



## Conversations About Retirement: What Do I Do Now?

In early 2009, Prudential sponsored a free webinar for individual investors looking for help in getting their retirement plans back on track. Over 1,000 participants joined the live event, during which over 250 questions were submitted; the most common themes represented by those questions are captured in the Q&A that follows.

### **1) How secure is Social Security; can we count on it? Do you foresee future changes?**

Although Social Security could be changed by Congress, it seems very unlikely that those at or near retirement will have their benefits changed. In Washington circles, age 55 seems to be the age that is generally agreed upon as those “near retirement”. Furthermore, the recent trillions of dollars of losses in 401(k) and IRA plans appear to make changing Social Security less popular. If changes are made to the program, they are likely to be made to younger workers who would have time to adjust their plans, the argument being that younger workers can absorb a benefit cut more easily since they also would expect to collect benefits to later ages as their life expectancies increase.

### **2) What are the implications of starting Social Security early vs. delaying payments?**

There is much more to this issue than may initially appear, as individuals live longer and employers shift away from traditional pensions and towards programs like 401(k)s that place much greater responsibility on the individual. Longevity protection, spousal benefits, survivor benefits, investment risk, and taxes are all key considerations that should be understood before an individual makes this decision. In recent years, Prudential has published industry-leading research on this issue. We encourage those interested to read our paper, “*Innovative Strategies to Help Maximize Social Security Benefits*” which can be found at <http://www.prudential.com/media/managed/IB-InnovativeStrategies.pdf>.

### **3) What are some ways that a married couple can optimize Social Security payments?**

The paper mentioned above, “*Innovative Strategies to Help Maximize Social Security Benefits*”, explains the many ways that married couples can optimize their Social Security payments. For example, a husband could take a Social Security benefit based on his wife’s work record (called a spousal benefit) while delaying his own earned Social Security benefit to the maximum age (and amount) at age 70. He could then switch over to this higher, delayed benefit and this benefit would also be inherited by his wife for the rest of her life should he predecease her.

**4) Given the current market environment, should I continue contributing to my workplace retirement plan? Should I continue contributing if my employer has terminated the match?**

It's important to remember that as a retirement investor, you are saving for the long term. In today's challenging financial environment, perhaps the most important word to retirement investors is "patience". It's easy to get caught up in "gloom and doom" financial headlines, but one of the greatest advantages of saving for retirement is that most people have time to ride out periods of market volatility. Contributing to your workplace retirement plan, even if your employer has terminated the match, remains one of the most effective ways to ensure a secure retirement later in life. With time on your side, and a little patience and perspective, you can ride out the storm and make the down times work for you in the long term.

One reason is that saving through your employer-sponsored retirement program helps you automatically follow one of the wisest investment strategies—dollar-cost averaging. Dollar-cost averaging is the practice of putting the same amount of money in the same investment consistently, regardless of market activity. This is beneficial because it allows you to automatically buy more shares when prices are lower and fewer shares when prices are higher. Over time, this tends to reduce the average cost of your shares. Dollar-cost averaging through an employer-sponsored retirement plan is a great "forced investment" strategy for people who might not be as good as they'd like at saving money on their own, because contributions are deducted from your paycheck and invested directly into a combination of investments you've selected, regardless of what's happening in the market. The sooner you begin your investment program of dollar-cost averaging, the greater the opportunities to potentially accumulate a sizable nest egg.

*Dollar cost averaging does not assure a profit or protect against loss in declining markets.*

**5) What are the implications of rolling my 401(k) into an IRA?**

Although the money in a workplace-based retirement program is less "liquid" than the money in other types of savings accounts, it is nonetheless portable. This means you can move the money from one retirement account into another with very little effort when you change jobs. The smartest way to move your money is with a rollover, which is the transfer of retirement money from one qualified, tax-deferred retirement program into another, such as a 401(k) or 403(b) account with a new employer, or an individual retirement account (IRA). A rollover is the easiest way to maintain your assets' tax-deferred status while you are still working, allowing you to postpone paying taxes on the money until you withdraw it, hopefully in retirement when your tax bracket may be lower. That can be a substantial advantage if the money stays in the account for a number of years.

## **6) How should I decide between contributing to a traditional 401(k) vs. a Roth 401(k)?**

The primary difference between a traditional 401(k) and a Roth 401(k) is the tax treatment. Traditional 401(k) contributions are taken out of earnings before taxes, reducing your taxable income for the year. The tax obligation on those contributions is deferred until your account is distributed—for example, at retirement. Because Roth 401(k) contributions are included in your W-2, you effectively pay income taxes on those amounts in the year of the contribution. So, assuming both 401(k) options are available to you, should you make Roth contributions, before-tax contributions, or both? One thing to consider is how your current tax rate will compare to your tax rate in retirement:

- If you think your tax rate will be higher in retirement than it is today, making designated Roth contributions (and paying taxes now) may make sense for you.
- If you think your tax rate will be lower in retirement than during your working years, you may benefit more by making before-tax contributions and deferring your tax obligation until retirement.
- With tax rates in retirement being uncertain, you may choose to diversify your taxation by making both before-tax and Roth contributions to your retirement program. This strategy may provide some taxation flexibility.

Of course, the approach you should take depends on your individual situation and overall retirement planning strategy. To model your own scenarios, visit our Roth contributions calculator at <http://www3.prudential.com/signature/calc-roth-contributions.html>. The calculator will compare the two different types of contributions and help you make the best decision for your individual circumstances.

## **7) Should I continue to rebalance my allocations, especially in the current market environment?**

Allocating your assets and diversifying your mix of investments are two of the most important steps toward making your retirement program work effectively for you, but proper planning doesn't end there. Even the smartest choices need to be evaluated and rebalanced periodically. With inevitable shifts in the market, even a well-diversified portfolio can drift away from the desired investment mix. Many investors may not realize that it is possible to improve investment returns and reduce portfolio risk by adjusting the asset allocation back to their original target—an investment discipline known as rebalancing.

Why rebalance? The mix of investments in your portfolio can change for a variety of reasons—fluctuations in the market, relative performance of funds, account contributions or withdrawals. However, if one asset class consistently outperforms the others or contributions to one asset class are greater, the asset allocation will drift away from the desired mix—this could hinder your long-term returns. Furthermore, the appropriate asset allocation may change as you near retirement or adjust your wealth requirements, or as general expectations in the market shift.

It's important to rebalance your asset allocation periodically. It is better to rebalance on a regular basis than to be tempted to change your investment allocations unwisely as a hasty reaction to a market correction. Consistency is the rule of thumb and periodic rebalancing is the most common approach. Simply review the balance of your assets regularly on a specified schedule—once a quarter or twice a year, for example. Many 401(k) plans even offer automatic rebalancing. It's not usually necessary to rebalance more than once a quarter unless stock and bond returns have diverged by at least 10 percent.

*Keep in mind that application of asset allocation and diversification concepts does not ensure safety of principal and interest. **It is possible to lose money by investing in securities.***

**8) Is there a rule of thumb for determining how much you need to retire comfortably? How much more savings will I need to cover healthcare costs in retirement?**

Saving for retirement is a favor you do for yourself and your family. Think of it as a reward for many years of hard work. But to help make sure your nest egg is a reasonable fit for the life you want to live, you need to figure out how much money you'll need to finance your retirement. Some experts say that you'll need to replace anywhere from 60 to 100 percent of your final working income to maintain your current standard of living in retirement. Some experts estimate you'll need even more. For the purposes of this estimation, final working income is calculated on the basis of your current income, years to retirement, and average annual salary increases. Then estimates are made for the portions of that final income that are likely to be replaced by Social Security, pensions, part-time work, and distributions from retirement accounts or other personal savings. This estimation requires that you consider the following:

When will you be ready to retire? Retirement is about having enough money to live the life you want after you've stopped working, no matter how old you are. The average length of retirement has gotten longer because people are living longer and retiring earlier. Although there is evidence that the trend of retiring earlier is starting to reverse itself, and in fact many are delaying retirement, adequate funding for a retirement that may last 20 years or more needs to be considered.

How do you plan to spend your retirement years? How much money you'll spend over the length of your retirement will depend on how you will spend your time, including vacations, hobbies – even post-retirement employment. It also depends upon the degree to which you will need to support dependants. No matter how you want to spend your retirement, or who is counting on you in retirement, you'll need to understand the income required to support your plans.

How much will it cost? When you are no longer bringing home a paycheck, your financial landscape may look somewhat different than it does today. While some expenses associated with your working life may be reduced or eliminated, others, such as healthcare, may even rise significantly. Additionally, when estimating how much you'll need to retire, it's essential to consider how inflation can erode the buying power of each dollar in your retirement account, meaning your cost of living will continue to rise throughout your retirement. That means you'll

probably need to increase the amount you withdraw from your investments each year you're retired just to maintain the same standard of living.

To reach a ballpark figure of the total amount you'll need, calculate 80 percent of your current income (or slightly more if you are just starting out in your career.) That will represent a rough estimate of your annual living expenses in retirement. Then multiply it by 20 or even 30 years. A better estimate could be obtained by working with a financial professional using more sophisticated modeling tools that use, for example, Monte Carlo analysis.

Healthcare costs have risen two to three times faster than inflation over the last few decades, with no signs of letting up. In fact, many experts say that retirees can expect to pay between 15 percent and 20 percent of their after-tax retirement income on healthcare. Others estimate that a couple retiring this year can expect to pay \$250,000 in retirement for medical costs that Medicare does not cover. Soaring healthcare costs may hit extra hard if you retire early, since Medicare coverage doesn't begin before age 65. That's why it's more important than ever for employees to familiarize themselves with how to evaluate how healthcare costs will impact their retirement. The reality is, healthcare costs will continue to rise, and most people will require more healthcare as they age. Healthcare is going to be a bigger expense than most people might have anticipated.

#### **9) What are some strategies for jump-starting retirement savings if I am middle-aged and just getting started?**

Everyone knows that time is the retirement saver's greatest friend—the longer you have to invest, the more time your money has to potentially grow. But maybe you've put off saving for retirement and are afraid it may be too late to do anything. Don't panic. Just because you're getting a late start doesn't mean that you can't make solid progress toward a retirement goal. Here are some suggested strategies to help you find ways to save more.

Get started now! First of all, don't waste any more time. Get started today so you can at least have a foundation for your retirement. If you are starting in your 50s, you may not have as much at retirement as you would have if you had started saving at age 25, but doing something is always better than doing nothing.

Make the most of tax-advantaged plans. If you have access to a retirement plan at work, make sure you take full advantage of all the tax benefits it offers. If possible, contribute the maximum amount allowed, or at least enough to get the full amount of matching contributions. If you're age 50 or older, you are allowed to save more as catch-up contributions. After you've put as much as you can into your retirement plan, look into other savings plans you might be eligible for, including traditional and Roth IRAs.

Cut back on some expenses. Invest the money from these give-ups in a tax-advantaged savings vehicle.

Rethink your retirement goals. Be realistic about what you can accomplish and plan accordingly. This may require reprioritizing a dream vacation or delaying retirement a few years to give you time to accumulate more money. The longer you work the more money you can save and the fewer years in retirement you'll need to finance. You can still have a comfortable retirement, even if you need to revise your dreams a little.

Monitor your progress. Once you have a plan in place, check in on it at least once a year to see how you're doing, and make adjustments as necessary. You may also want to consult with a professional financial advisor for more tips.

## **10) What role do guarantees play?**

Guarantees can play a big role in retirement security. Unless you are ultra-wealthy, your main focus with your retirement savings should be to generate an adequate amount of income no matter how long you live. The challenge is that no one knows how long that will be. Individuals can choose to "self-insure" their own risk of outliving their retirement wealth, but that involves taking out only a small portion of your savings each year to generate income. By utilizing a guarantee, such as an income guarantee, you not only ensure that you will have income for life, but you can do this in an efficient manner by pooling your longevity risk with other retirees. The presence of an income guarantee may also allow retirees to invest their other assets more aggressively since they have purchased "downside protection" and are therefore likely to have a bigger appetite to take on more investment risk.

Guaranteed income benefit is provided through group variable annuity contracts issued by Prudential Retirement Insurance and Annuity Company (PRIAC), Hartford, CT. This benefit, available for an additional fee, guarantees your ability to withdraw a designated amount from the annuity annually, subject to rules regarding the timing and amount of withdrawals. Guarantees are based on the claims-paying ability of the insurance company and are subject to certain limitations, terms and conditions. Product availability and terms may vary by jurisdiction. Subject to regulatory approvals. Contract form # GA-2020-TGWB3-0805 or state variations thereof.

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