
A Guide to Planning a Financially Secure Retirement



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The retirement planning landscape has changed drastically over the past couple of decades. In the past, most workers could count on generous retirement benefits from their employers through defined benefit pension plans that guaranteed them a fixed income throughout their retirement years.

Today, most Americans are responsible for planning for their own financial security during retirement. The good news is that there is a wide range of saving and investing vehicles to help you do this.

We've created this guide to offer concrete tips and strategies to help you reach your retirement financial goals. Inside, you'll find step-by-step guidance to help you plan a comprehensive retirement plan.

If you have any questions about the material included in this guide, please feel free to contact us.

Retirement: The Changing Landscape

There was a time, not so long ago, when many Americans took retirement for granted. They worked at the same company for their entire careers, and in exchange, they were promised a generous retirement package that included a comfortable income and health insurance for the rest of their lives.

In addition, most Americans could also count on steady income from Social Security every month, as well as comprehensive health benefits through Medicare.

So much for a stroll down memory lane. Twenty-first century Americans face a very different retirement landscape. The most dramatic change has been a shift among most employers away from the traditional defined benefit pension plans, which were funded by employers and promised employees a specified amount of money in retirement that they could count on, to defined contribution plans. These are funded primarily by employees, perhaps with matching contributions by employers, and include Individual Retirement Accounts (IRAs), 401(k) plans, Simplified Employee Pension plans (or SEPs), and 403(b) and 457 plans.

Other than the fact that defined contribution plans depend mostly on employee, rather than employer, contributions, the other main difference is that they are also dependent on investment performance. These two factors combined have shifted the responsibility for retirement planning squarely from the shoulders of employers to those of employees.

Fortunately, the federal government has taken steps to make it not only easy to save and invest for retirement, but also to provide generous tax breaks for doing so. This started with the introduction of IRAs in 1975 as the first government-sponsored, tax-advantaged tool to help Americans save for retirement. Starting in 2002, the annual IRA contribution limit has been indexed for inflation, and has now risen from the original \$2,000 to \$5,000 (or \$6,000 if you're age 50 or over).

Since then, a number of new retirement savings tools have also been introduced, like 401(k)s, SEPs, SIMPLE plans, and Roth IRAs and 401(k)s. Each has different features, benefits and requirements. A well-diversified retirement plan may include more than one of these retirement savings vehicles.

16%

PERCENTAGE OF WORKERS WHO SAY THEY ARE VERY CONFIDENT ABOUT HAVING ENOUGH MONEY FOR A COMFORTABLE RETIREMENT

21%

PERCENTAGE OF WORKERS WHO SAY THEY ARE DOING A GOOD JOB OF PREPARING FOR RETIREMENT

69%

PERCENTAGE OF WORKERS WHO SAY THAT THEY AND/OR THEIR SPOUSE HAVE SAVED FOR RETIREMENT

27%

PERCENTAGE OF WORKERS WHO SAY THAT THEY HAVE SAVED LESS THAN \$1,000 FOR RETIREMENT



Getting From Here to There Creating a Comprehensive Retirement Plan

There are a number of different aspects to creating a comprehensive retirement plan that you should consider. Following is a broad overview of **five key factors** you should think about as you craft your plan.

1. What's Your Number?

It's surprising how many people start planning for retirement with no idea how much money they'll actually need to accumulate in order to retire comfortably. Perhaps the reason why is because retirement seems so far away and so much can change between now and then.

However, this shouldn't stop you from trying to estimate your "magic number." One traditional rule of thumb is to plan on needing about 70-80 percent of your pre-retirement annual income during retirement. This is based on the fact that your expenses will likely be lower after you retire, since you won't have work-related expenses, your children will likely have moved out of your home and finished their education, and you may no longer have a mortgage.

However, this is only a general guideline, and everyone's situation is different. If you plan to travel extensively after you retire, pursue expensive hobbies, eat out and entertain often, or help support your children or grandchildren, your expenses in retirement could easily equal or exceed your pre-retirement expenses.

Also, don't forget to factor the effects of inflation into your projections. Even at low levels, **inflation erodes the value of your savings and eats into your purchasing power** over the long term. For example, the purchasing power of one dollar 20 years ago has shrunk to just 44 cents today—and will shrink to just 19 cents 20 years from now.*

See the worksheet "Finding Your Number" for more details.

2. What Vehicles Will You Use?

As we've noted, there are a number of different savings and investment vehicles that can help you reach your retirement goals. These include:

Individual Retirement Accounts (IRAs)—While other retirement savings vehicles have come along, IRAs remain the bedrock retirement savings tool for millions of Americans. An estimated 47 million U.S. households (40 percent) own IRAs* and IRA assets currently total about \$3.4 trillion, which represents 25 percent of the \$13.4 trillion in total U.S. retirement assets.

SOCIAL SECURITY: WHAT YOU MUST KNOW

There is a lot of confusion with regard to Social Security, especially when it comes to when you can begin receiving benefits. Here's the scoop:

In order to receive full Social Security benefits, you must wait until your full retirement age, which is between 65 and 67, depending on the year you were born. You can receive a reduced level of benefits starting at age 62. However, keep in mind that if you choose this option, you're locking in this level of benefits for your entire retirement.

It's important to note that you won't receive benefits automatically when you reach a certain age—you have to apply for them. You can do this online at www.socialsecurity.gov, by calling (800) 772-1213, or by visiting your local Social Security office. You should apply for benefits at least three months before you wish to begin receiving them.



There are two primary types of IRAs to choose from, each with its own features and benefits:

Traditional IRA: The original IRA, now referred to as a traditional IRA, **offers tax-deferred growth and an immediate tax break** in the form of a deduction equal to the amount of your annual contribution if you qualify. (Eligibility for this deduction phases out above certain adjusted gross income limits and may not be available if you participate in an employer-sponsored retirement plan.) Taxes must be paid at your ordinary income tax rate when you begin taking distributions during retirement.

Roth IRA: The Roth IRA differs from a traditional IRA in two key respects: First, there is no immediate tax deduction for annual contributions. But this is offset by the fact that **contributions grow tax-free, instead of just tax-deferred**. Qualified withdrawals in retirement are also tax-free. This can make a big difference over the life of the account.

Another benefit of Roth IRAs is that contributions (but not earnings) can be withdrawn tax-free and without penalty at any age. In contrast, withdrawals from a traditional IRA before age 59 ½ are usually subject to a 10 percent early distribution penalty. Keep in mind that eligibility for contributing to a Roth IRA phases out above certain adjusted gross income limits (see Roth vs. Traditional IRA chart).

In 2010, you and your spouse can each contribute up to \$5,000 (or \$6,000 if you're age 50 or over) to separate traditional and/or Roth IRAs for yourselves (this is the total limit for traditional and Roth contributions combined for each of you).

401(k) plans—Named after the IRS Code section that established them, 401(k)s have become almost synonymous with retirement saving. Unlike IRAs, 401(k)s are established by employers for their employees, who can make pre-tax salary deferrals into their accounts, thus reducing their current taxes. Meanwhile, earnings grow without the burden of taxation, since you don't pay taxes until you start taking distributions after retirement. Employers have the option of matching employee contributions at whatever percentage they choose—for example, on a dollar-for-dollar basis or maybe 50 cents for every dollar employees contribute.

One of the biggest benefits of 401(k)s is your ability to **take your money with you when you change jobs via what's known as a "rollover."** Your money can be rolled over into your new employer's 401(k) or into an IRA. Keep in mind that if you take possession of the money and don't roll it over into a qualified retirement plan within a certain period of time, you may be liable for taxes and penalties on the funds.

ROTH VS. TRADITIONAL IRA

	Traditional	Roth
Contributions may be tax-deductible ¹	X	
Earnings grow tax-deferred	X	
Earnings grow tax-free		X
Withdrawals can be made tax-free ²		X
Anyone can contribute ³	X	

¹ In 2010, deductibility for Traditional IRA contributions phases out for individuals with modified adjusted gross income (MAGI) between \$56,000 and \$66,000 and married couples filing jointly with MAGI between \$89,000 and \$109,000 who are covered by an employer-sponsored retirement plan.

² Withdrawals of principal from Roth IRAs can be made without tax or penalties at any age. Withdrawals of earnings are tax-free if the Roth IRA has been open for at least five years and the individual is age 59 ½ or over, or if the funds will be used for a first-time home purchase (subject to a lifetime limitation of \$10,000) or due to death or disability.

³ In 2010, eligibility to make Roth IRA contributions phases out for individuals with MAGI between \$105,000 and \$119,999 and married couples filing jointly with MAGI between \$167,000 and \$176,999.



In addition, Congress recently introduced Roth 401(k)s that offer tax-free growth potential like Roth IRAs. In 2010, you and your spouse can each contribute up to \$16,500 (or \$22,000 if you're age 50 or over) to separate traditional and/or Roth 401(k)s for yourselves (this is the total limit for traditional and Roth contributions combined for each of you).

403(b) and 457 plans—These are similar to 401(k) plans, but 403 (b) plans are designed specifically for educational and non-profit organizations, while 457 plans are for state and local government entities. The annual contribution limits are the same as 401(k) plans.

Simplified Employee Pension plans (SEPs) and SIMPLE IRAs—These are designed for small businesses and self-employed individuals. In 2010, you may contribute up to \$49,000 to a SEP and \$11,500 to a SIMPLE IRA (or \$14,000 if you're age 50 or over).

3. What's Your Investment Strategy?

When it comes to investing for a long-term goal like retirement, experts agree that the best way to increase your chances of success is to **diversify your investments** across a wide variety of different types of assets and asset classes.

A diversified retirement portfolio helps lessen market volatility by making sure all of your investment eggs aren't consolidated in one basket. The best way to achieve diversification is to practice what's known as **asset allocation**, which is the spreading of your investment dollars among the three primary asset classes of stocks, bonds and cash instruments. This way, if one asset class (like stocks, for example) is going down, the impact on your portfolio may be blunted by the other classes, which might be going up or holding steady.

You can diversify your portfolio further by spreading your assets out among different types of investments **within asset classes**. For example, you could invest in both growth and value stocks, or in treasury, corporate and municipal bonds. Your specific asset allocation strategy will depend on two main factors: your time horizon—or in other words, how many years until you plan to retire—and your risk tolerance.

The further out your planned retirement date and the more risk you're willing to assume, the higher percentage of your portfolio you may be comfortable allocating to stocks and stock mutual funds, which tend to be riskier in the short term but historically have offered higher returns over the long term. Conversely, if you're closer to your planned retirement date and don't like to assume as much risk, you'll probably want to allocate a higher percentage of your portfolio to bonds and cash instruments, which tend to be more stable and less volatile, especially in the short term.

Keep in mind, however, that when it comes to investing for retirement, taking the "safe" route by investing heavily in bonds and cash instruments **may end up jeopardizing your retirement goals** more than investing in "risky" assets like stocks. This is because these low-risk, but also low-yield, investments may not provide a high enough return to meet your retirement income needs. Therefore, most experts recommend that individuals with a long-term horizon (generally, 10 to 20 years or longer) allocate at least a portion of their assets to equities in order to potentially benefit from their long-term growth potential.

4. What About Your Health Care Costs?

Even with the passage of health care reform, health care costs remain a big unknown when it comes to retirement planning. Health care inflation has always been hard to predict, and the uncertainties posed by reform make it even more so now.



One study by the Employee Benefits Research Institute concluded that a 65-year-old couple who lives to average life expectancy (approximately 82 for the husband and 85 for the wife) **could need as much as \$295,000 for health insurance premiums and out-of-pocket expenses during retirement***. This amount rises to \$550,000 if they live to age 95. Medicare covers only about one-half of retiree medical expenses, the study noted.

Eligibility for Medicare generally begins at age 65. You'll receive Medicare Part A benefits automatically at this age if you're receiving Social Security benefits. This covers most hospital costs and some follow-up expenses. However, you must enroll in Medicare Part B, which covers some doctor and outpatient costs. **A supplemental Medigap policy** purchased through a private insurer will cover some of the holes that exist in Medicare coverage—about two-thirds of Medicare recipients buy such coverage.

In addition, you may have the option of **purchasing retiree health insurance** from your or your spouse's employer. In some instances, this costs less than a MediGap policy and provides better coverage.

Finally, you might consider **buying long-term care insurance before you retire**. If you buy a policy while you're relatively young and healthy, you may find that the premiums are surprisingly affordable. This can be a great way to lock in benefits for the long-term at a relatively low cost now.

5. What Will You Do in Retirement?

For most people, the word "retirement" conjures up visions of traveling, playing golf, visiting kids and grandkids and generally just taking it easy. While this may be how our parents and grandparents retired, there's a good chance it won't be how future generations do.

There are a number of different reasons for this, starting with longer life expectancies. If you're planning to stop working at the traditional age of 65, **you could easily spend 25 to 30 years or longer in retirement**—that's a lot of golf and traveling! That's why nearly eight out of ten baby boomers in a recent AARP survey said they expect to work at least part-time after they retire.

Another reason is financial. With the disappearance of guaranteed income provided by defined benefit pension plans for most Americans, **many simply will not have enough money when they reach age 65 to last for a 30+ year retirement**. Working either full- or part-time past the traditional retirement age can provide not only additional income and perhaps health care benefits during retirement, but also more time for retirement assets to accumulate.

IS TIME ON YOUR SIDE?

The Rolling Stones probably weren't singing about retirement planning in their classic hit from the '60s, but there's no question that having time on your side is one of the most important keys to retirement planning success.

For example, consider Mike, a 30 year old who just started making contributions to an IRA. If he contributes the maximum of \$5,000 a year into his IRA every year until he reaches age 65, he'll have accumulated almost a million dollars for retirement, or \$930,511 to be exact.

But look at what happens if Mike waits just five years and starts contributing \$5,000 a year to an IRA when he's 35. In this case, he'll have only \$611,729 at age 65.* So while he'll have contributed just \$25,000 less, he'll end up with *more than \$300,000 less* at retirement due to the loss of compounding returns on this \$25,000 over 30-plus years.

**Example assumes an 8% annual return*

* Source: Investment Company Institute (ICI)

** Based on an annual inflation rate of 4.2%.

*** Source: Employee Benefit Research Institute, "Issue Brief" July 2006



Different “Numbers”

Here are three different scenarios that show how your age, current income and when you want to retire can provide a target number for your retirement nest egg. To calculate your nest egg number, visit <http://partners.leadfusion.com/tools/firsttennessee/retire02h/tool.fcs> and use our free calculator.

Current ages (individual and spouse)	25
Planned retirement age	60
Expected number of years in retirement	25
Current combined annual income	\$40,000
Current retirement savings	\$0
Anticipated combined annual income at retirement	\$150,000*
Percentage of pre-retirement income they'll need in retirement	80%
Amount of annual income needed in retirement:	\$120,000
Total nest egg needed at retirement	\$1,600,000**
Monthly savings needed to reach the nest egg number:	\$997

* Based on 4% annual inflation

** Assuming 8% annual growth and annual distributions taken at the start of each year

Current ages (individual and spouse)	40
Planned retirement age	62
Expected number of years in retirement	23
Current combined annual income	\$80,000
Current retirement savings	\$150,000
Anticipated combined annual income at retirement	\$180,000*
Percentage of pre-retirement income they'll need in retirement	80%
Amount of annual income needed in retirement:	\$145,000
Total nest egg needed at retirement	\$2,175,000**
Monthly savings needed to reach the nest egg number:	\$2,340

* Based on 4% annual inflation

** Assuming 8% annual growth and annual distributions taken at the start of each year

Current ages (individual and spouse)	50
Planned retirement age	65
Expected number of years in retirement	20
Current combined annual income	\$100,000
Current retirement savings	\$600,000
Anticipated combined annual income at retirement	\$140,000*
Percentage of pre-retirement income they'll need in retirement	80%
Amount of annual income needed in retirement:	\$140,000
Total nest egg needed at retirement	\$1,570,000**
Monthly savings needed to reach the nest egg number:	\$460

* Based on 4% annual inflation

** Assuming 8% annual growth and annual distributions taken at the start of each year

For other useful calculators to help you plan, visit <https://www.firsttennessee.com/Planning/Goals-Calculator>





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