurance before making a pension payout election.

If the premium consumes too much of your monthly benefit amount, this strategy may not be an appropriate choice for you. In addition, guarantees of a life insurance policy are based upon the claims-paying ability of the insurer.

It is important to realize that selecting either income option requires you to give up your pension balance in exchange for income. Therefore, you cannot choose a payout option at one point, and then later decide that you would like to receive your remaining pension balance in a lump sum. Let's look at the final payout option, the lump-sum distribution, below.

Taking Control

If you want full control over your pension assets during retirement, or if you are concerned that your pension income may not keep pace with the cost of living, then a lump-sum distribution could be the better option. You can take a lump-sum distribution in one of two ways. You can either roll it over into your own **Individual Retirement Account (IRA)** or receive the pension proceeds (minus income taxes).

Unless you plan on using your pension assets for something other than retirement, it is probably not a good idea to receive your lump sum minus income taxes. The IRA rollover may be a more suitable choice because you will continue to receive the benefits of tax-deferred accumulation and only be taxed on withdrawals from the IRA.

While planning for possibly several decades in retirement, you will need to make a decision about your pension payout. Consider your options carefully to determine which method will best meet your *future* financial needs and lifestyle. Be sure to examine your situation with the assistance of a financial professional before deciding on a strategy. ■

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One often overlooked aspect of retirement planning is money management, especially once retirement has started. Periodic reviews of your finances with a qualified financial professional can help ensure that you get on—and stay on—the right track. In addition, by staying on top of your financial affairs and practicing the art of living within your means, you'll have a greater appreciation for how many more years you may have to enjoy your retirement. With more and more people in the U.S. living into their 80s and 90s, it's essential that you plan ahead to help ensure the retirement lifestyle you envision. ■