THINGS TO CONSIDER PRIOR TO RETIREMENT

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Agenda

01 Decisions Regarding Retirement

02 Solving The Financial Equation

03 Withdrawal Options

MAKING THE DECISION TO RETIRE

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MAKING THE DECISION

In the past, the decision for retirement-eligible colleagues was simple: continue working or retire.

Today, employees have more options and retirement can take many forms:

- Not working at all
- Working part-time
- Working full-time at another job – either in the same field or another (something fun!)

At a high-level, two questions must be answered:

Can I afford to retire?

What will I do with my time?

DECIDED TO RETIRE?

- What will I do with my time?
  - Time for travel
  - Hobbies
  - Spend time with family, grandchildren
  - Work part-time or full-time

- Today, we will focus on the financial aspects of retirement. If you can solve these questions, you can move forward with the second question, “what will I do with my time?”

SOLVING THE FINANCIAL EQUATION

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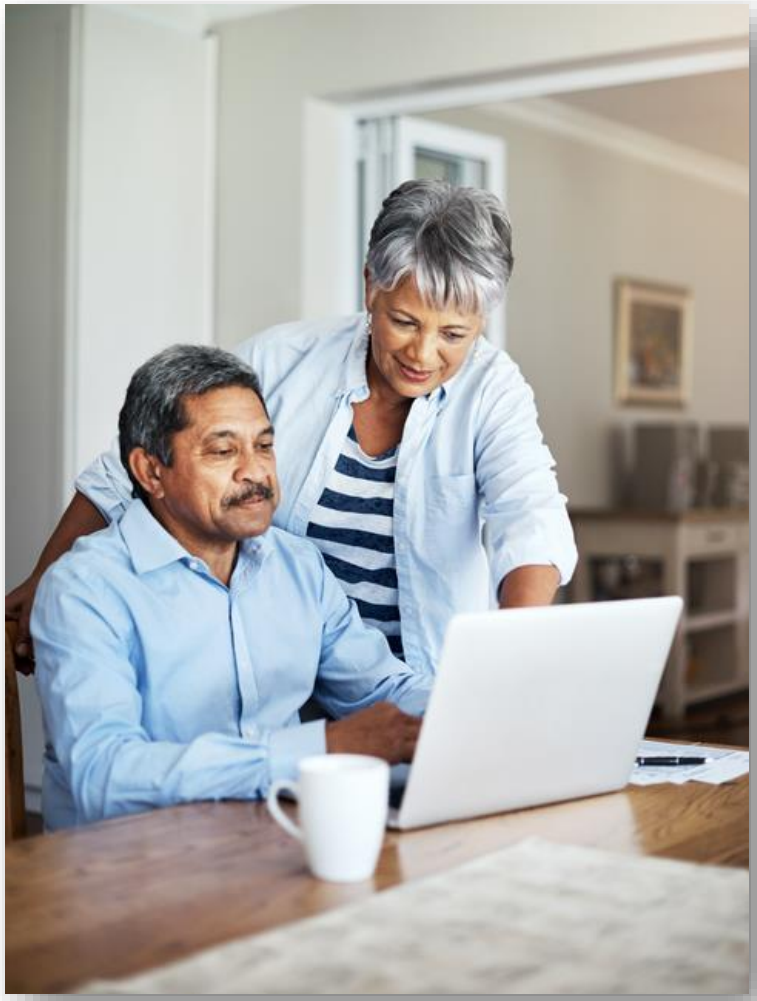
FINANCIAL ISSUES TO CONSIDER

Retirement Income

- Income from retirement accounts
- Savings
- Social Security (if applicable)
- Income from spouse/partner (wages, retirement income, Social Security)
- Income from job (part-time/full-time)

Health Insurance

- Pre-65 coverage
- Medicare coverage
  - Parts A, B, C, D
- Dental insurance
- Life insurance
  - Term, cash balance



DO I HAVE ENOUGH SAVED?

The Rule of 72

- The Rule of 72 helps determine how long it takes for an investment to double given a fixed annual interest rate
- Example:
  - $200,000 invested at age 55 and earning an assumed rate of return of 6%
  - The **Rule of 72:** 72 / 6 = 12
  - In 12 years, the $200,000 investment would be worth $400,000
- Key strategy: Keep the funds in your retirement account if you can take advantage of tax deferral and compounding
  - Take advantage of compounding by keeping funds in your account until a typical retirement date to improve your retirement savings
  - Many retirees are expected to live into their late eighties or nineties

PAYOFF DEBT

- Create a budget if you don't have one already
- You only need money to the extent you have bills !
- Payoff debt before you retire
  - The amount of retirement savings you need is less if you don't have monthly debt payments
    - **Example 1:** Mortgage balance is $100,000, monthly payment is $1,500
    - Retirement balance needed to generate $1,500 per month is $600,000

      $1,500 after tax $2,000 ($1,500/ .75 (1- effective tax rate (25%))

      $2,000 x 12 =$24,000 / 4 % =$600,000 (using 4 percent rule)
    - **Example 2:** Car loan balance is $20,000, monthly payment is $500

      $500 after tax $667 ($500/ .75 (1- effective tax rate (25%))

      $667 x 12 =$8,004 / 4 % =$200,100 (using 4 percent rule)

4% Rule assumes you withdraw 4% of your saving balance each year and add inflationary increases to withdrawals in future years. Some advisors now say 3.3% is a safer withdrawal rate to use.

WITHDRAWAL OPTIONS

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WHERE DO I START?

- Most financial planners will advise to withdraw taxable accounts first.

Taxable Savings- bank accounts, brokerage accounts

Tax Deferred Savings Accounts- 403(b), 401(a)"ARP", 457(b), Traditional IRA

Roth Accounts- Roth 403(b), Roth 457(b), Roth IRA

INVESTMENT EDUCATION - INCOME OPTIONS

Impact of account balances upon death:

- Income options are another differentiator between annuities (fixed versus variable) and mutual funds.
- Mutual funds are the most flexible, offering participants the ability to:
  - Leave the money in the account (age-73 for 2023 required minimum distribution (RMD))
  - Make lump-sum withdrawals
  - Make systematic withdrawals
  - Transfer balances to beneficiaries upon death
- Variable annuities typically offer lump sum and systematic withdrawals but may have restrictions on withdrawals based on the age of the participant and the length of time the investment has been owned (surrender charge- penalty for cashing in the annuity before a specified time period). They also offer annuity payouts based on the underlying investments in the variable annuity.
  - If a payout annuity has not been triggered, typically, the entire balance of the annuity will transfer to the participant's beneficiaries.
  - If annuity payments have begun, continuing payments will be determined based on choices the participant made upon triggering the annuity.
    - Joint annuitant (typically a spouse: full, half, two-thirds)
    - Periods certain (e.g., 10-, 15-, 20-years)
- Fixed annuities are similar to variable annuities, depending on whether or not a payout annuity has been established. If so, options will depend on choices made with joint annuitants and periods certain.
- Both fixed and variable annuities that have not been triggered are subject to age-73 RMD, with balances going to beneficiaries upon death.

INVESTMENT EDUCATION – ANNUITY PAYMENTS

How are annuity payments calculated?

- Fixed annuities can be based on a specified time period (e.g., 10-years) or provide lifetime income.
  - Fixed-year payouts will consider the number of years (e.g., 10), projected investment returns, and investment fees during the time period).
  - Lifetime income is based on the participant's life expectancy (mortality), investment returns, investment fees, joint annuitants, and periods certain.
  - Life Expectancy Example
    - A 65-year-old male is expected to live 19.3 years
    - A 65-year-old woman is expected to live 21.7 years.
  - The amount being annuitized is transferred from your account to the insurance company to establish the "payout" annuity.
  - Example: Single male or female, age-67 transfers $500,000 to insurance company in exchange for lifetime income
    - Payout is $2,564 per month – the equivalent of a 6.15 percent initial annual payout (return of principal, earnings).
    - If second person is added, this drops to $2,167 or a 5.2 percent

Note: Annuity payouts are for illustration purposes only. Actual calculations will vary depending on mortality tables, interest rates, insurance products and overall expenses of the program.

INVESTMENT EDUCATION – CALCULATING VARIABLE ANNUITIES

How are variable annuities calculated?

- Factors in calculating variable annuity payments
  - The amount being annuitized (e.g., $500,000)
  - The expected rate of return
    - This is typically tied to the underlying investment: equity fund, fixed income fund
    - An initial rate of return may be used for year-one, with ongoing payments adjusted based on the actual market return
  - Mortality (i.e., the expected life expectancy of the annuitants)
  - Expenses (e.g., investment, recordkeeping, and company profit)
- Example: $500,000 annuitized in a large-cap growth variable annuity
  - 4 percent year-one earnings, then adjusted annually based on market returns
  - Actual payment of $2,891 is the equivalent of a 6.94% annual return (return of principal, earnings, and longevity credits)
- Both fixed and variable lifetime annuities may contain longevity credits ("mortality credits," which are a bonus derived from the pool of annuitants who died before their average life expectancy).

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INVESTMENT EDUCATION: ANNUITY APPLICATION

Example: A participant has $250,000 in a fixed annuity and $400,000 in a mutual fund or variable annuity

- Social Security and/or pension is expected to be $1,500 per month
- Desired monthly income is $4,000 per month **(pre-tax)**

$4,000	desired monthly income
($1,500)	less Social Security and/or pension
$2,500	needed from retirement accounts
($1,281)	provided from the $250,000 fixed annuity (6.15 percent payout)
$1,219	shortfall

Options:

- Transfer $237,853 to fixed annuity if guaranteed income is desired
- Make up difference with **systematic withdrawal** payments

  $1,219 x 12 = $14,628 / $400,000 = 3.7 percent

  - Withdrawal rate is within 3.3%-4% rule
  - Full balance in account is available to beneficiaries at death

INVESTMENT EDUCATION: ANNUITY IMPACT ON ESTATES

- Annuity payments may provide participants with a larger payout at retirement versus the 3.3% to 4% payout rule
  - Trade-off is exchanging lump sum transfer to insurance company for return of principal, expected returns, and “longevity credits”
  - Participant’s account balance at death is lower due to transfer to insurance company for the payout annuity purchase
- Systematic withdrawal payments taken from a mutual fund or variable annuity allow for a full balance transfer to beneficiaries at retirement
  - Income can vary based on market returns (e.g., 4 % or fluctuating account balance), or percentage taken may be higher than expected if set amount is taken (e.g., $1,000 per month)
  - Account balances are subject to RMD at age 73.

INVESTMENT EDUCATION - SUMMARY

- Fixed annuities can provide participants with a guaranteed rate of return and a fixed-income stream at retirement (lifetime income).
  - At retirement, participants exchange a lump sum from their account balance for a series of monthly lifetime income payments.
- Variable annuities offer the possibility of higher returns (versus fixed annuities).
  - Income options are similar to both mutual funds (lump sum, systematic cash withdrawal) and fixed annuities (lifetime income).
  - Annuity payments are based on the underlying investments over time.
- Mutual funds provide investment options at a lower cost compared to variable annuities (no mortality and expense charges). Income options are flexible, offering lump sum and systematic cash withdrawals.
- Mutual fund balances may be transferred to in-plan annuities anytime or, upon separation, to annuities purchased through another retirement plan (e.g., 403(b)) or IRA).

THANK YOU FOR YOUR TIME

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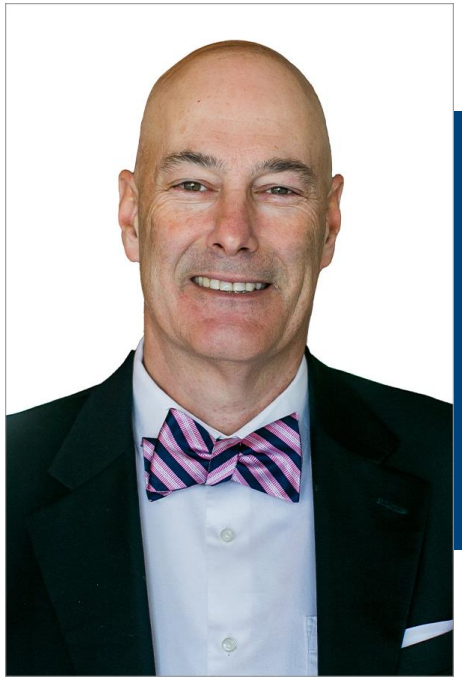

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