written by Christopher L. Hayes, Ph.D.

handbook 2

A Pension That Will Place *You First*

A Guide for Baby Boomers

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NATIONAL ENDOWMENT FOR
FINANCIAL EDUCATION

Partnering for Financial Well-Being

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Written by Christopher L. Hayes, Ph.D.

Acknowledgments

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Introduction

The Baby Boom generation (born between 1946-1963) has marched into every stage of life with a unique set of values, perspectives, and needs. Even planning for retirement, Boomers march to a different beat, which is the reason for this series of handbooks. They were written to encourage Baby Boomers to harness their individuality in addressing present and future needs.

The *You First* Planning Process

Each handbook in this series is based on a concept we call *You First*. The term means that you have the power and ability to chart your own course to actualizing your goals and dreams. *You First* means that you have the power to learn and implement new strategies based on changing needs and circumstances. *You First* encourages you to use outside resources in an ongoing quest to make informed and educated decisions about present and future needs. Most importantly, these handbooks provide you with a foundation to sharpen your skills and abilities, putting you in control of the planning process.

Setting up your personal future is based on five principles:

– *You First* need to *understand* that your older years will be different from what any other generation has experienced.
– *You First* must *recognize* that your future is an individual responsibility. You cannot depend on others to meet your needs in later life.
– *You First* need to *believe* that planning takes minimal effort and will not add burdens to your already busy life.
– *You First* must *recognize* that taking any step forward builds momentum and creates greater opportunity for accomplishing your goals.
– *You First* need to *acknowledge* that your own individuality is a tremendous resource, which will nurture and guide you throughout the process.

The *You First* Steps to Planning

You First, as an infant, couldn't walk. Walking was part of a process that began with crawling before you advanced slowly onto two feet, with the occasional fall. Likewise, creating the future you want requires taking incremental steps, and sometimes making mistakes. Just like the marathon runner, you set the pace of completing each step in the handbook series. Each step is designed to be fun; and every step contains suggested *You First* strategies, designed to enhance the likelihood of success.

Throughout each booklet you will read quotes from people just like you. These individuals act as companions who make the material "come to life." In fact, each handbook in the series was based on suggestions and insights from fellow Baby Boomers who were interviewed for this project. At the end of each handbook is a series of *You First* action steps based on the material covered.

You First Handbook Background

The *You First* handbooks were created and written by Christopher L. Hayes, Ph.D., professor of gerontology at Southampton College of Long Island University. The materials were developed as part of a National Endowment for Financial Education® (NEFE®) grant titled *Re-Casting Pre-Retirement Planning Information for the 21st Century*, produced by the Center for Aging Research and Education (CARE). An in-depth research report was generated from Baby Boomer focus groups, which encompassed a wide range of socio-economic and racial/ethnic backgrounds. The author of these *You First* handbooks wishes to thank NEFE for its support in helping reshape the scope and nature of pre-retirement planning materials.

The *You First* Handbook Series

Other handbooks in the series are:

– Investing in *You First*
– A New Career That Will Place *You First*
– Placing *You First* Within Financial Transitions
– Caring for the Long Term: *You First* Need Knowledge

"I feel somewhat embarrassed telling you this story, but it may help others. I have been working for a financial institution for the last 15 years. It was just three years ago that I realized the company had a pension plan. It came as a shock to realize that I had not taken the steps needed to educate myself about this plan and how I could use it for safeguarding my financial future. Since enrolling in the plan, I have watched my money grow and only now realize the power and importance of having a pension." —Delores M. (48 years old)

A Pension That Will Place *You First*

Unfortunately, these stories are true. Studies have found that at least 25 percent of Americans don't take advantage of their employer's 401(k) plan (more on this term later). At the same time, studies have consistently shown that approximately 75 percent of retirement plan participants do not consider themselves to be knowledgeable investors.

This Handbook Delivers Three Important Messages About Pensions:

– *You First* must *understand* that a pension plan is a central foundation for building your financial future.

– *You First* must *care* about your plan's investment practices, because the amount of your pension benefit will be based on how your money is managed.

– *You First* must *realize* that it is your responsibility to maximize the benefits of your pension plan.

This booklet is based on implementing action steps. By following through on each of these steps, you should be able to build a strong pension plan.

"When I started my job I was given a packet of information that explained the firm's 401(k) plan and the different investment options I had. For the first two years, I didn't elect to participate. When my daughter was born, it prompted me to look again at this issue. I started having money taken out of my pay check, and placed in a Money Market account. I now realize that my pension could have grown three times as fast if I had only known about the employer match and placed a greater portion in higher growth investments. Employees need to pay attention to their pension benefits as soon as possible!"
—Michael S. (36 years old)

"Until coming to this group meeting I never really gave a tremendous amount of thought to my pension plan. I'm a little uneasy now realizing what I don't know."
—Bernice N. (34 years old)

Step no. 1 Assessing Your Pension Plan Knowledge

It is better to answer this checklist after reviewing a *Summary Plan Description* of your pension (and/or that of your spouse) and a written estimate of your pension benefit amount. If you don't have these documents, try filling out the checklist anyway.

Answer "yes" or "no" to the following questions.

	Yes	No
1. I currently have a job that provides me with a pension.	☐	☐
2. I have read and understood the information contained in my employer's *Summary Plan Description*.	☐	☐
3. I understand the type of pension plan that is offered at my place of employment (if applicable).	☐	☐

	Yes	No
4. I understand the process involved in participating in the pension plan offered at my place of employment (if applicable).	☐	☐
5. I understand whether my employer "matches" contributions made under my plan.	☐	☐
6. I take full advantage of my employer's match (if applicable).	☐	☐
7. My pension plan fund is insured by the Pension Benefit Guaranty Corporation.	☐	☐
8. I understand how to monitor my employer's pension benefit program.	☐	☐
9. I understand how my pension benefits will be paid to me upon retirement or transfer to another employer.	☐	☐
10. I understand what I will receive from my spouse's pension plan in the event that he/she dies.	☐	☐

The above questions represent the basic foundation of what you should understand about your pension plan. If you checked "no" on certain questions, don't worry. This booklet is intended to help you get the information you need.

How to Find Out About Your Pension Benefits

Your employer is required by federal law to provide you with a variety of plan information, including participation rules, financial operation, and management of the plan.

- *Contact your Pension Plan Administrator and request a Summary Plan Description, which provides you with information on the type of plan you have and how it operates.*
- *In addition to the above, you should request annually an Individual Benefit Statement, a document describing your total accrued and vested benefits.*

Step no. 2 Determine Your Pension Plan Type

Although not all employers provide pension plans, a great many do. It is important first to understand the type of pension plan offered. There are two basic types:

- **Defined Benefit Plans.** A defined benefit plan provides a specific monthly payment when you retire. You will know exactly what you will receive (generally based on a formula of a percentage of salary earned, years worked, or some other measure), and you can plan your lifestyle accordingly. In these plans, benefits do not change or vary based on the plan's investment performance. Your employer is obligated to contribute enough to pay you the promised benefits.

How much value or vested benefit you have built up depends on the number of years you have participated in the plan, not the number of years you have worked. Examine your *Summary Plan Description* to find out how long it takes to become vested.

- **Defined Contribution Plans.** There are two major classifications of defined contribution plans: money purchase pension plans and profit sharing plans. A money purchase pension plan specifies the contribution that will be made for each participant. For example, an employer may specify that it will contribute 10 percent of each participant's salary to the plan. In contrast, a profit sharing plan is not required to specify the amount of contributions that will be made for each participant; instead, contributions may be made at the discretion of the employer and are allocated based on your compensation or some other formula. In a defined contribution plan, you have a separate account that is periodically credited with your share of employer contributions. Unlike defined benefit plans, you will not know the amount of your benefit before you retire because the returns cannot be calculated in advance. The amount of money you will receive at retirement will vary according to how much is contributed to your account, how long these amounts are invested, and how well the investments perform.

"I really attribute my interest in investing to first starting to understand my 401(k) plan. It is great to see how my account has grown over a 15-year period and realize that this is my 'golden egg' for the future. The sad fact is that some of my friends at work don't contribute much to the plan. I don't think they realize what they are doing." —Horace F. (47 years old)

Step no. 3 Benefiting From a 401(k) Plan

The most popular *Defined Contribution Plan* today is called a 401(k). As the 21st century began, it was estimated that more than 22 million Americans had 401(k) plans, with the number climbing each year. The name 401(k) refers to the section of the Internal Revenue Code that permits this type of retirement plan. You contribute part of your salary to an account set up for you. You contribute pre-tax salary (income earned by you but not yet subject to taxes), and your earnings grow tax-free until you retire or otherwise withdraw/receive a taxable distribution. At least 60 percent of employers match at least a portion of your contribution. For example, an employer may offer to contribute 50 cents for each dollar you put in, up to six percent of your salary.

401(k) Action Steps

– **Find out whether your employer offers 401(k) plans—some companies do not.** (This information can be obtained from your *Summary Plan Description*.)

- **Determine when you are eligible to participate.** Federal law stipulates that your company must allow you to participate after you reach 21 years of age and have one year of employment.

- **Complete the paperwork needed to set up your 401(k) account.** This includes how much you want to contribute and the type of investments or strategies (based on level of risk) you want to use within your account. There is no cost for enrolling in this type of plan; however, most 401(k) plans require you to make monthly salary reduction contributions.

- **Contribute the maximum amount possible right from the start.** Most 401(k) plans permit you to contribute a fixed percentage of your pre-tax income. For 2004, you are allowed to contribute a maximum of $13,000 a year. This amount will increase to a maximum of $14,000 a year for 2005 and $15,000 for 2006.

- **Check out and benefit from any employer match into your 401(k) account.** If your employer matches a percentage of your contributions up to a certain limit, try to contribute at least that amount. If you don't, it's like throwing away free money. The amount matched by your employer does not count against the $13,000 limit for 2004.

- **If you are over 50, you can contribute an additional "catch up" amount each year beyond the normal limit.** For 2004, you can contribute an additional $3,000. This amount will increase to a maximum of $4,000 a year for 2005 and $5,000 for 2006.

"I signed up for the company 401(k) plan as soon as I was able. The problem is that many people (including myself) at the company have no idea what we should be doing to grow the money taken out of our checks every month. A few of us went to H.R. (human resources) to find out if they had any literature or a seminar program and found nothing. I am really frustrated because I know how important these funds are for retirement." —Jamey L. (36 years old)

Step no. 4 Managing Your 401(k) Plan

Starting a 401(k) is a great stride forward, but a more important concern is making sure that it grows and your assets are protected. Here are some tips:

Ensuring the Growth of Your 401(k)

– **Understand your investment options.** Many 401(k) plans allow participants to direct how the assets in their accounts will be invested. Generally, investment choices are limited to several mutual funds that offer different types of investment options. Each has its distinctive risk-reward aspects. Study and educate yourself on all the various investment choices. **TIP:** Use the Internet or purchase a basic book on investments that covers stocks, bonds, and mutual funds.

– **Avoid investing too conservatively.** A common mistake by many 401(k) participants is that they have no strategy or goal for allocating their retirement invenstments. **TIP:** Enroll in a company-sponsored pension or financial seminar to learn more about the merits of asset allocation.

Asset Allocation Resources for Your 401(k)

Understanding asset allocation strategies for your 401(k) plan is critical to ensure long-term growth. Almost every large mutual fund company has a Web site that can help you with asset allocation. Often, your plan sponsor has a site dedicated to educating you on investing your pension assets. If your company doesn't offer such a service, ask your Human Resources Department to check out these Web sites:

- *mPower at www.mpowercafe.com*
- *Financial Engines at www.financialengines.com*
- *Morningstar SM ClearFuture SM at www.morningstar.com/cover/clearfuture.html*
- *Discover Learning at www.discover-learning.com*

- **Taking out a loan can hurt your return.** Many plans allow employees to borrow from the plan, with the loan interest paid into the employee's account. Unfortunately, some individuals cannot repay the loan, and this may result in a "taxable" withdrawal that triggers income taxes and an early withdrawal penalty. **TIP:** If you need funds for some non-emergency expense, it may be wiser to consider a home equity loan.

- **Evaluate the management fees**. Your 401(k) custodian charges a fee to manage your account. The more the fee is, the less money you have working for you in compounding interest. **TIP:** Try to identify funds that charge less than one percent for managing your account.

- **Stay away from timing the market**. Shifting your investments from one fund or investment to another can often backfire. Although you want to be diligent about monitoring your investments' growth, don't become fixated on short-term performance. Most experts agree that market timing does not work. **TIP:** Consider shifting some of your 401(k) funds when your employer offers new investment options that better meet your financial goals, or when you need to re-balance your asset allocation.

- **Continue to press the company for financial education programs.** More and more companies are starting in-house financial investing seminars to help explain 401(k) options. It is critical that you and your colleagues continue to lobby for this type of resource.

Like Jonathan, many Baby Boomers believe their company stock is a “safe” investment. Unfortunately, having a high percentage of your company’s stock in your 401(k) portfolio exposes you to three types of risk:

– **Market volatility.** The swing in the share price due to the stock market itself.

– **Industry risk.** The degree to which the stock is affected based on the sector it is in.

– **Individual company risk.** How the company’s shares are impacted based on performance and other factors.

If you have shares of your company in a 401(k), consider the following:

– Experts disagree about the number and percentage of individual stocks necessary for diversification of a portfolio. In general, more than 20 percent of a single stock is considered risky. This risk is intensified if it’s your company’s stock.

– In some situations, employees cannot shift 401(k) share matches until reaching a certain age. In this case, identify how soon you can sell some of your company stock and move the funds into other asset classes. If you need to wait, add as much as you can to your other savings, using the rest of your portfolio to produce a more comfortable asset allocation.

– Develop a broad asset allocation formula for your 401(k) plan. Choose a mix of stocks, bonds, mutual funds, etc. that meets your risk tolerance, individual goals, and years until retirement.

“I want to retire in 10 years and become a jazz musician. Right now, I work for a big technology firm designing software applications. My company provides a generous matching program for company stock. Over 60 percent of my 401(k) was in shares of my company. Since the shares kept growing in value, I thought that was great! Six months ago, we missed our quarterly income projections by two cents. My ‘heart almost stopped’ when, over the next week, my 401(k) account dropped in value by $267,000! I realized then that I had placed most of my future into the performance of one stock.”
—Jonathan B. (48 years old)

"The most difficult aspect of changing jobs for me was knowing how to handle my pension accumulations. I had absolutely no guidance." —Jerry G. (38 years old)

If You Decide to Roll Over Your Pension Funds

If you switch jobs, you may want to control the funds you have accumulated. To do a roll over is quite simple. Contact a different custodian (bank, mutual fund, or brokerage firm) to open a new account. Contact your former employer's plan custodian and direct them to send the funds directly into that account. ***WARNING!*** *If you take the check and deposit it, or even endorse it over to the new custodian, you could be responsible for income taxes (and penalties if you're under age 59-1/2) on the entire account.*

Step no. 5 Handling a Change of Jobs

The average worker today will change jobs at least five or six times over his or her lifetime. During a job relocation, determining how to handle your 401(k) contributions can be confusing. Here are some pointers:

– If you switch jobs and have an account balance that is more than $5,000, you may be able to keep the money in the existing plan.
– If you have less than $5,000 in your 401(k) account when you leave the company, your employer may cash you out without your consent.
– You may be able to transfer your balance to your new employer's qualified pension program, if that program accepts such transfers.
– Another option is to place your account balance in an *IRA Rollover Account* (explained later).
– Before you change jobs, find out what will happen to your 401(k) account. Learn what benefits you may have from all previous employers.
– For a free booklet on private pensions, call the U.S. Department of Labor at 800-998-7542.

"When my wife unexpectedly became pregnant with twins, I needed some extra money. I looked at the money in my 401(k) and said, 'Hey, what a neat way to pay for adding a room onto the house.' It was the biggest financial mistake I ever made!" —Tom F. (41 years old)

Before Borrowing From Your 401(k)

If you are tempted to borrow money from your 401(k) account, think about the following:

- When you borrow money from your 401(k), you lose not only investment earnings, but also the future growth on the money.
- Loans must be repaid within five years (unless the funds are used to buy a personal residence), and repayments are often made after-tax by paycheck deductions.
- If you lose your job, your loan must be repaid within 60 to 90 days (in most cases), or it is considered a withdrawal, subject to taxes and penalties.
- Many employers will allow you withdrawals from your 401(k) in cases of real hardship (immediate and heavy financial need such as medical expenses, purchase of a personal residence, payment of certain educational expenses, or to prevent eviction from your home), but taxes and penalties may still apply.

"You might say I'm the impulsive, 'have-to-have-it-now' type of guy. Five years ago I borrowed money from my 401(k) plan to tour Europe for two months with the wife and kids. If I knew then the consequences of borrowing the money, the plane would have never taken off." —Brian O. (51 years old)

Withdrawing Money From Your 401(k)

When you withdraw money from a 401(k) account you'll pay ordinary income taxes on all your pre-tax contributions, your employer's contributions, and all cearnings on these contributions.

If you take money out before age 59-1/2 there's an additional 10 percent federal tax penalty, and you may also owe state income taxes. When you do the math, half of your early withdrawal could be lost to taxes and penalties.

"Four years ago I had a big financial shock. I had been working for a hospital with a pension plan that took $128.00 a month out of my salary. For the first three years I would get statements confirming my contribution and the hospital's match. Last year, these statements stopped coming altogether. Rumors started flying around the hospital that the CEO and CFO were using our monthly contributions to keep the hospital afloat. For three months they kept taking the money out of our checks, but no statements ever came. Our union had to threaten them with a lawsuit to get them to make our contributions on time. I realized for the first time in my life that you need to stay vigilant about your pension contributions." —Naomi J. (40 years old)

Step no. 6 Protecting Your Pension Plan

Newspaper stories abound concerning pension plans that become insolvent, go bankrupt, or engage in illegal contribution practices. By paying attention to these *You First* Pension Protection Strategies, you can feel comfortable that your employer will deliver when your benefits are due.

10 Warning Signs

1. Your 401(k) or individual account statement is consistently late or comes at irregular intervals.
2. Your account balance does not appear to be accurate.
3. Your employer fails to transmit your contribution to the plan on a timely basis.
4. There is a significant drop in your account balance that cannot be explained by normal market ups and downs.
5. 401(k) or individual account statements show your contribution from your paycheck was not made.
6. Investments listed on your statement are not what you authorized.

7. Former employees are having trouble getting their benefits paid on time or in the correct amounts.
8. Unusual transactions occur, such as loans to the employer, a corporate officer, or one of the plan trustees.
9. There are frequent and unexplained changes in investment managers or consultants.
10. Your employer recently has experienced severe financial difficulty.

Actions to Protect Your Employer-Pension Benefits

– **Under federal law your pension plan is required to give you information about your investments.** The plan must automatically give you a summary of its finances for each year, or a written notice of your right to receive that summary. The summary is called a *Summary Annual Report* (SAR). Request a copy of the SAR, in which you can find information about:
  – Whether the plan's investments have lost large amounts of money during the year.
  – The plan's total administrative expenses for the year.
  – Items that can alert you to questionable financial arrangements with individuals or organizations closely connected to the plan.
  – Whether any money loaned by the plan is still outstanding.

– **Ask your plan administrator (in writing) for access to IRS Form 5500, Form 5500-C, or Form 5500-R.** The plan administrator is required by law to give you the applicable form. Look on the form for the following information:
  – Who is responsible for managing the pension plan's money and whether the funds are being invested in your best interest.
  – The amount of fees, commissions, and expenses related to operating the plan.
  – A breakdown of investments that illustrates the level of diversification within the plan.

- **NOTE:** For defined contribution plans in which participants make decisions on the investment of their individual accounts, the plan's overall investment performance may not reflect how your account is doing. Participants will need to look instead at information they receive on their individual account statements.

– **Obtain a copy of *Protect Your Pension: A Quick Reference Guide* by the U.S. Department of Labor's Employee Benefits Security Administration.** It is available online at www.dol.gov/dol/ebsa, or write to: U.S. Department of Labor Employee Benefits Security Administration, 200 Constitution Avenue, NW, Room N5625, Washington, DC 20210.

A Word of Advice for Those in a Defined Benefit Plan

Traditional pension plans (defined benefit plans) use actuaries and accountants to determine your payout. Sometimes mistakes are made that diminish the amount you receive. If you believe a mistake was made, you can hire (for a fee) an actuary or accounting firm to examine your retirement plan distributions. For more information contact the National Center for Retirement Benefits at 800-666-1000 or www.ncrb.com.

"My biggest frustration is all the different options out there for building a retirement nest egg. How do I determine the one that is best for me? Which ones should I use to shield my retirement money from taxes?" —Paul B. (45 years old)

Step no. 7 Simplifying Retirement Plan Options

Below is an easy-to-understand chart that helps you determine how to use different tax-sheltered retirement vehicles. With the introduction of 401(k) plans, IRAs, and the Roth IRA, you can easily become confused by their similarities and differences, and which ones are best for sheltering money for your later years.

Tax Shelter Options	What They Offer	Investment Options
401(k) Plans	– Lowers taxable salary by as much as $13,000 a year (for 2004). – Upon withdrawal, contributions and profits are taxed as oridinary income. – Plans typically limit investment choices.	– If mutual funds are available, consider growth and value large capitalization and small capitalization stock funds, bond funds, income funds, and some international exposure. – For those investing in company stock, try to limit exposure to 25 percent or less of portfolio.
Rollover IRAs	– Used for money rolled over from a 401(k) or other employer plan when changing jobs or retiring.	– See Traditional IRAs on the following page.

Tax Shelter Options	What They Offer	Investment Options
Traditional IRAs	– Allows contributions of $3,000 a year per person; or $6,000 per couple. – Individuals over 50 may contribute an additional $500 each year, for a maximum contribution of $3,500. – Contributions grow tax-free until you take distributions. – Contributions may be tax-deductible based on you or your spouse not participating in a employer retirement plan; or if adjusted gross income is under a certain limit. – Withdrawals prior to age 591/2 are subject to 10 percent penalty (certain exceptions exist). – Must take minimum distributions following the year you reach 701/2.	– Use traditional IRAs if you expect to be in a lower income-tax bracket when you retire than you are in now—a deductible IRA may result in a larger after-tax accumulation. If your tax bracket will be the same or higher, consider a Roth IRA. – If you're going to own individual equities, consider blue chip stocks.
Roth IRAs	– Allows annual non-deductible contributions of $3,000 (married couples filing jointly can contribute up to $6,000). – Individuals over 50 may contribute an additional $500 each year, for a maximum contribution of $3,500. – Principal and profits compound tax free. – Unlike traditional IRAs, contributions can be made after age 701/2. – Withdrawals of nondeductible contributions are tax free. – Eligibility to contribute is governed by wage test: single people earning $95,000 a year begin losing access; completely cut-off at $110,000. The phase-out for married couples is $150,000-$160,000.	– Use a Roth IRA if you are unable to make deductible IRA contributions. – Consider converting from a traditional to a Roth only after you balance the cost of the tax you will pay on the conversion against the benefit of eventual tax-free distributions. – Almost all planners agree that the Roth IRA is an "agressive assets" (the rationale is that the Roth is not taxed so you want the most growth to occur).

"I made the decision a year ago to start my own business. Here it is, one year later, the business is growing great, but I have done nothing to put money away for retirement. I purchased one of those financial self-help books to help me understand my options, and it was so filled with 'mumbo jumbo' that I am more confused now than I was before picking up this book. Would somebody please put into 'plain English' what I need to do?" —Martha C. (45 years old)

Step no. 8 Pension Programs for the Self-Employed

During the next decade, we will witness a massive exodus of Baby Boomers moving from being an "employee" to being their own "employer." Based on current estimates, 42 million Baby Boomers will establish their own businesses. In fact, many who are still employed are already earning money from an alternative business or profession. Establishing a *Keogh Plan* can greatly enhance their pension benefits and shelter money from taxes.

What's A Keogh?

A Keogh plan is a retirement vehicle for the self-employed. Keogh plan contributions are deducted from your gross income, and the tax is deferred until you withdraw the funds. If you own a business, are self-employed, or earn money as a freelancer, a Keogh plan may best suit your needs. Almost anyone who files a Schedule C ("Profit or Loss from Business or Profession") can dramatically reduce taxable income and generate retirement contributions by opening a Keogh. *Even if you contribute to a company-sponsored pension plan and have an IRA, you may still be able to put aside up to $41,000 of your self-employment income, deduct it from your adjusted gross income, and have it grow tax free until your later years!*

The rules governing contributions to multiple retirement plans are complex. Consult your financial or tax advisor to make sure your contributions do not exceed the legal limits.

Keogh Pointers

Consult your accountant or tax advisor as to which type of Keogh (profit-sharing or money purchase) best meets your needs.

Profit Sharing Version. *Allows you, as the self-employed business owner, to contribute up to 25 percent of compensation or $41,000, whichever is less.*

Money-Purchase Plan. *Requires you, as the self-employed business owner, to commit to a percentage of earnings (up to 25 percent) annually or $41,000, whichever is smaller, regardless of however your business did.*

"I had been dreaming about setting up my own business for years. Finally, five years ago I started a clothing store in New York. I poured every bit of time and energy into making it successful. Starting with two employees, it has grown to over 18 full-timers. Once the business grew, I realized I had placed so much effort into the store that I forgot about having a pension…let alone setting up one for my employees. We started with a SIMPLE-IRA, and once the business had a stable revenue stream, we began a SEP-IRA." —Jody D. (51 years old)

Step no. 9 Pensions for Small-Business Owners And Employees

Only 46 percent of full-time employees in small companies have a retirement plan, compared to 79 percent of workers in large companies. According to the Employee Benefit Research Institute, 54 percent of small companies that don't offer retirement pension benefits said they had never heard of SEPs, and 33 percent didn't know about SIMPLEs. If you work for a small business firm that doesn't offer a pension plan, you can change that!

IRA Retirement Plans—Options to Consider

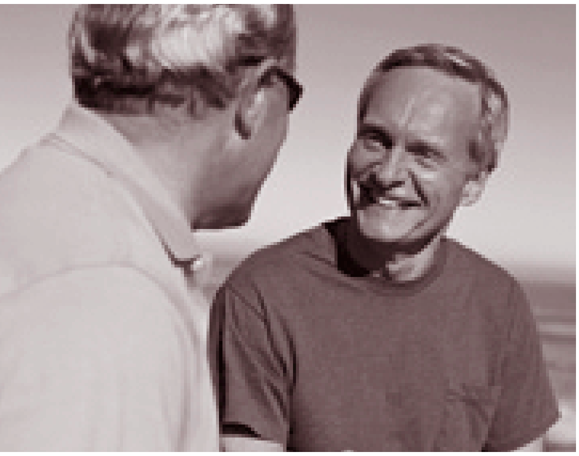
– **Simplified Employee Pension IRA (SEP-IRA).** This option operates like a traditional IRA but is sponsored by a small business. With a SEP, the employer makes the contributions—up to 25 percent of each employee's total compensation or $41,000, whichever is less. This plan allows an *employer* to contribute to an employee's IRA without having to offer a more complex retirement plan. Many young companies have adopted a SEP-IRA due to its flexibility and minimal paperwork.

- **Savings Incentive Match Plan for Employees (SIMPLE-IRA).** This option is designed for *both* the employee and the employer to contribute. The employee may contribute up to $9,000 per year, along with an additional $1,500 limit for workers over 50. The employer must either match an employee's contribution up to three percent of the employee's compensation, or contribute two percent of compensation (for 2004) for all eligible employee's up to $4,100 (for 2004).

Actions For Getting A Pension

Small companies cite lack of employee interest as the main reason why they don't sponsor a pension plan. Change that by discussing with your employer the importance of having a plan.

- If you are an employee, educate your employer about the above options. They might realize that administrative requirements and paperwork are not that extensive.
- Simplified plans can be set up by certain employers. For information on simplified employee pensions, order Internal Revenue Service Publication 590 by calling 800-829-3676.
- If you are an employer, realize that offering a retirement plan ensures your future and prevents high employee turnover by providing a critical benefit.



"I really thought the hard part of retirement planning was behind me after I accumulated a pension nest egg. Boy, was I wrong! There is a tremendous amount to consider before you start receiving a pension check. You really need to think through your options and plan." —Homer T. (65 years old)

Step no. 10 Planning for Pension Withdrawals

A generation ago, retiring workers had little choice in withdrawing money from a pension account. Many received a pension check based on their years of service and salary, and a Social Security check—that was it. With the dawning of the 401(k) plan, the responsibility for planning for retirement income is squarely on the back of the individual—and there are complicated decisions to make. Your employer may provide a fixed payout option, or you may roll the entire pension into an IRA. Other than Roth IRAs, all pension plans have tax consequences.

If you're in a *defined benefit pension plan* you eventually will have to choose how you want to receive your payments. Usually, the choice you make is irrevocable. If you are married you have two choices: collect benefits over your lifetime only, or collect a reduced monthly amount throughout your life and the life of your spouse. While the simple lifetime benefit pays a larger sum each month, benefits stop at death, potentially leaving your spouse with little or no income.

401(k) Withdrawal Pointers to Consider for Retirement

- *Sit down with your plan sponsor well before you retire to set up a specific strategy for funding your retirement.*
- *Consider spending money from accounts on which you have already paid taxes before you withdraw cash from tax-sheltered accounts. This allows your tax-deferred earnings to grow. (If you withdraw money from your IRA at age 70-1/2, take the minimum required and allow the account to continue to grow).*
- *In consultation with your plan sponsor (or financial advisor), investigate the pros and cons of taking a lump-sum distribution up front and paying the taxes. Or, see whether you qualify for special 10-year tax averaging.*
- *Consult your IRA custodian or financial advisor about the tax implications and withdrawal requirements for tapping into your IRAs.*

Some employers offer additional choices, such as a lump-sum, a fixed number of payments, or a fixed number of years' benefits. Before you take a lump-sum payment, be sure to calculate (or have your tax advisor calculate) how much you would save in income taxes if you choose this option.

If you have substantial assets that you expect to tap later in your retirement (from an IRA or 401(k) plan), you might consider spreading your pension payments over a specified number of years. That way, you would enjoy larger pension benefits at the beginning of your retirement, while drawing on your other assets for future income.

Need Help Calculating Your IRA Distributions?

There are many things you need to consider when calculating your IRA distributions. One resource to help you understanding different IRA distribution issues is the IRA Advisor (800-663-1340) or www.irahelp.com. In addition, there are a variety of financial books that can help you understand the intricacies of taking IRA distributions. (See the Suggested Reading in the back of this booklet.)

Actions Summary

#1 ☐ Complete an assessment of how much you know about your pension and the important issues related to having a pension.

#2 ☐ Identify the type of pension you have and ask your employer for a *Summary Plan Description*.

#3 ☐ If you are not covered by a pension, investigate the various types of pension/retirement programs available to you (such as an IRA).

#4 ☐ Determine whether your employer has a 401(k) plan and whether there is a "matching" component. If so, try to place the *maximum* amount into the plan.

#5 ☐ Educate yourself about how you can grow your 401(k) account without taking on too much risk by utilizing asset allocation.

#6 ☐ In the event of changing jobs, roll over your pension funds and avoid borrowing/withdrawing from your 401(k) account.

#7 ☐ Continuously monitor your pension contributions and understand how to protect your funds.

#8 ☐ If eligible, invest in additional IRAs, Roth-IRAs, and other tax-sheltered retirement plan options.

#9 ☐ If you are self-employed, evaluate and implement a pension program that fits your needs.

#10 ☐ Prior to retirement, work with your pension plan administrator or advisor to calculate the best method to withdraw funds.

Suggested Reading

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