NATIONAL ENDOWMENT FOR FINANCIAL EDUCATION

DON'T FALL VICTIM TO TYPICAL RETIREMENT PLANNING BLUNDERS

Make a New Year's Resolution to Plan Smarter in 2004

ENGLEWOOD, COLORADO—With another holiday season looming, funding your retirement may be the last thing on your mind. Unfortunately, too many people *never* get around to planning their retirement, and the results can be disastrous.

"A recent survey found that many Americans spend more time planning for holidays than planning for retirement,"[1] says William L. Anthes, Ph.D., president and CEO of the Colorado-based National Endowment for Financial Education® (NEFE®). NEFE is an independent foundation whose mission is to educate Americans about personal finance. Anthes adds, "These men and women are setting themselves up for a financial struggle when they retire, rather than a time to do all the things they've dreamed about."

Spend just a few hours every year doing some planning, however, and you can avoid mistakes, like the following ones, that often derail a comfortable retirement.

1. Not having a vision for retirement—Write down your goals for retirement. Do you want to travel or go back to school? Start a second career, take care of the grandchildren or just slow down a bit? Where will you live? What will it cost? How does your spouse feel about it? "Before you jump into retirement, take a few practice runs," Anthes suggests. "For example, use the weekends to try on a retirement schedule you think you would enjoy. Or, if your dream is to live somewhere else when you retire, vacation there first, research the area and consider renting before buying to make sure it's the right move for you."

Also remember that even the best-laid plans can be torpedoed by unexpected events, such as an early job layoff, a serious health problem, a divorce or a hoped-for inheritance that never materializes. "Think about your retirement in terms of the best—and worst—case scenarios and have a back-up plan ready," Anthes says.

2. Blindly following simplistic financial guidelines—Some experts estimate that people need 70 percent to 80 percent of their pre-retirement income when they stop working. But that percentage could be much higher if you plan to travel a lot or are hit with major medical costs. Conversely, it could be lower if you already live on a fraction of your income, won't have a mortgage by the time you retire or move somewhere less expensive. Retirement planning should be specific to you and should address the following questions:

At what age do you want to retire? How much money will you need? How much must you save each year to retire at that age? How will you invest the money to achieve your retirement goals?

To get an idea of the amount of money you'll need in retirement, estimate those expenses that you think will decrease in the future—work-related costs, mortgage payments, college tuition for your offspring and so on—and the expenses that may go up, such as travel, a Medicare supplement plan, long-term care insurance and hired assistance. A retirement planning calculator or worksheet can help. For example, the American Savings Education Council (ASEC) has a Ballpark Estimate worksheet, which can be found at http://www.asec.org/. "In its *2003 Retirement Confidence Survey*, the Employee Benefit Research Institute found that 61 percent of American workers have not done such a calculation," Anthes says. "Yet, of those individuals who did calculate their anticipated expenses, 40 percent made changes in their retirement planning, and many started to save more."

Also be sure to factor in how long you may live during retirement. Today's 65-year-old Americans can expect to live another 20 years, if not longer, and they don't want their money to run out before they do.

3. Assuming that Social Security will meet all, or none, of one's retirement needs—The answer is somewhere in the middle. Social Security currently provides about 40 percent of the average worker's pre-retirement income.[2] The balance must come from retirement savings and other sources. In addition, remember that many of today's workers won't be eligible to receive full Social Security benefits until age 67.

4. Thinking that it's too late, or too early, to start saving for retirement—The sooner you start to save, the better. This way, you can take advantage of the compounding of interest over time. "If you're in your 20s, you could end up a millionaire at age 65 if you save steadily and invest wisely," Anthes says. "But it's never too late, either."

The difference is that late savers may have to get a little more creative. Freeing up cash by selling the house to the kids and leasing it back from them, delaying retirement for a few years or moonlighting to earn extra money for a retirement nest egg are a few of the strategies Anthes has seen people use successfully.

For example, a person age 55 who contributes $3,500 to a Roth IRA every year for 10 years, and earns 8 percent on that investment will accumulate more than $54,000 at age 65. If that amount is left to grow another 10 years at 8 percent, at age 75 the individual will have over $118,000 tax free. "That's money that could come in handy at an age when the costs of medical and other care typically increase," Anthes notes.

5. Failing to take advantage of tax-deferred retirement plans—Whenever possible, use every retirement savings plan you qualify for, including individual IRAs and company plans, especially when your employer matches part of your savings.

For example, if your employer matches 25 cents for every $1 you contribute, that is a guaranteed 25 percent return on your money, assuming it is immediately vested. Even if your employer does not have a matching provision, your taxable income will decrease by the amount you contribute, so, in effect, the government is helping you to make those contributions.

If you're 50 or older, you also can take advantage of recent tax laws that allow you to put additional tax-sheltered money into your retirement account. These "catch-up" provisions may not extend beyond 2010, however, so take advantage of them now. Finally, the law also provides an income tax credit of up to $2,000 for lower-income workers to save for retirement through IRAs or employer plans.

6. Investing too conservatively or too aggressively—Inflation and taxes can erode the purchasing power of your retirement nest egg. For example, if you buy a certificate of deposit paying 2 percent now, with inflation running at about 2.5 percent and taxes taking perhaps 25 percent of the interest income, you are actually going backwards financially, even though your money is "safe." On the other hand, with the recent losses in the stock market, you might be tempted to move your money into high-risk investments to try to recoup those losses.

"Be cautious about investing a disproportionate amount of your retirement savings in high-risk investments," Anthes warns. "Similarly, don't overweight your portfolio with your company's stock. Diversify your investments, monitor them regularly and give your strategy time to work."

7. Dipping into retirement savings before retirement—Many people don't roll over their retirement fund into another account when they change jobs. They spend part or all of it instead, even when that means paying a tax penalty. "As tempting as it is, don't cash out your retirement plan to pay for a vacation, purchase a new car or buy other things that are here today and gone tomorrow," Anthes says. "Save separately for these purchases."

8. Making job changes without considering the effect on retirement savings—If you are almost vested in your company's retirement plan and decide to quit now, instead of waiting a bit, you inadvertently could leave a lot of money on the table. Likewise, if you are considering a new job offer, make sure you research the retirement plan before you make a decision—a generous one could be worth many thousands of dollars.

9. Going it alone—Hiring a professional to help you position your retirement plan in the context of your overall financial plan can be money well spent. A financial planner can advise you on the best mix of investments to reach your retirement goals, as well as a strategy for withdrawing retirement savings later. "A common error is to take out too much in the early years, resulting in too little available later," Anthes explains.

To find a financial planner, interview two or three whose names have been recommended to you. Ask about their education, experience, professional credentials, compensation and approach to retirement planning.

10. Putting everyone else's needs first—Footing the kids' college bills or financially supporting aging parents could mean that you'll come up short at retirement. "Don't lend or give away money that you will need later," Anthes warns. Look at other alternatives, instead, such as having your college-age children take out student loans so you can keep contributing to your retirement plan.

"As you begin to prepare for the upcoming holidays, consider how much time you are taking to plan these events. Do you dedicate that much time each year to plan your retirement?" Anthes asks. "Resolve that starting in 2004, retirement planning will stay at the top of your yearly 'to do' list."

For additional retirement planning tips, visit NEFE's Web site at http://www.nefe.org/. Click on Multimedia Access and look for the "You First" Retirement Planning Series, the *Wealth Care Kit* (Retirement Planning) and *Guidebook to Help Late Savers Prepare for Retirement*.

1 Source: *2003 Retirement Confidence Survey*, Employee Benefit Research Institute (http://www.ebri.org/).

2 Source: Social Security Administration and American Savings Education Council, "Save for the Future" campaign press release, May 17, 2002.