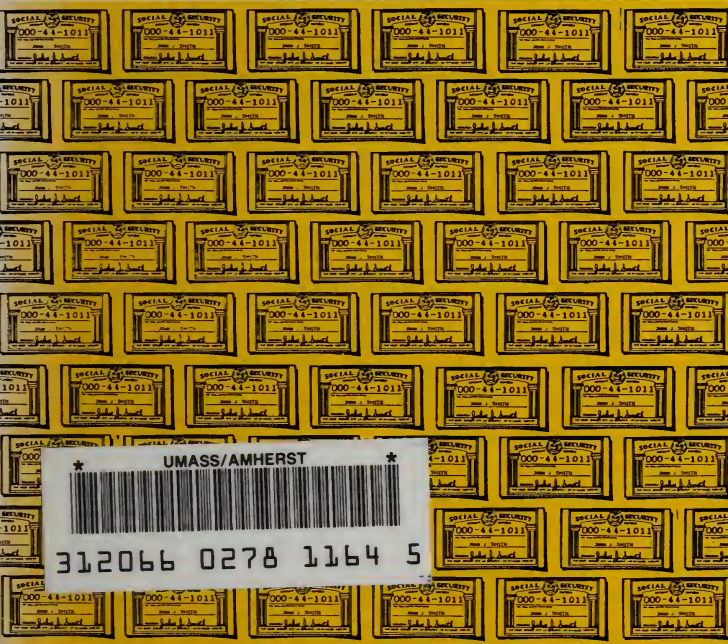
PREPARING FOR RETIREMENT

Social Security may not be all the security you need.



A Public Service from the Office of Treasurer and Receiver General Robert Q. Crane.

MONEY MATTERS

Preparing for Retirement

If you're counting on Social Security benefits to carry you through retirement, you could be counting yourself short.

Social Security isn't intended as a pension to cover all your retirement expenses. In fact, chances are Social Security won't replace even half the salary you once earned.

That means preparing for retirement is a huge task, no matter how far off that stage of life might seem. Since you could well live 15 or 20 years beyond your retirement date, you must be in a position to somehow provide a sizeable chunk of your living expenses for that period of time. And you must be able to do that despite the ravages of inflation.

Planning is extremely important to adequately provide for retirement. A key element in the planning process is knowing what your retirement income will be.

Unfortunately, rules and regulations governing Social Security and pension plans are so complicated that individuals must investigate carefully to get even a rough idea of what their retirement incomes might be. Generally, though, your goal should be to assure that your annual income is as close as possible to the income you earn in the years immediately preceding retirement. That will allow you to avoid serious cutbacks in your style of life.

Where Will the Money Come From?

Social Security benefits vary widely; a worker who recently retired at age 65, receives anywhere from $133.90 to $553.30 monthly. Trying to determine what your Social Security income might be sometime far in the future is nearly impossible because the exact amount depends on, among other things, how long you pay Social Security taxes, the amount of your earnings, whether you retire at age 62 or 65, and whether both husband and wife work.

Generally speaking, though, lower income workers can expect a higher percentage of their incomes to be replaced with Social Security benefits than higher income workers. Individuals on the verge of retiring and earning $5,000 yearly will typically receive Social Security equal to about 60% of their pay while individuals earning over $30,000 might receive less than 20%.

Individuals over age 56 can ask the Social Security Administration to check their records and provide an estimate of benefits at age 62 and 65. For further information on Social

Security benefits and regulations, contact the Social Security Administration district office nearest your home, as listed under the U.S. Government listings in your phone book.

The amount you can expect to receive through company pension plans is also highly variable. In many cases, the amount is linked directly to your Social Security benefit. Thus, in setting the amount of your earnings the pension will replace, your Social Security benefit is figured in. The net effect of such plans is to reduce the actual corporate pension of lower income workers and raise the pension for higher income workers.

Some companies provide retirement benefits through profit-sharing plans or through plans to which employers contribute a certain amount of money annually. These plans aren't linked to Social Security.

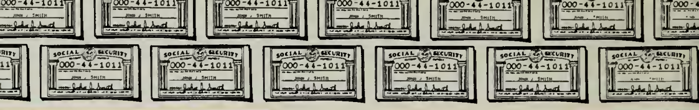
Asking the Right Questions

Just because you know what benefits your company's plan provides doesn't mean you can start calculating your expected payments, however. For instance, you must determine if your work category is eligible to receive benefits. Once you've determined that you're eligible and even that benefits are being credited to you, you must determine how long your company requires you to work before you're guaranteed the payments when you retire. Such guarantees are referred to as vesting. Many companies require that you work five or even ten years before the benefits become vested. If you leave before the plan is vested, you will receive nothing, even though benefits might have been credited to you. Thus, workers who frequently switch jobs may find themselves with no pension other than Social Security.

A number of other questions must be answered before you can begin estimating your company pension benefits. For example, what happens to your vesting rights if you leave the company for a short period or are laid off and then return? Does the pension plan include any medical benefits?

Many companies explain their pension programs in pamphlets they give to employees. But because the rules are usually so complex, you should inquire with your company's benefits department about anything that isn't clear to you.

In addition, a non-profit public interest group, the Pension Rights Center, publishes a series of fact sheets that in simple language explain the current pension law. One fact sheet relates to recent changes in the law and a second to women's pensions. The sheets can be obtained for 25 cents each by sending a stamped self-addressed envelope to the Pension Rights Center, 1346 Connecticut Ave. N.W., Washington, D.C. 20036.



Helping Your Cause

Besides what Social Security and company pension plans may provide, you can do things to add to your retirement income. Some companies offer savings plans, deferred compensation plans, and employee contribution pension plans under which you can set aside income and in some cases have your contribution matched with a company contribution. Besides increasing the income you can expect when you retire, such plans have the added advantage of deferring income taxes until you retire, which makes the plans especially desirable.

Also, if you are not covered by a company pension plan of some sort, you can start your own. Two types exist:

1. An Individual Retirement Account, which is for employees not covered by a corporate plan. An IRA allows you to set aside up to 15% of your salary each year, up to a maximum of $1,500, under special arrangements.

2. A Keogh Plan, which is for the self-employed and corporate employees who earn side incomes from freelancing, consulting, or other self-employment. As with an IRA, up to 15% of earnings from self-employment can be contributed to set up a Keogh, but the maximum is a significantly higher $7,500.

For both IRA's and Keoghs, the money set aside can be placed in a bank savings account or invested in government bonds, mutual funds, or insurance company annuities and endowments. The big advantage for both devices is that your contribution and the interest earned on the contribution are exempt from federal income taxes until you begin using the funds for retirement, at which time you are likely to be in a lower tax bracket.

A word of caution about IRA's and Keoghs, however: If any money is withdrawn before you reach age 59½, you must pay income taxes plus a 10% tax penalty on the amount withdrawn. Most banks, brokerage firms, and other financial institutions can answer questions you might have about IRAs and Keoghs.

In addition to the various formal devices for providing retirement income, you can do some saving on your own. One way is to buy an annuity from an insurance company. Annuities typically cost a minimum of $5,000, although some are available for less. Because of the interest the purchase price accumulates, annuities guarantee a specified income for life. Annuities can be bought to provide income at some time in the future or immediately for people about to retire. One key advantage of annuities is that the interest that accumulates is deferred from income taxes until it is paid out. Check with a number of insurance companies to compare the income you would receive from different plans.

Of course, the most basic way to provide retirement income is to start a regular savings plan and stick to it. Over a long period of time, such savings can grow to an amazing size. If you place $1,000 into a savings account paying the current interest rate of $5\frac{1}{2}\%$, compounded daily, the account will have grown to slightly more than $3,000 in 20 years. But bear in mind that periods of double digit inflation could diminish the buying power of these savings.

What Will Your Expenses Be?

As you approach retirement age, you will have a clearer indication of your expected income. Then you can begin to look more closely at your expected living costs during retirement.

Some costs can be expected to decline. For instance, your house will probably be paid off, eliminating mortgage payments. Expenses for clothes and commuting will also be reduced.

But many costs are difficult to predict. For instance, health costs could be substantial. And you may want to move to a warmer region, which could involve a costly condominium purchase or constantly rising rental payments. And chances are you'll be inclined to spend more on personal entertainment, such as travel, movies, and sporting events.

If, as you approach retirement, you find that your expected income won't cover your expected costs, you have some options. You could continue at your job beyond the traditional age 62 or 65 retirement ages. A recent change in federal law has made forced retirement at age 65 illegal. And working longer usually allows you to keep up more effectively with inflation.

Another option is to work part-time after you retire. Such a compromise approach can provide much needed income and satisfaction as well.

Whatever you do, however, don't count on Social Security to carry you through your retirement. Start planning . . . now.

Robert Q. Crane

Robert Q. Crane
Treasurer and Receiver General
Commonwealth of Massachusetts
State House, Boston, MA 02133