

TABLE OF CONTENTS

| | |
|---|----|
| A Financial Warmup | 2 |
| Your Savings Fitness Plan | 4 |
| How’s Your Financial Fitness? | 5 |
| Avoiding Financial Setbacks | 8 |
| Boost Your Financial Performance | 9 |
| Strengthening Your Fitness Plan | 11 |
| Employer “Fitness” Programs | 12 |
| Maximizing Your Workout Potential | 13 |
| Personal Financial Fitness | 14 |
| Financial Fitness for the Self-Employed | 15 |
| Staying on Track | 16 |
| A Lifetime of Financial Growth | 17 |
| A Workout Worth Doing | 18 |
| Resources | 20 |

Most of us know it is smart to save money for those big-ticket items we really want to buy — a new television or car or home. Yet you may not realize that probably the most expensive thing you will ever buy in your lifetime is your...*retirement*.

Perhaps you've never thought of "buying" your retirement. Yet that is exactly what you do when you put money into a retirement nest egg. You are paying today for the cost of your retirement tomorrow.

The cost of those future years is getting more expensive for most Americans, for two reasons. First, we live longer after we retire — with many of us spending 15, 25, even 30 years in retirement — and we are more active.

Second, you may have to shoulder a greater chunk of the cost of your retirement because fewer companies are providing traditional pension plans and are contributing less to those plans. Many retirement plans today, such as the popular 401(k), are paid for primarily by the employees, not the employer. You may not have a retirement plan available at work or you may be self-employed. This puts the responsibility of choosing retirement investments squarely on your shoulders.

Unfortunately, just about half of all Americans are earning retirement benefits at work, and many are not famil-

iar with the basics of investing. Many people mistakenly believe that Social Security will pay for all or most of their retirement needs. The fact is, since its inception, Social Security has provided a minimum foundation of protection. A comfortable retirement usually requires Social Security, pensions and investments.



In short, paying for the retirement you truly desire is ultimately your responsibility. You must take charge. You are the architect of your financial future.

That may sound like an impossible task. Many of us live paycheck to paycheck, barely making ends meet. You may have more pressing financial needs and goals than "buying" something so far in the future. Or perhaps you've waited until close to retirement before starting to save. Yet you still may be able to afford to buy the kind of retirement you want. Whether you are 18 or 58, you can take steps toward a better, more secure future.

That's what this booklet is all about. The U.S. Department of Labor and the Certified Financial Planner

Board of Standards (CFP Board) want you to succeed in setting financial and retirement goals. *Savings Fitness... A Guide to Your Money and Your Financial Future* starts you on the way to setting goals and putting your retirement high on the list of personal priorities.

The Department of Labor's interest in retirement planning stems from its desire to improve the security of American workers in retirement. In 1995, the Department launched its Retirement Education Campaign. Saving is now a national priority, with the passage of the Savings Are Vital to Everyone's Retirement Act of 1997 (SAVER). With this congressional mandate, the Department brings front and center the need to educate Americans about retirement savings.

The CFP Board also has a keen interest in helping Americans meet their personal and financial goals. A nonprofit, professional regulatory organization, the CFP Board exists to benefit the public by fostering professional standards in personal financial planning. To this end, it authorizes individuals who meet its competency, ethics, and professional standards to use its federally registered trademarks CFP® and Certified Financial Planner®.



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This booklet shows you the key tool for making a secure retirement a reality: financial planning. It will help clarify your retirement goals as well as other financial goals you want to “buy” along the way. It will show you how to manage your money so you can afford today's needs yet still fund tomorrow's goals. It will help you make saving for retirement and other goals a *habit*. You'll learn there is no such thing as starting to save too early or too late — only not starting at all! You'll learn how to save your money to make it work for you, and how to protect it so it will be there when you need it for retirement. It explains how you can take the best advantage of retirement plans at work, and what to do if you're on your own.

Yes, retirement *is* a big purchase. The biggest one you may ever make. Yet you can afford it — with determination, hard work, a sound savings habit, the right knowledge, and a well-designed financial plan.

GETTING FIT . . . MANAGING YOUR FINANCIAL LIFE

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

How do you manage all these financial challenges and at the same time try to "buy" a secure retirement? How do you turn your dreams into reality?

Start by writing down each of your goals on a 3"x 5" card so you can organize them easily. You may want to have family members come up with ideas. Don't leave something out at this stage because you don't think you can afford it. This is your "wish list."

Sort the cards into two stacks: goals you want to accomplish within the next 5 years or less, and goals that will take longer than 5 years. It's important to separate them because, as you'll see later, you save for short-term and long-term goals differently.

Sort the cards within each stack in order of priority.

Make retirement a priority! This needs to be among your goals regardless of your age. Some goals you may be able to borrow for, such as college, but you can't borrow for retirement.

Write on each card what you need to do to accomplish that goal: When do you want to accomplish it, what will it cost (we'll tell you more about that later), what money have you set aside already, and how much more money will you need to save each month to reach the goal.

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

We'll come back to these goals when we put together a spending plan.

BEGINNING YOUR SAVINGS FITNESS PLAN

Now let's look at your current financial resources. This is important because, as you

will learn later in this booklet, your financial resources affect not only your ability to reach your goals, but your ability to protect those goals from potential financial crises. These are also the resources you will draw on to meet various life events.

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

First, add up the approximate value of all your assets. This includes personal possessions, vehicles, home, checking and savings accounts, and the cash value (not the death benefits) of any life insurance policies you may have. Include the current value of investments, such as stocks, real estate, certificates of deposit, retirement accounts, IRAs, and the current value of any pensions you have.

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

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

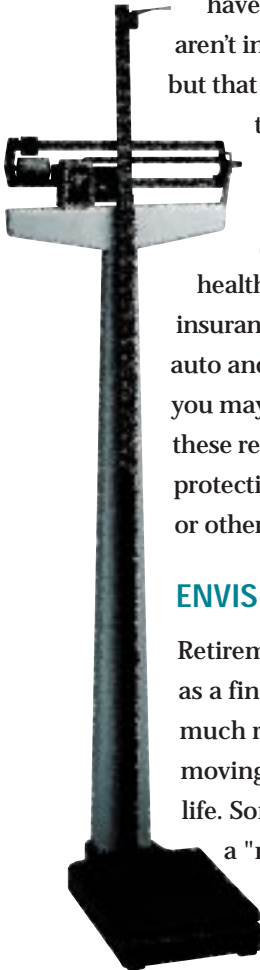
Your aim is to create a positive net worth, and you want it to grow each year. Your net worth is part of what you will draw on to pay for financial goals and your retirement. A strong net worth also will help you through financial crises.

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

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

ENVISION YOUR RETIREMENT

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



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

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

ESTIMATE HOW MUCH YOU NEED TO SAVE FOR RETIREMENT

Now that you have a clearer picture of your retirement goal, it's time to estimate how large your retirement nest egg will need to be and how much you need to save each month to buy that goal. This step is critical! The vast majority of people never take this step, yet it is very difficult to save adequately for retirement if you don't at least have a rough idea of how much you need to save every month.

Planning for Retirement While You Are Still Young

Retirement probably seems vague and far off at this stage of your life. Besides, you have other things to buy right now. Yet there are some crucial reasons to start preparing now for retirement.

You'll probably have to pay for more of your own retirement than earlier generations. The sooner you get started, the better.

You have one huge ally — time. Let's say that you put \$1,000 at the beginning of each year into an IRA from age 20 through age 30 (11 years) and then never put in another dime. The account earns 7 percent annually. When you retire at age 65 you'll have \$168,514 in the account. A friend doesn't start until age 30, but saves the same amount annually for 35 years straight. Despite putting in three times as much money, your friend's account grows to only \$147,913.

You can start small and grow. Even setting aside a small portion of your paycheck each month will pay off in big dollars later.

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

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

There are numerous worksheets and software programs that can help you calculate approximately how much you'll need to save. Professional financial planners and other financial advisors can help as well. At the end of this booklet, we provide some sources you can turn to for worksheets.

Regardless of what source you use, here are some of the basic questions and assumptions the calculation needs to answer.

How much retirement income will I need?

An easy rule of thumb is that you'll need to replace 70 to 90 percent of your pre-retirement income. If you're making \$50,000 a year (before taxes), you might need \$35,000 to \$45,000 a year in retirement income to enjoy the same standard of living you had before retirement. Think of this as your annual "cost" of retirement. The lower your income, generally the higher the portion of it you will need to replace.

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

will need a lot less money than someone who plans to be active, take expensive vacations, and live in an expensive region.

For younger people in the early stages of their working life, estimating income needs that may be 30 to 40 years in the future is obviously difficult. At least start with a rough estimate and begin saving something — 10 percent of your gross income would be a good start. Then every 2 or 3 years review your retirement plan and adjust your estimate of retirement income needs as your annual earnings grow and your vision of retirement begins to come into focus.

How long will I live in retirement? Based on current estimates, a male retiring at age 55 today can expect to live approximately 23 years in retirement. A female retiring today at age 55 can expect to live approximately 27 years. And the likelihood of living at least 20 years for someone retiring at 55 today is high — over 60 percent for a man and about 75 percent for a woman.

These are average figures and how long you can expect to live will depend on factors such as your general health and family history. But using today's average or past history may not give you a complete picture. People are living longer today than they did in the

past, and virtually all expert opinion expects the trend toward living longer to continue.

What other sources of income will I have?

As of October 1999, Social Security will mail a statement to workers age 25 and older showing all the wages reported and an estimate of retirement, survivors and disability benefits. You can also request a statement by visiting the **Social Security Administration's Website** at www.ssa.gov or by calling **800-772-1213** and requesting a free Personal Earnings and Benefit Estimate Statement.

Will you have other sources of income?

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

What savings do I already have for retirement? You'll need to build a nest egg sufficient to make up the gap between the total amount of income you will need each year and the amount provided annually by Social Security and any pension income. This nest egg will come from your retirement plan accounts at work, IRAs, annuities, and personal savings.



What adjustments must be made for inflation? The cost of retirement will likely go up every year due to inflation — that is, \$35,000 won't buy as much in year 5 of your retirement as it will the first year because the cost of living usually rises. Although Social Security benefits are adjusted for inflation, any other estimates of how much income you need each year — and how much you'll need to save to provide that income — must be adjusted for inflation. The annual inflation rate is 2.3 percent currently, but it varies over time. In 1980, for instance, the annual inflation rate was 13.5 percent; in 1998, it reached a low of 1.6 percent. When planning for your retirement it is always safer to assume a higher, rather than a lower, rate and have your money buy more than you previously thought. Retirement calculators should allow you to make your own estimate for inflation.

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

It's important to choose realistic annual returns when making your estimates. Most

financial planners recommend that you stick with the historical rates of return based on the types of investments you choose or even slightly lower.

How many years do I have left until I retire? The more years you have, the less you'll have to save each month to reach your goal.

How much should I save each month? Once you determine the number of years until you retire and the size of the nest egg you need to "buy" in order to provide the income not provided by other sources, you can calculate the amount to save each month.

It's a good idea to revisit this worksheet at least every 2 or 3 years. Your vision of retirement, your earnings, and your financial circumstances may change. You'll also want to check periodically to be sure you are achieving your objectives along the way.

"SPEND" FOR RETIREMENT

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

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

people who make high incomes often have difficulty saving. But we've got some ideas that may help you.

Let's start with a "spending plan" — a guide for how we want to spend our money. Some people call this a budget, but since we're thinking of retirement as something to buy, a spending plan seems more appropriate.

A spending plan is simple to set up. Consider the following steps as a guide, but you may want to use a computer program.

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

Expenses. Add up monthly expenses: mortgage or rent, car payments, average food bills, medical expenses, entertainment, and so on. Determine an average for expenses that vary each month, such as clothing, or that don't occur every month, such as car insurance or self-employment taxes. Review your checkbook, credit card records, and receipts to estimate expenses. You probably will need to track how you spend cash for a month or two. Most of us are surprised to find out where and how much cash "disappears" each month.

How to Prepare for Retirement When There's Little Time Left

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

- It's never too late to start. It's only too late if you don't start at all.
- Sock it away. Pump everything you can into your tax-sheltered retirement plans and personal savings. Try to put away at least 20 percent of your income.
- Reduce expenses. Funnel the savings into your nest egg.
- Take a second job or work extra hours.
- Aim for higher returns. Don't invest in anything you are uncomfortable with, but see if you can't squeeze out better returns.
- Retire later. You may not need to work full time beyond your planned retirement age. Part time may be enough.
- Refine your goal. You may have to live a less expensive lifestyle in retirement.
- Delay taking Social Security. Benefits will be higher when you start taking them.
- Make use of your home. Rent out a room or move to a less expensive home and save the profits.
- Sell assets that are not producing much income or growth, such as undeveloped land or a vacation home, and invest in income-producing assets.

Include savings as an expense. Better yet, put it at the top of your expense list. Here's where you add in the total of the amounts you need to save each month to accomplish the goals you wrote down earlier on the 3"x 5" cards.

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

Cut expenses. There are hundreds of ways to reduce expenses, from clipping grocery coupons and bargain hunting to comparison shopping for insurance and buying new cars less often. The section that follows on debt and credit card problems will help. You also can find lots of expense-cutting ideas in books, magazine articles, and financial newsletters.

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

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

- Pay yourself first. Put away first the money you want to set aside for goals. Have money

automatically withdrawn from your checking account and put into savings or an investment. Join a retirement plan at work that deducts money from your paycheck. Or deposit your retirement savings yourself, the first thing. What you don't see you don't miss.

- Put bonuses and raises toward savings.
- Make saving a habit. It's not difficult once you start.
- Revisit your spending plan every few months to be sure you are on track. Income and expenses change over time.

AVOID DEBT AND CREDIT PROBLEMS

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

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

What's the difference between "good debt" and "bad debt"? Yes, there is such a thing as good debt. That's debt that can provide a

financial pay off. Borrowing to buy or remodel a home, pay for a child's education, advance your own career skills, or buy a car for getting to work can provide long-term financial benefits.

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

Do you have debt problems?

Here are some warning signs:

- Borrowing to pay off other loans.
- Creditors calling for payment.
- Paying only the minimum on credit cards.

- Maxing out credit cards.
- Borrowing to pay regular bills.
- Being turned down for credit.

Avoid high-interest rate loans. Loan solicitations that come in the mail, pawning items for cash, or "payday" loans in which people write postdated checks to check-cashing services are usually extremely expensive.

For example, rolling over a payday loan every 2 weeks for a year can run up interest charges of over 600 percent! While the Truth-in-Lending Act requires lenders to disclose the cost of your loan expressed as an annual percentage rate (APR), it is up to you to read the fine print telling you exactly what the details of your loan and its costs are.

The key to recognizing just how expensive these loans can be is to focus on the total cost of the loan — principal and interest. Don't just look at the monthly payment, which may be small, but adds up over time.

Handle credit cards wisely. Credit cards can serve many useful purposes, but people often misuse them. Take, for example, the habit of making only the 2 percent minimum payment each month. On a \$2,000 balance with a credit card charging 18 percent interest, it would take 30 years to pay off the amount owed. Then imagine how fast you would run up your debts if you did this with several credit cards at the same time. (For more examples of how long it will take to pay off a credit card balance, see the "Resource" section at the end of this publication.)

Here are some additional tips for handling credit cards wisely.

- Keep only one or two cards, not the usual eight or nine.
- Don't charge big-ticket items. Find less

expensive loan alternatives.

- Shop around for the best interest rates, annual fees, service fees, and grace periods.
- Pay off the card each month, or at least pay more than the minimum.
- Still have problems? Leave the cards at home or cut them up.

How to climb out of debt. Despite your best efforts, you may find yourself in severe debt. A credit counseling service can help you set up a plan to work with your creditors and reduce your debts.

SAVING FOR RETIREMENT

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

- Savings accounts, money market mutual funds, certificates of deposit, and U.S. Treasury bills. These are sometimes referred to as cash or cash equivalents because you can get to them quickly and there's little risk of losing the money you put in.
- Domestic bonds. You loan money to a U.S. company or a government body in return for its promise to pay back what you loaned, with interest.



- Domestic stocks. You own part of a U.S. company.
- Mutual funds. Instead of investing directly in stocks, bonds, or real estate, for example, you can use mutual funds. These pool your money with money of other shareholders and invest it for you. A stock mutual fund, for example, would invest in stocks on behalf of all the fund's shareholders. This makes it easier to invest and to diversify your money.

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

For goals that are at least 5 years in the future, however, such as retirement, you may want to put some of your money into stocks, bonds, real estate, foreign investments, mutual funds, or other assets. Unlike savings accounts or bank CDs, these types of investments typically are not insured by the federal government. There is the risk that you can lose some of your money. How much risk depends on the type of investment. Generally, the longer you have until retirement and the greater your other sources of income, the more risk you can afford. For those who will be retiring soon and who will

depend on their investment for income during their retirement years, a low-risk investment strategy is more prudent. Only you can decide how much risk to take.

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

The differences in the average annual returns of various types of investments over time is dramatic. Since 1926, the average annual return of short-term U.S. Treasury bills, which roughly equals the return of other cash equivalents such as savings accounts, has been 3.8 percent. The annual return of long-term government bonds over the same period has been 5.3 percent. Large-company stocks, on the other hand, while riskier in the short term, have averaged an annual return of 11.2 percent.

Let's put that into dollars. If you had invested \$1 in Treasury bills in 1926, that \$1 would have grown to approximately \$15 today. However, inflation, at an annual average of 3.1 percent, would have eaten \$9 of that gain. If the \$1 had been invested in government bonds, it would have grown to \$44. But invested in large-company stocks, it would have grown to over \$2,300. None of these

rates of returns is guaranteed in the future, but they clearly show the relationship between risk and potential reward.

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

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

Reducing investment risk. There are two main ways to reduce risk. First, diversify *within* each category of investment. You can do this by investing in pooled arrangements, such as mutual funds, index funds (i.e., stocks), and bank products sold by reliable professionals. These investments typically give you a small share of different individual investments and will allow you to spread your money among many stocks, bonds and other financial instruments, even if you don't have a lot of money to invest. Your risk of losing money is less than if you buy shares in only a few individual companies. Distributing your investments in this way is called *diversification*.

Second, you can reduce risk by investing *among* categories of investments. Generally

speaking, you should put some of your money in cash, some in bonds, some in stocks, and some in other investment vehicles. Studies have shown that once you have diversified your investments within each category, the choices you make about how much to put in these major categories is the most important decision you will make and should define your investment strategy.

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

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

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

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

THE POWER OF COMPOUNDING

Regardless of where you choose to put your money — cash, stocks, bonds, real estate, or a combination of places — the key to saving for retirement is to make your money work for you. It does this through the power of compounding. Compounding investment earnings is what can make even small

Facts Women Should Know About Preparing for Retirement

Women face challenges that often make it more difficult for them than men to adequately save for retirement. In light of these challenges, women need to pay special attention to making the most of their money.

- Women tend to earn less than men and work fewer years.
- Women tend to change jobs or work part-time more often, and they interrupt their careers to raise children. Consequently, they are less likely to qualify for company-sponsored retirement plans or receive the full benefits of those plans.
- On average, women live 5 to 7 years longer than men, and thus need to build a larger retirement nest egg for themselves.
- Some studies indicate women tend to invest less aggressively than men.
- Women are less likely to be financially informed than men.
- Women tend to lose more income than men following a divorce.
- Women are twice as likely as men during retirement to receive income below the poverty level.

For more information, call the **Pension and Welfare Benefits Administration** at (800) 998-7542 and ask for the booklets *Women and Pensions* and *QDROs: The Division of Pensions through Qualified Domestic Relations Orders* (for example, divorce orders). Also call the **Social Security Administration** at (800) 772-1213 for their booklet *Social Security: What Every Woman Should Know*, or visit the agency’s Website at www.ssa.gov.

investments become larger given enough time.

You’re probably already familiar with the principle of compounding. Money you put into a savings account earns interest. Then you earn interest on the money you originally put in, *plus* on the interest you’ve accumulated. As the size of your savings account grows, you earn interest on a bigger and bigger pool of money.

The chart below provides an example of how an investment grows at different annual rates of return over different time periods. Notice how the amount of gain gets bigger each 10-year period. That’s because money is being earned on a bigger and bigger pool of money.

Also notice that when you double your rate of return from 4 percent to 8 percent, the end result after 30 years is over *three* times what you would have accumulated with a 4 percent return. That’s the power of compounding!

| POWER OF COMPOUNDING | | | | |
|--|---------|---------|----------|----------|
| Value of \$1,000 compounded at various rates of return over time | | | | |
| Years | 4% | 6% | 8% | 10% |
| 10 | \$1,481 | \$1,791 | \$2,159 | \$2,994 |
| 20 | \$2,191 | \$3,207 | \$4,661 | \$6,728 |
| 30 | \$3,243 | \$5,743 | \$10,063 | \$17,449 |

The real power of compounding comes with time. The earlier you start saving, the more your money can work for you. Look at it another way. *For every 10 years you delay before starting to save for retirement, you will need to save three times as much each month to catch up.* That’s why no matter how young you are, the sooner you begin saving for retirement, the better.

USING EMPLOYER-BASED RETIREMENT PLANS

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

Employer-based plans come in one of two varieties (some employers provide both): defined benefit and defined contribution.

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

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

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

Workers with a pension are more likely to be covered by a defined contribution plan, usually a 401(k) plan, rather than the traditional defined benefit plan. In many defined contribution plans, you are offered a choice of investment options, and *you* must decide where to invest your contributions. This shifts much of the responsibility for retirement planning to workers. Thus, it is critical that you choose to contribute to the plan once you become eligible (usually after

working full-time for a minimum period) and that you choose your investments wisely.

Tax Breaks. Even though you typically are responsible for funding a defined contribution plan, you receive important tax breaks. The money you invest in the plan and the earnings on those contributions are deferred from income tax until you withdraw the money (hopefully not until retirement). Why is that important? Because postponing taxes on what you earn allows your nest egg to grow faster. Remember the power of compounding? The larger the amount you have to compound, the faster it grows. Even after the withdrawals are taxed, you typically come out ahead.

The tax deduction also means that the decline in your take-home pay, because of your contribution, won't be as large as you might think. For example, let's assume you are thinking about putting \$100 into a retirement plan each month and that the rate you pay on income taxes is 15 percent. If you don't put that \$100 into a retirement plan, you'll pay \$15 in taxes on it. If you put in \$100, you postpone the taxes. Thus, your \$100 retirement plan contribution would actually reduce your take-home pay by only \$85. If you're in the 28 percent tax bracket, the cost of the \$100 contribution is only \$72. This is like buying your retirement at a discount.

How to Make the Most of a Defined Contribution Plan

- **Study your employee handbook and talk to your benefits administrator to see what plan is offered and what its rules are. Read the summary plan description for specifics. Plans must follow federal law, but they can still vary widely in contribution limitations, investment options, employer matches, and other features.**
- **Join as soon as you become eligible.**
- **Put in the maximum amount allowed.**
- **If you can't afford the maximum, try to contribute enough to maximize any employer matching funds. This is free money!**
- **Study carefully the menu of investment choices. Some plans offer only a few choices, others may offer hundreds. The more you know about the choices, investing, and your investment goals, the more likely you will choose wisely.**
- **Many companies match employee contributions with stock instead of cash. Financial experts often recommend that you don't let your account get overloaded with company stock, particularly if the account makes up most of your retirement nest egg. Too much of a single stock increases risk.**
- **Plan fees and expenses reduce the amount of retirement benefits you ultimately receive from plans where you direct the investments. It's in your interest to learn as much as you can about your plan's administrative fees, investment fees, and service fees. Read the plan documents carefully. For more information on fees, call the PWBA Publication Hotline at (800) 998-7542 and request the booklet *A Look at 401(k) Plan Fees*.**

Vesting Rules. Any money you put into a retirement plan out of your pay, and earnings on those contributions, always belong to you. However, contrary to popular belief, employees don't always have immediate access to the money their employer puts into their pension fund or their defined contribution plan. Under some plans, such as a traditional

pension plan or a 401(k), you have to work for a certain number of years — say 5 — before you become "vested" and can receive benefits. Some plans vest in stages. Other defined contribution plans, such as the SEP-IRA and the SIMPLE-IRA, vest immediately. You have access to the employer's contributions the day the money is deposited. No employer

CAUTION

- Don't borrow from your retirement plan or permanently withdraw funds before retirement unless absolutely necessary.
- Your retirement plan may allow you to borrow from your account, often at very attractive rates. However, borrowing reduces the accounts earnings, leaving you with a smaller nest egg. Also, if you fail to pay back the loan, you could end up paying income taxes and penalties. As an alternative, consider budgeting to save the needed money or pursue other affordable loan options.
- Also avoid permanently withdrawing funds before retirement. This often happens when people change jobs. According to a study by the Employee Benefits Research Institute and Hewitt Associates, only 40 percent of workers changing jobs rolled over into an IRA or a new employer's retirement plan the money they received from their former employer's retirement plan. They spent 6 out of every 10 dollars, rather than letting it grow in another plan or IRA.
- Pre-retirement withdrawals reduce the ultimate size of your nest egg. In addition, you'll probably pay federal income taxes on the amount you withdraw (15 percent to as high as 39.6 percent) and a 10 percent penalty may be tacked on if you're younger than age 59-1/2. In addition, you may have to pay state taxes. If you're in a SIMPLE plan, that early-withdrawal penalty climbs to 25 percent if you take out money during the first 2 years you're in the plan.

can require you to work longer than 5 years before you become vested in most of your pension benefit.

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

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

Retirement Plan Rights. The federal government regulates and monitors company retirement plans. The vast majority of employers do an excellent job in complying with federal law. Unfortunately, a small fraction don't. For 10 warning signs and other information on protecting your pension rights, call the **Pension and Welfare Benefits Administration (PWBA)** at **(800) 998-7542** and request the booklet *Protect Your Pension*.

TYPES OF DEFINED CONTRIBUTION PLANS

The following are some of the most common types of defined contribution plans. For a more detailed description and comparison of some of these plans, go to the Website www.dol.gov/dol/pwba and click on the **Small Business Retirement Savings Advisor**.

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

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

SIMPLE-IRA. The Savings Incentive Match Plan for Employees of Small Employers is one of the newest types of employer-based retirement plans. There is also a 401(k) version of the SIMPLE.

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

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

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

Other retirement plans you may want to learn more about include money purchase plans; paired plans (money purchase and profit-sharing plans); 457 plans, which cover

Retirement Planning for Employees in Small Companies

Only about two out of every 10 small employers with fewer than 100 employees offer some type of retirement plan or pension to their employees. Many believe their workers prefer higher salaries or other benefits, and they believe the rules are too complex and the costs too high.

If you don't have a plan available at work, encourage your employer to start one.

Mention the following benefits:

- A retirement plan can attract and retain valued employees in a competitive labor market, as well as motivate workers.
- Establishing a retirement plan and encouraging employee participation can help employers fund their own retirement. Even after taking into account the cost of establishing an employee plan, they may still be better off than funding retirement on their own.
- Some plans cost less and have fewer administrative hassles than employers may realize. Alternatives to traditional defined benefit plans and the 401(k) include the SIMPLE and the SEP.

For more information, contact the PWBA at (800)998-7542 and request *Savings Incentive Match Plans for Employees of Small Employers, Simplified Employee Pensions: What Small Businesses Need to Know*, and *Simple Retirement Solutions for Small Businesses*.

state and local government workers; and the Federal Thrift Savings Plan, which covers federal employees. If you are eligible, you may also want to open a Roth IRA.

WHAT TO DO IF YOU CAN'T JOIN AN EMPLOYER-BASED PLAN

You may not be able to join an employer-based retirement plan because you are not eligible or because the employer doesn't offer one. Fortunately, there are steps you can still take to build your retirement strength.

Take a job with a plan. If two jobs offer similar pay and working conditions, the job that offers retirement benefits may be the better choice.

Start your own plan. If you can't join a company plan, you can save on your own.

You can't put away as much on a tax-deferred basis, and you won't have an employer match. Still, you can build a healthy nest egg if you work at it.

Open an IRA. You can put up to \$2,000 a year into an individual retirement account on a tax-deductible basis if your spouse isn't covered by a retirement plan at work, or as long as your combined incomes aren't too high. You also can put another \$2,000 tax-deferred into an IRA for a nonworking spouse if you file your income tax return

jointly. (By the way, you don't have to put in a full \$2,000; you can put in less.) With a regular IRA, you delay income taxes on what you put in and on the earnings until you withdraw the money. With the Roth IRA, the money you put in is already taxed, but you won't ever pay income taxes on the earnings as long as the account is open at least 5 years.

Consider an annuity. An annuity is when you pay money to an insurance company in return for its agreement to pay either a regular fixed amount when you retire or an amount based on how much your investment earns. There is no limit on how much you can invest in a private annuity, and earnings aren't taxed until you withdraw them. However, annuities present complex issues regarding taxes, fees, and withdrawal strategies that may not make them the best investment choice for you. Consider discussing this type of investment first with a financial planner.

Build your personal savings. You can always save money on your own, either in mutual funds, stocks, bonds, real estate, CDs, or other assets. It's best to mark these investments as part of your retirement fund and don't use them for anything else unless absolutely necessary.

Investing in an IRA, an annuity, or in personal savings means you are totally responsible for

directing your own investments. How conservatively or aggressively you invest is up to you. It will depend in part on how willing you are to take investment risks, your age, the stability of your job, and other financial needs. Learn as much as you can about investing and about specific investments you are considering. You also may want to seek the help of a professional financial planner.

WHAT TO DO IF YOU ARE SELF-EMPLOYED

Many people today work for themselves, either full-time or in addition to their regular job. They have several tax-deferred options from which to choose.

SEP-IRA. This is the same type of SEP described earlier under employer-based retirement plans. Only here, you're the employer and you fund the SEP from your earnings. You can easily set up a SEP through a bank, mutual fund, or other financial institution.

Keogh. Keoghs are more complicated to set up and maintain, but they offer more advantages than a SEP. For one thing, they come in several varieties. Some of the varieties allow you to sock away more money — sometimes a lot more money — than a SEP.

SIMPLE-IRA. Described earlier under employer-based retirement plans, a

SIMPLE-IRA can be used by the self-employed. However, generally you can't save as much as you can with a SEP or Keogh.

IRA. Usually you are better off funding a SEP or a Keogh unless your self-employment income is small.

Annuities. See annuities under the section on “What to Do if You Can't Join an Employer-Based Plan” (see page 15).

MANAGING FOR A LIFETIME OF FINANCIAL GROWTH

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

Here are a few suggestions for saving for retirement while financially managing some common life events.

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

Tips on How to Save Smart for Retirement

- Start now. Don't wait. Time is critical.
- Start small, if necessary. Money may be tight, but even small amounts can make a big difference given enough time, the right kind of investments, and tax-favored vehicles such as company retirement plans, IRAs, and SEPs.
- Use automatic deductions from your payroll or your checking account for deposit in mutual funds, IRAs, or other investment vehicles.
- Save regularly. Make saving for retirement a habit.
- Be realistic about investment returns. Never assume that a year or 2 of high market returns will continue indefinitely. The same goes for market declines.
- Roll over retirement account money if you change jobs.
- Don't dip into retirement savings.

spending plan is essential. Remember, every little bit helps.

Raising children. The U.S. Department of Agriculture estimates that it costs the average American family over \$200,000 to raise a child to age 18. Furthermore, in some cases a spouse may stay out of the workforce to raise children, thus cutting into income and

the opportunity to fund retirement. Having a child may alter your major financial goals, but should never eliminate them. Make the best effort you can. Also, many financial planners stress that saving for retirement should have priority over saving for a child's college education. There are financial aid programs for college-bound students but not for retirement.



Changing jobs. It's estimated that the average worker changes jobs 10 times and careers three times in a working lifetime. Changing jobs often puts you at risk of not vesting in your current job, or a new job may not offer a retirement plan. Consider rolling money from an existing company retirement plan into a new company plan or an individual retirement account (IRA). Don't cash out and spend the money, however small the amount.

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

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

Death. The premature death of a spouse can undermine efforts for the partner to save for

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

COPING WITH FINANCIAL CRISES

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

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

Insure yourself. Insurance protects your financial assets, such as your retirement funds, by helping to take care of the really

big financial disasters. Here's a list of insurance coverage you should consider buying:

Health. If you and your family aren't covered under an employer's policy, at least try to buy catastrophic medical coverage on your own.

Disability. Did you know you are more likely before age 65 to miss at least 3 months of work because of a disability than you are to die? Social Security Disability Insurance can pay you and your family benefits if you are severely disabled and are expected to be so for at least 12 months. (Worker's compensation only helps if the disability is work-related.) In addition, your employer may offer some disability coverage, but you may need to supplement it with private coverage.

Renters. Homeowners usually are insured against hazards such as fire, theft, and liability, but the majority of renters aren't. Renter's insurance is inexpensive.

Automobile. Don't drive "bare." It's usually against the law to drive without auto coverage, to say nothing of being costly if you are in an accident.

Umbrella. This provides additional liability coverage, usually through your home or auto insurance policies, in the event you face a lawsuit.

Life. Having life insurance can help you or your spouse continue to save if either one of you dies before retirement. Social Security may be able to pay benefits to your spouse and/or minor children. On the other hand, you may not need life insurance if no one depends financially on you. There are many types of life insurance, with a variety of fees and commissions attached.

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

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

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

MONITOR YOUR PROGRESS

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

If You Choose to Work With a Financial Planner

You are the one ultimately responsible for the management of your own financial affairs. However, you may want additional help along the way from a professional financial planner. A professional planner can:

- Provide expertise you don't have.
- Help improve your current financial management.
- Save you time.
- Provide an objective perspective.
- Help you through a financial crisis.
- Motivate you to take action.

For more information, call the Certified Financial Planner Board of Standards at 1-888-237-6275 and request *Ten Questions to Ask When Choosing a Financial Planner*.

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

WHERE TO GO FROM HERE

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

Look back on those 3"x 5" cards outlining your goals. Perhaps they seem more realistic now. Even if you can't do as much as you would like to right away, you can do something.

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

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

All that matters is that you start saving...now!

RESOURCES

This publication is presented by the:

Pension and Welfare Benefits Administration
U.S. Department of Labor
200 Constitution Ave., N.W.
Washington, DC 20210

Website: www.dol.gov/dol/pwba
Toll-free Publication Hotline: 1-800-998-7542

Certified Financial Planner Board of Standards
1700 Broadway, Suite 2100
Denver, CO 80290-2101

Website: www.CFP-Board.org
Toll-free number: 1-888-237-6275

Sample Financial Calculator Websites:
(as mentioned on page 6)

www.kiplinger.com – Click on “Retirement.”

www.moneymag.com – Click on “Retirement.”

www.usnews.com – Click on “Retirement Calculator.”

www.asec.org - Click on “Ballpark Estimate Worksheet.”

www.nasd.com – Click on “Investor Services,” then “Financial Calculators.”

(Note: The sites above are only a sample of calculators available on the Web. The Department of Labor does not endorse a specific calculator or the products and services offered on these Websites.)

Paying off your Credit Card Balance:

(as mentioned on page 9)

Consolidated Credit Counseling Services, Inc.
www.debtfree.org

Other Web sources that highlight savings and retirement planning:

www.sec.gov and www.sec.gov/consumer/camp99/quiz.htm

The U.S. Securities and Exchange Commission (SEC) has developed an interactive quiz for students, “Test Your Money Smarts.” And for those already in the stock market, check out the information on consumer protection, listed under “Investor Assistance and Complaints.”

Toll-free number for consumer information:
1-800-732-0330

www.ftc.gov

Check out the Federal Trade Commission’s (FTC) section on “Consumer Protection,” including a quiz on investment scams.

www.pueblo.gsa.gov

The Consumer Information Center’s (CIC) site contains text versions of hundreds of consumer publications. See the “Money” section for a list of brochures on money management and retirement planning.

www.ssa.gov

Visit the Social Security Administration’s Website for these sites: “Access America for Seniors” and “Youth Link.” You can also request a Personal Earnings and Benefits Estimate Statement to find out what your Social Security benefits will be.

www.publicdebt.treas.gov and
www.publicdebt.treas.gov/sav/savinvt.htm

The Department of Treasury’s Website answers questions about interest rates, buying and cashing savings bonds, and taxes.

www.investoreducation.org

Investors of all ages can link to “Investing Basics” and the “Kid’s Savings Calculator” on the Alliance for Investor Education (AIE) Website.

www.aarp.org and www.aarp.org/programs/retire/reaarp.html

The American Association of Retired Persons (AARP) site provides advice on a host of retirement planning issues. Link to the “Retirement” section for a wealth of information.

www.nefe.org

Check out the “High School Financial Planning Program” at this site, sponsored by the National Endowment for Financial Education.

www.jumpstartcoalition.org

JumpStart Coalition for Personal Financial Literacy offers a wealth of financial education materials aimed at grades K-12.

www.consumerfed.org

Links to investor education sites are among those offered on the Consumer Federation of America’s Website. You can also download information on “Teenage Consumers: Teaching Your Children How to Save and Spend” at www.consumerfed.org/teachchild.pdf.