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Retirement Income Planning

Three Basic Questions

As you approach or enter retirement, your mindset needs to begin to move from accumulation to distribution. That's what retirement income planning is all about — understanding how much annual income you'll need during your retirement years to support the lifestyle that you want, and positioning your assets to provide that income.

Up-front planning is important because the consequences of a bad decision can be severe. Draw too heavily on your savings and investments in the early years of your retirement and you run the risk of depleting your funds too quickly, leaving nothing for your later years.

The planning process begins with just a few simple questions.

What does retirement mean to you?

What is it that you want and expect in retirement? Do you see yourself pursuing hobbies? Traveling? Do you plan on volunteering your time, taking the opportunity to go back to school, or perhaps starting a new career? Examine your expectations carefully; your retirement income plan is just a means to financially support the lifestyle that you want.

When do you want to retire?

The age at which you begin relying on retirement income can have a significant impact on your overall financial situation, so you'll want to make sure that you've considered your decision from every angle. As you'll see, there are many factors to consider.

How long will your retirement last?

The good news is that, statistically, you're going to live for a long time. That's also the bad news, though, because that means your retirement income plan has to be able to provide for your needs over, potentially, a very long period of time.

How long? The average 65-year-old American can expect to live for approximately 18.4 additional years.* And keep in mind that life expectancy has increased at a steady pace over the years and is likely to continue to do so.

The bottom line: you may want to plan for retirement income to last 25 years or more.

*Source: NCHS Data Brief, Number 456, December 2022 (most current data available)

When Should You Retire?

Can you retire early?

Can you afford to retire early? That could be wonderful if you're both emotionally and financially ready. But it can also have significant negative financial repercussions.

Retiring early means you're giving up what could be prime earning years. During those years, you could be making substantial additions to your retirement savings. If you're covered by an employer pension plan, there's also the possibility that retiring early could affect the pension benefit you receive. And the amount of monthly income you receive from Social Security might be less than if you continued working for a while.

Most important, though, retiring early means you're increasing the number of years that you'll need to rely on your retirement savings for income.

Should you delay retirement?

Maybe you're considering delaying retirement. Doing so lets you continue to add to your retirement savings.

But even if you're not saving more, delaying retirement postpones the date that you'll need to start withdrawing from your savings. And the longer you put off tapping your retirement savings for income, the fewer years you'll need to rely on those savings. A shorter retirement distribution period reduces the chance that you will outlive your savings.

Of course, delaying retirement has a cost (e.g., less time spent with family, traveling, and enjoying hobbies).

Key Decision Points		
	Age	Don't Forget
Eligible to tap tax-deferred savings without early withdrawal penalty	59 1/2*	Federal income taxes will be due on pretax contributions and earnings
Eligible for early Social Security benefits	62	Taking benefits before full retirement age reduces each monthly payment
Eligible for Medicare	65	Contact Medicare 3 months before your 65th birthday
Full retirement age for Social Security	66-67 Based on the year you were born	After full retirement age, earned income no longer affects Social Security benefits
* Age 55 for distributions from employer plans upon termination of employment (age 50 for certain qualified public safety employees); other exceptions apply		

How Much Income Will You Need?

Start with your expenses

A successful retirement income plan is based on an accurate projection of expenses, including potential expenditures for any planned travel or hobbies. It often makes sense to focus on your actual expenses today, and then think about whether they'll stay the same, increase, or decrease over time.

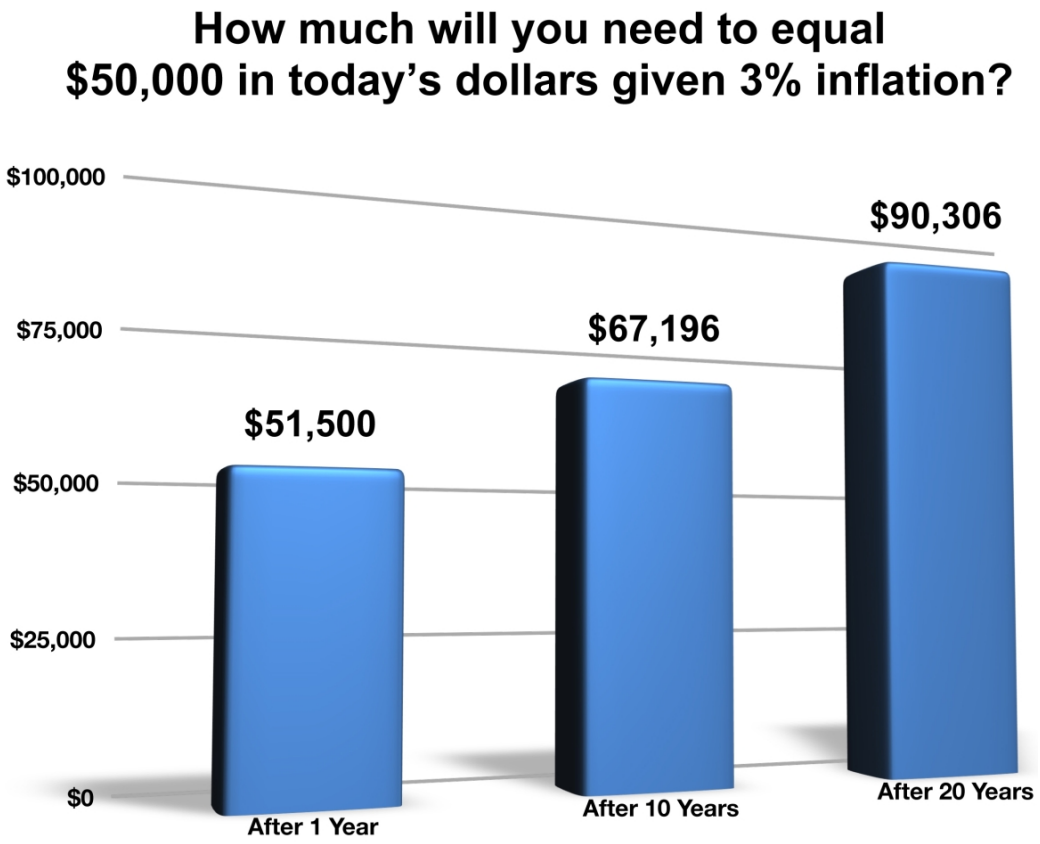
When listing your expenses, here are some things to consider:

- **Housing costs**--If you have a mortgage, will it be paid soon? Do you plan to relocate to a less (or more) expensive area?
- **Work-related expenses**--You'll eliminate expenses such as commuting, dry cleaning, and retirement savings contributions, in addition to payroll taxes.
- **Health care**--Health-care costs can impact your retirement finances, especially if you retire before you're eligible for Medicare.
- **Long-term care costs**--The potential costs of an extended nursing home stay can be catastrophic.
- **Entertainment**--It's not uncommon to see an increase in entertainment expenses like dining out.
- **Children/parents**--Are you responsible financially for family members? Could that change in future years?
- **Gifting**--Do you plan on making gifts to family members or a favorite charity? Do you want to ensure that funds are left to your heirs at your death?

Consider inflation

Inflation is the risk that the purchasing power of a dollar will decline over time, due to the rising cost of goods and services. If inflation runs at a relatively low rate of about 3%, a given sum of money will lose half its purchasing power in 23 years.

Assuming a consistent annual inflation rate of 3%, and without considering taxes and investment returns, if $50,000 satisfies your retirement income needs in the first year of your retirement, you'll need $51,500 of income the following year to meet the same income needs. In 10 years, you'll need about $67,196. In other words, inflation generally means that you'll need more income each year just to keep pace.



This hypothetical example of mathematical principles is used for illustrative purposes only.

It's important to contact the Social Security Administration to discuss your options. For more information, visit the Social Security Administration's website at www.ssa.gov or call (800) 772-1213 to speak with a representative.

Sources of Income: Social Security

Part of the three-legged stool

Traditionally, retirement income has been described as a "three-legged stool" composed of Social Security, traditional employer pension income, and individual savings and investments.

For most, Social Security provides a steady, lifelong source of income in retirement. You'll receive a monthly benefit for the duration of your retirement, and your benefit will be adjusted annually for inflation. You can begin receiving Social Security as early as age 62, can wait until your full retirement age (shown in the chart below), or can delay benefits as late as age 70.

When should you begin receiving Social Security?

Your Social Security benefit is based on the number of years you've worked and the amount you've earned, but your benefit amount also depends on the age at which you begin receiving benefits. Electing to receive Social Security before your full retirement age will result in a lower monthly benefit than if you wait until your full retirement age. If you delay receiving Social Security benefits past your full retirement age, you can receive delayed retirement credits that will increase your benefit by a certain percentage for each month you wait, up until age 70.

There's no "right" time to begin receiving Social Security benefits. There are many variables to consider, including whether you plan to work, how long you expect retirement to last, how your spouse will be affected, and the impact on your overall retirement income plan.

If you were born in:	Your full retirement age is:
1943 – 1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

Sources of Income: Pensions and Personal Savings

Employer pensions

If you're eligible to receive a traditional employer pension and haven't already selected a payout option, you'll want to carefully consider your choices.

Pension plans generally provide a retirement benefit in the form of an annuity, payable over your lifetime, beginning at the plan's normal retirement age (typically age 65). Many plans allow you to retire early (for example, at age 55), but will reduce your benefit to account for the fact that payments are beginning earlier, and are payable for a longer period of time.

If you're married, the plan generally must pay your benefit as a qualified joint and survivor annuity (QJSA). A QJSA provides a monthly payment for as long as either you or your spouse is alive. The payments under a QJSA are generally smaller than under a single-life annuity because they continue until both you and your spouse have died. If your spouse consents in writing, you can decline the QJSA and elect a single-life annuity or another option offered by the plan.

Your plan may offer other options as well, including the possibility of taking a lump-sum distribution. The best option for you depends on your individual situation, including your (and your spouse's) age, health, and other financial resources.

What is "pension maximization"?

One option to consider when deciding between a single-life annuity and the QJSA is a concept that is frequently referred to as "pension maximization." With this strategy, you choose the single-life annuity, with its larger annual benefit, and then use the additional annual income to purchase life insurance with your spouse as the beneficiary, thereby providing for your spouse's financial future if you die first.

Compare the advantages and disadvantages of this strategy with any QJSA option available to you.

The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased. Before

implementing a strategy involving life insurance, it would be prudent to make sure that you are insurable. As with most financial decisions, there are expenses associated with the purchase of life insurance. Policies commonly have mortality and expense charges. In addition, if a policy is surrendered prematurely there may be surrender charges and income tax implications.

Personal savings

Your personal savings are the funds that you've accumulated in tax-advantaged retirement accounts such as 401(k) plans, 403(b) plans, and IRAs as well as any investments you hold outside of tax-advantaged accounts.

As you saved for your retirement, your focus was on accumulation — building as large a nest egg as possible. As you transition into retirement, however, that focus changes. Rather than accumulation, you're going to need to look at your personal savings in terms of distribution and income potential. The bottom line: you want to help enhance the ability of your personal savings to provide annual income during your retirement years.

Even if your asset allocation was right for you when you chose it, it may not be appropriate for you now. It needs to change as your circumstances and priorities change.

Asset allocation and diversification cannot guarantee a profit or insure against investment loss. There is no guarantee that any investment strategy will be successful.

Converting Your Personal Savings into Retirement Income: Considerations

Estimating the "gap"

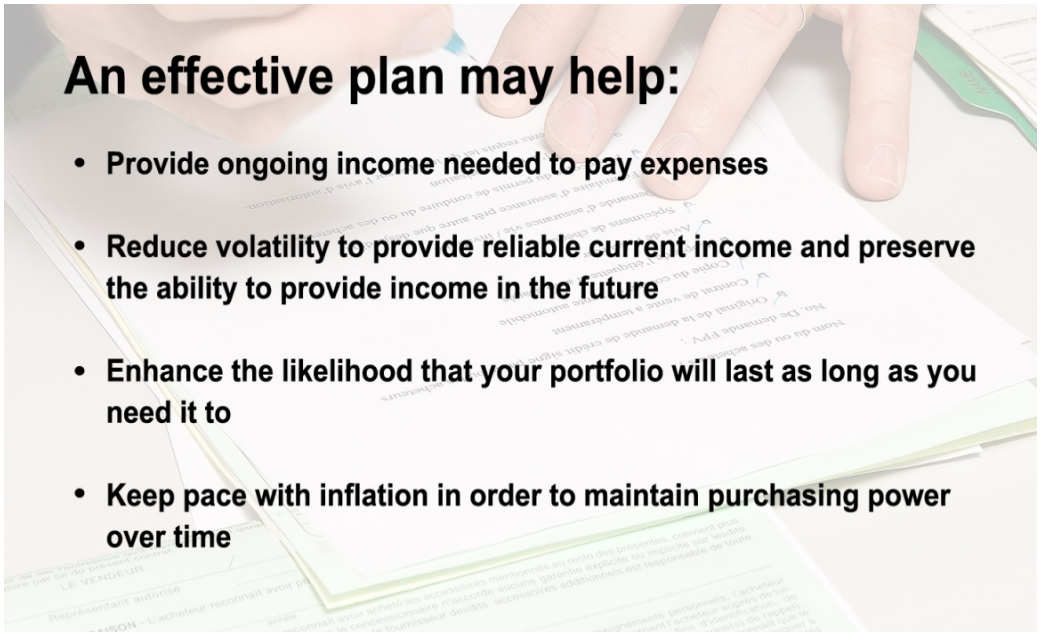
If you compare the annual income that you're going to need in retirement to the annual income that you can count on from Social Security and employer-pension benefits, you're likely going to find a "gap." That is, unless you're lucky enough to have a very generous employer pension, you're going to have unmet retirement income needs that you will have to fund with your personal savings and investments.

The challenge is to implement an investment strategy that provides, with reasonable certainty, for the annual income you will need throughout your retirement, while balancing that need for regular income with other considerations, such as your need for liquidity and your risk tolerance.

Asset allocation

During your accumulation years, your asset allocation decisions may have been focused primarily on long-term growth. But as you transition into retirement, your priorities for and demands on your savings and investments are likely to be different. For example, when you were saving, as long as your overall portfolio was earning an acceptable average annual return, you may have been happy. However, now that you're relying on your savings to produce a regular income, the consistency of year-to-year returns and your portfolio's volatility may assume much greater importance.

Balancing the need for both immediate income and long-term returns can be a challenge. Invest too conservatively, and your savings may not be able to grow enough to maintain your standard of living. Invest too aggressively, and you could find yourself having to withdraw money or sell securities at an inopportune time, jeopardizing future income and undercutting your long-term retirement income plan. Without proper planning, a market loss that occurs in the early years of your retirement can be devastating to your overall plan. Asset allocation alone does not guarantee a profit or ensure against investment loss, but it can help you manage the level and types of risk you take with your investments based on your specific needs.



Your financial situation is unique, which means you need an asset allocation strategy that's tailored to you. That strategy may be a one-time allocation that gets revisited and rebalanced periodically, or it could be an asset allocation that shifts over time to correspond with your stage of retirement. The important thing is that the strategy you adopt is one that you're comfortable with and understand.

Withdrawal rate

Your retirement lifestyle will depend not only on your asset allocation, but also on how quickly you draw down your retirement savings. The annual percentage that you take out, whether from returns or the principal itself, is known as your withdrawal rate.

Your withdrawal rate is especially important in the early years of your retirement. Take out too much too soon, and you might run out of money in your later years. Take out too little, and you might not enjoy your retirement years as much as you could.

What's the right withdrawal percentage? It depends on your overall asset allocation, projected rate of inflation and market performance, as well as countless other factors, including the time frame that you want to plan for. For many, though, there's a basic assumption that an appropriate withdrawal rate falls around 4%. So you're typically withdrawing just a small percentage of your investment portfolio each year.

Special concerns: tax-advantaged accounts

You may have assets in accounts that are tax deferred (e.g., traditional IRAs) and tax free (e.g., Roth IRAs), as well as taxable accounts. Given a choice, which type of account should you withdraw from first?

You might consider withdrawing money from taxable accounts first, then tax-deferred accounts, and lastly, any tax-free accounts. The idea is that, by using your tax-favored accounts last and avoiding taxes as long as possible, you'll keep more of your retirement dollars working for you on a tax-deferred basis.

But that's not always the best choice. For example, if you have appreciated or rapidly appreciating assets, it may make sense for you to withdraw those assets from your tax-advantaged accounts first. The reason? These accounts will not receive a step-up in basis at your death, as many of your other assets will.

The bottom line is that this decision is complicated, and needs to be looked at closely both in terms of your retirement income needs and your estate planning goals.

Required minimum distributions (RMDs)

Your choice of which assets to draw on first may, to some extent, be directed by tax rules. The law requires you to start taking required minimum distributions (RMDs) from traditional IRAs by April 1 of the year following the year you turn age 73, if you were born from 1951 to 1959, or age 75 if you were born in 1960 or later. The same rule applies to employer plans unless you are still working for the employer that sponsors the plan, in which case you can generally defer taking RMDs until the year you retire. Roth IRAs and Roth employer accounts aren't subject to the lifetime RMD rules.

If you have more than one IRA, a required distribution amount is calculated separately for each IRA. These amounts are then added together to determine your total RMD for the year. You can withdraw your RMD from any one or more of your IRAs. [Similar rules apply to 403(b) accounts.] Your traditional IRA trustee or custodian must tell you how much you're required to take out each year, or offer to calculate it for you. For employer retirement plans, your plan will calculate the RMD and distribute it to you. (If you participate in more than one employer plan, your RMD will be determined separately for each plan.)

> ***If you withdraw less than your RMD, you could pay a penalty tax equal to 25% of the amount you failed to withdraw. (The penalty is reduced to 10% if "timely corrected" by making up the missed RMD, generally in two years unless the penalty is assessed earlier.) The good news: you can always withdraw more than your RMD.***

Investment Choices

An appropriate asset allocation plan is the foundation of your investment strategy, but you should also carefully consider the specific investments that you choose to carry out your plan. While it's impossible to discuss every option available, it's worth highlighting some common choices.

Annuities

An annuity is a contract between you and an annuity issuer (an insurance company); in the most general terms, you pay money (a premium or premiums) in exchange for the issuer's promise to make payments to you for a fixed period of time or for the rest of your life. Annuities are able to offer something unique — a guaranteed income stream for the rest of your life or for the combined lives of you and your spouse (although that guarantee is subject to the claims-paying ability and financial strength of the issuer). In return for this guaranteed income stream, you generally give up control of your funds, so annuities are not as liquid as other investment options; you get a fixed income, but you may not have the ability to withdraw extra cash if you need it. And, annuities often do not provide as great a potential return as other investment options — especially when fees and expenses are factored in.

The bottom line is that annuities may be seen as a full or partial solution, since they can offer stable, predictable income payments, but they're not right for everyone.

Generally, annuity contracts have fees and expenses, limitations, exclusions, holding periods, termination provisions, and terms for keeping the annuity in force. Most annuities have surrender charges that are assessed if the contract owner surrenders the annuity. Withdrawals of annuity earnings are taxed as ordinary income. Withdrawals prior to age 59½ may be subject to a 10% federal income tax penalty.

Bonds

Bonds can help you address investment goals in multiple ways. Buying individual bonds at their face value and holding them to maturity can provide a predictable income stream and the assurance that you'll get your principal back once the bond matures — unless, of course, the bond issuer defaults. Bear in mind that if a bond is callable, it may be redeemed early, and you would have to replace that income. You also

All investing involves risk, including the possible loss of principal.

can buy bonds through mutual funds or exchange-traded funds (ETFs), although these funds have no specific maturity date and fund values can fluctuate.

Before investing in a mutual fund or ETF, carefully consider the investment objectives, risks, charges, and expenses of the fund. This information is available in the prospectus, which can be obtained from the fund. Read it carefully before investing. Bond funds are subject to the same inflation, interest-rate, and credit risks associated with their underlying bonds. As interest rates rise, bond prices typically fall, which can adversely affect a bond fund's performance.

The principal value of bonds may fluctuate with market conditions. Bonds redeemed prior to maturity may be worth more or less than their original cost. Investments seeking to achieve higher yields also involve a higher degree of risk.

Dividend-paying stocks

Dividend-paying stocks, as well as mutual funds and ETFs that invest in them, also can provide income. Because dividends on common stock are subject to the company's performance and a decision by its board of directors each quarter, they may not be as predictable as income from a bond. Dividends on preferred stock are different; the rate is fixed and they're paid before any dividend is paid to common stockholders.

The amount of a company's dividend can fluctuate with earnings, which are influenced by economic, market, and political events. Dividends are typically not guaranteed and could be changed or eliminated.

Other options worth noting

Other common choices include bank certificates of deposit (CDs) and Treasury Inflation-Protected Securities (TIPS).

It's also worth noting that some mutual funds (sometimes designated "distribution funds") are specifically designed to provide an income stream from year to year, but with no guarantee that a fund will accomplish its income objectives.

All investing involves risk, including the possible loss of principal. You should not purchase an investment without a full understanding of the advantages and disadvantages the investment offers, as well as an understanding of how any earnings are taxed.

The FDIC insures CDs and bank savings accounts, which generally provide a fixed rate of return, up to $250,000 per depositor, per insured institution.

U.S. Treasury securities are guaranteed by the federal government as to the timely payment of principal and interest. The principal value of TIPS

fluctuates with changes in market conditions. If not held to maturity, TIPS may be worth more or less than their original value. Unless you own TIPS in a tax-deferred account, you must pay federal income tax on the income plus any increase in principal, even though you won't receive any accrued principal until the bond matures.

Other Considerations

Working in retirement

It's becoming increasingly common for people to work for at least some period of time during their retirement years. While there are plenty of nonfinancial reasons to work in retirement, the obvious advantage is that you'll be earning money and relying less on your retirement savings — leaving more to potentially grow for the future and helping your savings to last longer.

But working in retirement may present other benefits as well. For example, it's possible that continued employment could provide access to affordable health care. It's also possible that continuing to work could enable you to delay taking Social Security retirement benefits. If so, your annual Social Security benefits — when you begin receiving benefits — may be higher.

Nontraditional sources of retirement income

If you have built up substantial home equity, it may be possible to tap it as a source of retirement income. You could sell your home, then downsize or buy in a lower-cost region. Your freed-up cash could be used as needed. Another possibility is borrowing against the value of your home (a course that should be explored with caution).

Although not the primary function of life insurance, an existing permanent life insurance policy that has cash value can also sometimes be a potential source of retirement income. (Again, caution is warranted; policy loans and withdrawals can reduce the cash value, reduce or eliminate the death benefit, and have negative tax consequences.)

Permanent life insurance offers lifetime protection and a guaranteed death benefit as long as you keep the policy in force by paying the premiums. A portion of the permanent life insurance premium goes into a cash value account, which accumulates on a tax-deferred basis throughout the life of the policy. Withdrawals of the accumulated cash value, up to the amount of the premiums paid, are not subject to income tax. Loans are also free of income tax as long as they are repaid. Loans and withdrawals from a permanent life insurance policy will reduce the policy's cash value and death benefit, could increase the chance that the policy will lapse, and might result in a tax liability if the policy terminates before the death of the insured. Additional out-of-pocket payments may be needed if actual dividends or investment returns decrease, if you

If you'll be receiving Social Security benefits while working, make sure you understand how your work income will affect the amount of Social Security benefits that you receive.

withdraw policy cash values, or if current charges increase. Any guarantees are contingent on the claims-paying ability and financial strength of the issuing insurance company. As with most financial decisions, there are expenses associated with the purchase of life insurance. Policies commonly have mortality and expense charges. If a policy is surrendered prematurely, there may also be surrender charges and income tax implications. The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased.

NOTES

IMPORTANT DISCLOSURES

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