NAGDCA

2009 ISSUE BROCHURE

PLAN SPONSOR BASICS FOR RETIREES

Plan sponsors often design communication and education efforts to be applicable to a broad range of active participants. However, as participants near retirement or enter into retirement, their needs and interests change and they are often uninformed or misinformed about plan features and options. Therefore, plan sponsors should consider tailoring their communications to meet the changing needs of this segment of participants. Plan sponsors should communicate these typical policies and features:

- The distribution options available through the plan. These could include periodic payments (monthly, quarterly, semi-annually or annually) over a fixed number of years or life expectancy, full or lump sum payments, or fixed dollar or percentage amounts among other options.
- Most plans accept one time lump sum contributions to the plan at retirement. Participants who have accrued sick and vacation time may be able to defer additional income to the plan and, BONUS! lose less of those payouts to taxes.
- Employees nearing retirement eligibility with underutilized deferrals from prior years should consider the regular retirement catch-up provision. The provision allows them to defer considerably more income during any or all of the three calendar years before their normal retirement age.
  - Plan sponsors may also consider targeted communications to participants age 50 and over about the age 50 catch-up provision. Many participants may not be able to utilize the 'regular' catch-up provision for the full three years. Starting earlier though, at age 50, with higher contributions allowed by the age 50 catch-up provision will assist in achieving better, greater account balances.
- Upon retirement, participants may access their accounts prior to attaining the age of 59 ½ without an IRS imposed penalty.
- Participants should understand that they need to begin to withdraw a required minimum distribution by the end of the calendar year in which they turn 70 ½ years of age.
- Participants may continue to exchange between investment options even after separation from employment.
- Once a withdrawal option has been selected, participants have the option to make changes to that selection at their discretion (within any distinct numbers limitation that may be set by their plan administrator). However, participants who are allowed to annuitize their balance lose this flexibility.
- Plans can provide the option to elect individuals, a trust, a charitable organization or an estate as beneficiary

Communication from plans to participants is vitally important, but communication in the other direction is also key. Retirees should be encouraged to keep their retirement plan informed of changes in their life, especially when changing residences or internet service providers – as more and more information is being communicated through e-mail. With an incorrect address, a retiree will miss out on getting their quarterly account data as well as investment or legislative information communicated through newsletters. Retirees with multiple residences may consider paperless options for their statements to ensure they continue to get account or plan information when they move. In addition to addresses and contact information, relationships can change as well. A retiree whose family dynamics change should remember (and be reminded) to check with their retirement plan to be sure their beneficiary designation(s) still meets their needs.

FINANCIAL AND OTHER CONSIDERATIONS

Participants preparing to retire have a lot of challenges. One of the greatest challenges is sorting through all of the sales pitches and other information provided by "financial advisors." The term "financial advisor" can run the gamut of experience, tenure and education level. The responsibility of filtering advice that is in the participant's best interest versus that of the advisor ultimately falls on the shoulders of the participant. However, as a plan sponsor, here are some important items you can communicate to your participant as they prepare for retirement:

- Encourage them not to rush into any decisions and to take time to become comfortable with any proposed changes.

- Encourage them to seek out the education, resources and tools available through the plan.
- If a potential retiree has needs that can't be met in full by the plan administrator, encourage them to seek out financial professionals who educate their clients as opposed to high pressure salespeople wanting to simply sell a product.
- Encourage participants to consider fee-only financial advisors. These advisors may be a good choice since their commission is not tied to any one particular financial product.

WORKING IN RETIREMENT

"If I retire, can I come back and work part-time?" "I'm going to try to earn some extra money on the side when I retire, what do you think?" If I retire and my wife/husband keeps working, is that okay?" These are just some of the questions plan sponsors are likely to receive over the next few years. Traditional work cycles and retirement circumstances will continue to evolve, so plan sponsors will need to be knowledgeable about a broad range of retirement issues. Some of the more pressing issues that may be of particular concern are:

The Social Security Decision

The size of a person's monthly Social Security check depends partly on how old an individual is when he/she first applied for benefits. For those who begin at 62, the earliest allowable age, the amount will always be smaller than those who will wait until reaching full retirement age (FRA). It is important to note that an individual can retire any time and choose not to apply for benefits until some later point. However, no matter when applied for, there may be penalty and tax consequences to the collection of benefits that change throughout the retirement years.

Currently, individuals, who collect benefits before reaching their FRA, can earn up to $13,560.00 per year without penalty. Income earned over that amount will result in a penalty loss of $0.50 on every benefit dollar. The **year** that the individual reaches FRA, they can earn $36,120.00 with no penalty. Income over that amount will result in a $0.33 penalty. Once past FRA, a individual can earn any amount without a penalty reduction. It is important to note that wages, bonus, and commissions count against the total. Once, however, an individual has achieved FRA and is no longer subject to penalty reductions, there is still the matter of taxability of Social Security benefits. If the sum of an individual's adjusted gross income, non-taxable interest, and half of Social Security is between $25,000.00 and $34,000.00 for individuals or $32,000.00 to $44,000.00 for couples, up to 85% of their Social Security could be taxed.

Social Security Offset

There may be consequences if an individual expects to receive income from Social Security and an employer-sponsored pension plan. This concept is often referred to as "offset" or "integration". The roles and consequences differ for those covered by Social Security and for those who have worked in jobs not covered. Employer-provided pension plans, for those covered by Social Security, often take into account the amount of projected Social Security benefits when determining contributions and benefits. An "integrated plan" approach takes into consideration that the employer's contributions to Social Security (FICA tax) are at the same percentage rate for both high- and low-income workers. The theory is that although the percentage rate is the same, the amount of money contributed on behalf of the lower earning employees buys a proportionately higher share of benefits. Pension benefits are thereby lowered for all workers and the total retirement benefits (pensions and Social Security) replace a more uniform percentage of pay for all employees.

The "offset approach" reduces pension amounts one-to-one for each dollar received by Social Security. The maximum permitted is up to one-half the annual Social Security benefit. The exception is a "step rate" approach. This is a plan that can offer higher benefits to those earning higher than a prescribed wage level (integration level). The integration level is set by law and cannot be higher than the maximum taxable earning base (MTEB) or the earning subject to Social Security in a given year.

Individuals who are entitled to both Social Security and a pension-based unemployment from a job not covered under Social Security (some public sector Plans) may expect a reduction (offset) on Social Security benefits. Two rules may apply:

- *The Two Thirds Rule* where the Government-pension offset will reduce the amount of Social Security the spouse or widow of an employee not covered by Social Security by two-thirds of the amount of a government pension and;
- The *Windfall Elimination Provision*, which affects the person who spent most of their career working for a job not covered by Social Security but worked at other jobs where they paid Social Security taxes long enough to qualify. This offset reduces the normal benefit formula calculation and determines the Social Security benefits due based on the lower number. This is an attempt to try to eliminate a windfall of both government pension and Social Security benefits combined. A guarantee is provided to protect workers with relatively low pension. It provides that the reduction of Social Security under this formula cannot be more than one-half of that part of the pension attributable to earnings after 1956 not covered by Social Security.

Working with a Financial Plan

Even if an individual decides to work when retired, it is still a good idea to develop a financial plan that determines income needs during various phases of retirement. Many people will spend a large percentage of their life retired and will not always be able to count on working forever. A good plan will identify fixed and variable assets that are anticipated as either "long term" and "current" based on life expectancy. Changes in health and living arrangements will change, so it's important not to raise an individual's standard of living based on working in retirement with little or no plan to reduce fixed or variable cost as circumstances dictate.

Reallocating to a Tax-friendly State

Many individuals have been lowering their cost of retirement by moving to a more tax-friendly state. Everyday from 1998 through 2007, at least 1,100 people moved from the nine highest income tax states to the nine no-income tax states. This move would seem to make sense not just from a lower tax angle, but also from the increased job opportunities that follow population growth.

INVESTMENTS IN RETIREMENT

Many retirees are adverse to risk and are tempted to gravitate towards the safest investment vehicles available. Popular investments among retirees include; products from a federally insured bank, government debt, or in some cases, cash buried in the backyard in an old coffee can. There is even a greater temptation if retirees believe they already have all the money needed and just want to protect the status quo. Unfortunately, it is not always that easy. True enough, bank accounts, CDs, and other guaranteed vehicles won't lose money and all will feel fine for the short time. Unfortunately, over the long term, not keeping up with inflation could undermine even the largest fortunes.

Although there is no way to predict the rate of inflation, it is almost a certainty that inflation will occur. For example, according to U.S. government data, in the 30 years from 1978 to 2008, the cost of energy for U.S. homes rose by 3.8 times. During the same period, rent and groceries increased 3.5 times. Healthcare cost can be particularly worrisome since the cost of hospital care is up 88% in the past eleven years.

Recent events, however, have taught investors that the stock market may not be an easy solution to the inflation problem. In fact, deflation has become as big a problem as inflation so retirees must take this into consideration when planning for income replacement and the associated risks.

For the extremely conservative risk-adverse retirees, one solution may be TIPS or Treasury-Inflated Protected Securities. These are bonds issued by the federal government guaranteed to keep pace with the consumer price index. Retirees investing in these vehicles should keep in mind that in the event that the consumer price index is calculated as a deflation, the value of the TIPS will decline accordingly. Subsequently, in a low inflation situation, TIPS earnings will be low as well. Finally, TIPS earnings are based on government calculations and may not equate to a retiree's personal inflation rate. It would seem that in light of inflation/deflation, retirees still need a diversification strategy to maintain the retirement goals.

For those willing to take moderate risk with an eye towards staying ahead of either inflation or deflation a number of alternatives exist.

Income Replacement Ratio and Related Risks

Retirement assets can serve either or both of the following purposes depending on the person's financial situation:

1. **Income for retirement (primary or supplemental income)**
   Many participants need to use most of their retirement assets to achieve their desired standard of living during retirement.

2. **Estate planning**
   Some participants, with substantial Defined Benefit (DB) plan income, social security, and large DC balances, may have substantial assets left when they die. Any risks they face during retirement will have little effect on their spending. Instead, the risks affect the size of their estate.

Income Replacement Ratio Risks

When deciding how much of the principal and income to spend, individuals who will use their assets as retirement income must consider the following risks:

1. Investment
2. Inflation
3. Longevity

Investment Risk and Inflation Risk

For most investment portfolios, the future value of the portfolio cannot be predicted with certainty. This uncertainty is called **investment risk**.

Inflation will erode the purchasing power of a participant's account balances over time. With average inflation at 3%, purchasing power will fall by about one third after ten years. If inflation averages 5%, purchasing power will fall by about two thirds after ten years. This is called **inflation risk.**

When still active employees, participants have many tools to deal with both investment and inflation risk. They can adjust:
1. the risk of their portfolio;
2. their contributions;
3. their retirement date; and
4. their planned standard of living in retirement. Spending less than the maximum possible amount will build up a reserve which can then be used to absorb any investment losses which may occur.

After retiring, a participant has only the first and last of these tools.

Longevity Risk

The life expectancy of a seventy year old is about 17 years. This means that half of all seventy year olds will live more than another 17 years. This is called **longevity risk**.

A participant's spending strategy must allow for the significant probability that he will live to age 95, or even beyond. One way of handling longevity risk is to spend less in the early years of retirement. This maintains a higher investment balance which can then be used for spending in later years.

Another way to deal with longevity risk is to switch from typical investments (stocks, bonds, etc) into certain kinds of annuities offered by insurance companies that deal specifically with longevity risk. Often this change occurs at retirement, but it can be phased in earlier or later. With a single premium straight life annuity, the insurance company pays the participant a fixed amount for as long as the participant is alive.

Not all insurance annuities offer this kind of protection, so thorough investigation is required. Theoretically, these insurance contracts can offer an inflation adjusted payout, but this is not common. All leave the participant exposed to the credit risk of the insurance company, and some have substantial other investment risk as well.

Income and Investment Solutions

The participant's withdrawal strategy has to satisfy the federal Required Minimum Distribution (RMD) **and** address the risks mentioned above. The key question for retirees is how to both spend and invest their money so that it allows them to maintain specific standard of living until they die. To help retirees with their retirement strategy, plan sponsors can consider offering the following:

- Income/investment solutions that address inflation, longevity, and investment risk
- Communication/education that will help retirees deal with the complexities of finances in retirement and address the income replacement ratio risks.

There is no single/investment strategy that will work for all retirees. The following are income and investment solutions that plan sponsors could consider offering to their retirees:

1. **Fixed annuities**. A fixed annuity is a contract in which the retiree pays for a guarantee of certain annual income. There are two major types of such contracts:
   a. X year – contract guaranteeing income for X years whether you do or don't live that long – does not address longevity risk.
   b. Life annuity – contract guaranteeing income for life. This annuity addresses longevity risk as it pays income until the beneficiary (or the spouse if joint survivor option is included for either full or partial amount) dies. It usually does not address inflation risk although there are discussions of potential new offerings providing real (as opposed to nominal) annuity. Life annuity may also address the investment risk. However, if the annuity is backed by single insurer, the investment risk is not fully mitigated as single insurer contracts carry credit risk.

   Plan sponsors thinking about offering retirement income options in their plans should consider annuities because they address the biggest risks faced by retirees. Additionally, plan sponsors can likely offer them to retirees at costs much lower from those which retirees would have to pay in the retail market.

2. **Variable annuity.** A variable annuity is a contract purchased by making a single up front payment or a series of purchase payments under which the insurer agrees to make periodic payments to participant, beginning either immediately or at some future date.

   The amount of periodic payment depends on the performance of the investment options chosen as a part of the contract. Typical choices of investments include mutual funds that invest in stocks, bonds, money market instruments, or some combination of the three.

   This option is designed to address longevity risk. However, because the value of the payment varies with investment return, it carries investment risk. Unless the return is invested in inflation-hedged instrument, the inflation risk is not mitigated either. Although variable annuities are tax-deferred and there are no taxes on the income and investment gains from the annuity until the time of withdrawal, the withdrawals are taxed at the ordinary income rather than the lower capital gains rates. In general, the benefits of tax deferral will outweigh the costs of a variable annuity if held as a long-term investment to meet retirement and other long-range goals.

   The following benefits can be added to variable annuities to provide additional guarantees (Source: Institutional Retirement Income Research Council):

   a. Guaranteed Minimum Accumulation Benefit (GMAB) – a rider which guarantees the minimum amount received by the annuitant, after the accumulation period or a set period of time, is either the amount invested or is locked-in gain. It protects the value of the annuity and the annuitant from market fluctuations.

   b. Guaranteed Minimum Income Benefit (GMIB) – an option to protect annuitants against downside market risk by giving them the right to withdraw a maximum.

c. Guaranteed Lifetime Withdrawal Benefit for Life (GWBL) – a rider which allows minimum withdrawals from the invested amount without requiring annuitization of the investment. The amount that can be with drawn is based on a percentage of the total amount invested in the annuity.

d. Guaranteed Withdrawal Benefit Amount (GWBA) – the amount eligible for withdrawal each contract year after the youngest annuitant reaches age 59.5.

e. Lifetime Annual Withdrawal or Annual Guaranteed Withdrawal Amount – a rider that allows minimum withdrawals from the invested amount without having to annuitize the investments. The amount that can be withdrawn is based on a percentage of the total amount invested in the annuity.

Plan sponsors need to be very careful when offering variable annuity contracts as it the word "annuity" does not always represent instruments that fully solve the problem of longevity risk. They may also be very expensive. Therefore, careful due diligence and communication is recommended if such instruments are offered. Some of the key questions to address when evaluating such solutions include the following:

a. Does it offer a guarantee of income?
b. Are there multiple insurers?
c. What combination of financial instruments does the solution use?
d. What fees are involved?

3. **Laddered TIPS strategies** (15, 20, 25, 30 year ladders) Laddered TIPS strategies eliminate reinvestment and inflation risk. Plan sponsors could offer the ladders which would have to be set up to satisfy RMD. Participants would have to manage buying some of the TIPS back to ensure that they save some of the distributions.

4. **Target date funds**, also known as lifecycle funds, are characterized by the investor's ability or option to pick a year in which the funds will be needed for retirement income. As the date approaches, the fund automatically adjusts its asset allocation from aggressive, more stocks, to conservative, more bonds. Depending upon the fund structure, the automatic adjustments may even continue into retirement, taking into account the need to maintain enough risk exposure to help beat inflation. Despite the one-stop shop appeal of these types of funds, investors should understand that some lifestyle and target date funds may charge investors a fee for the fund manager service.

   There are generally two types of target date funds;

   a. Without income guarantee – Some target date funds treat the retirement date as a "bump on the road" and claim to be designed to manage participant's assets until they die. Plan sponsors should thoroughly understand those design approaches as they usually carry high market risk (high equity exposure) well past retirement.

   Depending on the plan's participant demographics and especially the role of the plan as either a primary retirement plan or supplemental plan (estate planning or primary income), those types of risk may or may not be appropriate for your retirees. If the market risk goes against a retiree, he/she may have to significantly reduce his/her standard of living or slide into poverty. On the other hand, if the retiree has affluent retirement (stable DB plan, significant savings outside of the plan etc.), they may be able to afford the risk. Maybe 100K instead of 150K is not a big issue for them. However, a plan sponsor can't really assume that this is their situation.

   b. With income guarantee – new target date strategies are emerging to combine the accumulation and distribution phases of the investment cycle and to tie an income guarantee to the target date fund. Plan sponsors need to carefully understand those solutions and their participant base before offering them as an option in their plan.

5. **Lifestyle funds** are built on an array of mutual funds within an asset mix that reflects a conservative, moderate, or aggressive growth strategy. They are designed to be a single fund solution. Investors need to only select the lifestyle fund that fits their current time horizon, risk profile, and investing goals. From there, the fund manager rebalances the portfolio to remain true to the fund state strategy.

6. **Fixed-income** investments typically pay interest or dividends on a regular schedule and may promise to return principal at maturity, though that promise may not be a guarantee in many cases. Examples of this type of investment include government, corporate, and municipal bonds, as well as preferred stock and guaranteed investment contracts (GICs). The advantage of holding fixed-income securities in an investment portfolio is that they provide regular, predictable income. Concerns include:
   a. Fixed-dollar withdrawal programs increase investment risk and introduce the possibility of self-liquidating the portfolio during extended market declines.
   b. Time horizons cannot accurately be predicted.
   c. IRA and pension-forced withdrawals at age 70½ may accelerate an increased income, triggering taxation in excess of need.

OTHER RETIREMENT INCOME SOURCES

Another decision facing retirees is what to do with money **currently** held in a 401(k), 457, or other such qualified retirement plans. Retirees are often encouraged by financial planners, advisors and brokers to consolidate their retirement assets with other eligible retirement savings vehicles by moving all retirement assets to one common plan provider. However, many variables should be considered to determine if this is in the best interest of the retiree, such as:

- In general, an employer sponsored plan may provide more attractive investments and better pricing because of its size and scale than one might find in individual products. In many cases, employer sponsored plans may have professional investment oversight to ensure investments remain competitive and to instill confidence in investment fund companies and managers.
- 457 plans have no early withdrawal penalties, unlike Individual Retirement Accounts.
- Plans often provide a stable value fund or similar fixed income product which may be difficult to match outside of an employer sponsored plan.
- Plans might offer the ability to consolidate funds under one provider and possibly reduce cost of investing under multiple plans while also providing simplification of paperwork and record keeping.
- Generally, employer sponsored plans are continually making changes to improve their offerings and seeking more competitive fees. Due to the plan sponsor and/or employer's fiduciary responsibilities, employer sponsored plans tend to have greater oversight and advocacy for the participant.

Plan sponsors should make sure that retirees are aware that plans have a website that provides access via the internet to keep them informed about their investments or the plan in general.

Newsletters and statements are frequently sent out to keep participants up to date on their accounts and changes to each particular plan or legislation on 457(b) plans in general. Plans might want to consider separate retiree newsletters focused on retiree needs and issues.

Retirees can also access the IRS website at http://www.irs.gov/ to stay informed on new legislation impacting plans.

There are also many professional organizations that maintain websites and issue publications dedicated to keeping plan sponsors educated. Examples include the National Association of Governmental Defined Contribution Administrators (NAGDCA), PLANSPONSOR, Pensions & Investments, and the American Society of Pension Professionals & Actuaries (ASPPA.)

Regardless, many retirees will roll their money into another product either immediately or at some point in the future. The most popular rollover vehicles include:

1. FDIC-insured products — these products are offered through institutions, such as a bank or deposits are insured by the FDIC. The accounts insured in any one institution are cumulative up to $250,000.00. Generally, the returns are small in exchange for security.

2. Alternate investments — An investment that does not fall into one of the traditional asset types, i.e. stocks, bonds, or cash are considered alternatives. Examples include hedge funds, managed futures, real estate, commodities, and derivative contracts. These investments may be favored because their returns have a low correlation to the abovementioned asset types and may be part of a strategy for diversification.

While the small investor may be shut out of some alternative edge investment opportunities, real estate and commodities such as precious metals are widely available. The potential is for a higher rate of return but is not guaranteed. Many carry higher fees and administrative charges and may generate unrelated business income (UBI) that may be taxed prior to withdrawal. Retirees should remember that higher return potential means higher risk and suitability and risk tolerance must be key determining factors.

In any and all events, circumstances may change and the retiree's decision may change as well. Retirees may always be aware that penalties and tax consequences may accompany their decisions.

OTHER CONSIDERATIONS

Required Minimum Distributions

Retirees can defer paying some income taxes by refraining from distributing retirement assets, but this can't be done indefinitely. The IRS requires retirees to begin receiving required minimum distributions in the year they reach age 70 ½. An understanding of those requirements is important when developing all retirement plans. The affected retirement accounts are for individuals who currently participate in a traditional SEP, SIMPLE IRA, qualified plan, or a 403(b) or 457 account. Each investor must start receiving distributions from a retirement account by the required beginning date (RBD). Generally, a person's RBD is April 1st of the year following the year in which they reach the age of 70 ½. If they're still employed at the age of 70 ½ and participate in a qualified plan or a 403(b) account they may be allowed to defer the start of their RMDs until after they retire.

The RMD, which is updated each year, is calculated for each account by dividing the prior December 31st balance of that account by a life expectancy factor published by IRS. It provides equal distributions over a participant's remaining lifespan. For example, the average 70 year old will live to age 97, and the RMD for a 70 year

FIGURE 1: REQUIRED MINIMUM IRA DISTRIBUTIONS

Age of retiree	Distribution period (in years)	Age of retiree	Distribution period (in years)
70	27.4	93	9.6
71	26.5	94	9.1
72	25.6	95	8.6
73	24.7	96	8.1
74	23.8	97	7.6
75	22.9	98	7.1
76	22	99	6.7
77	21.2	100	6.3
78	20.3	101	5.9
79	19.5	102	5.5
80	18.7	103	5.2
81	17.9	104	4.9
82	17.1	105	4.5
83	16.3	106	4.2
84	15.5	107	3.9
85	14.8	108	3.7
86	14.1	109	3.4
87	13.4	110	3.1
88	12.7	111	2.9
89	12	112	2.6
90	11.4	113	2.4
91	10.8	114	2.1
92	10.2	115 or older	1.9

old is about one seventieth of the plan balance or 3.6%. (Participants should refer to IRS Publication 590 for the specific requirements.)

Even though retirees are responsible for making the RMDs, some plan sponsors provide service or assistance by computing and executing the RMDs. The provided service might be one that retirees opt into, or it might be mandatory. If the retiree has assets in more than one investment alternative, this service is complicated by having to decide from which alternative to make the withdrawal. In some cases, plans simply distribute the entire balance at age 70.5.

RMD life spans fall over time, increasing the percentage of the plan balance that must be distributed. For example, a 90 year old has a 11.4 RMD distribution life span, not the 27 RMD life span of a 70 year old. The RMD for a 90 year old would be approximately 8.8% of their plan balance. This generally means that retirees who spend all their RMDs will experience a decline in living standard over time. Therefore, most retirees should reinvest a portion of their RMD, instead of spending it all. Principal and income from these reinvestments can be then used to supplement the distributions from the plan as they decrease over time. Because the RMD cannot be rolled into a tax deferred plan, the reinvestment must be made in taxable account.

Age 70 ½ Determination

Determining when a retiree reaches the age 70 ½ is important and it is easy. RMD regulations explain that retirees reach the age of 70 ½ six months after the 70th anniversary of their birth. For example, if the date of birth is June 30, 1940, the 70th anniversary of the birth date is June 30, 2010 and the retiree reaches the age of 70 ½ on December 30, 2010. Since the retiree reached age 70 ½ during 2010, the first RMD must be distributed by April 1, 2011. If the retiree reached age 70 between July 1, 2010 and December 31, 2010, then he or she became 70 ½ during 2011 and the RBD is April 1, 2012. Only the first RMD may be delayed until April 1st of the following year. All subsequent RMDs must be distributed by December 31st of the year to which it applies.

If a retiree took their first RMD distribution for 2010 on April 1, 2011, they would also be required to take their 2011 RMD by December 31st of 2011. That means that the retiree would have to include both RMDs in their income for 2011, the year in which distributions occurred. This may be a consideration when determining whether or not to delay the first RMD payment until April 1st of that year.

Calculating The RMD Amount

The amount required for RMD changes from year to year. It is calculated by dividing an account year and balance by the distribution period determined by the IRS*. These tables are published by the IRS each year. RMD amounts are not rollover eligible. Amounts representing RMDs may not be rolled into an IRA or other eligible retirement plans and cannot be converted to a Roth IRA. If a person does rolls over or convert their RMD, it will be treated as an excess contribution which must be removed from the account by a certain time in order to avoid taxes and penalty. The first distribution from an IRA for any year for an RMD is due is considered to be part of the RMD for that year and is, therefore, not rollover eligible.

Aggregation of RMDs

If a retiree participates in more than one qualified plan or 457 plan, the RMD for each plan must be determined separately and each applicable amount must be distributed from the respective plans. RMD amounts for qualified plans cannot be distributed from IRAs and vice versa. However, if multiple IRAs or multiple 403(b) accounts are owned, the RMD may be aggregated for all similar plans and the amount taken from one account of each type of plan. If a participant has multiple 457 accounts, the RMD must be determined and distributed from each 457 account. A 457 account cannot be aggregated for RMD purposes.

Penalty for Failure to Take RMD

As mentioned earlier, the first RMD is due by April 1st of the year following the year in which the retiree reaches age 70 ½. All subsequent RMDs must be taken by December 31st of each applicable year. If the retiree fails to take the RMD by the applicable deadline, he or she will owe the IRS a 50% excise tax on the amount not taken.

Estate Planning

Potential retirees are typically concerned not only with their income needs, but also in protecting their assets in case of illness or death. If allowed, it is very common for potential retirees to consider annuities, if they are concerned about out-living their resources. However, it is important to consider that many public employees may retire with an annuity from a defined benefit pension. Retirees often appreciate having the best of both worlds; a strong pension combined with a defined contribution account that is not annuitized. By not annuitizing all of their savings, the retiree maintains flexibility, both for their life, and for their beneficiaries. Any account balance left in a defined contribution account will pass directly to heirs assuming the beneficiary information remains updated. If a retiree has concerns or stipulations regarding how they want their assets used after death, establishing a trust and naming it as beneficiary is the best method of ensuring their wishes are executed after their passing. Additionally, naming a trustworthy power of attorney is also very important. With this in place, one's wishes can be carried out in the event a retiree's health deteriorates.

Avoiding Scams and Bad Decisions

The oldest baby boomers turned 62 in 2009 and more than 70 million of them will likely enter retirement over the next twenty years. The current crop of retiring baby boomers is faced with a misfortune of ending their income accumulation years during a bear market. Moreover, after a period where the S&P 500 Index barely advanced, many feel they need to make up for lost capital fast. This fear, coupled with a general lack of financial education, makes them easy targets for hustlers looking to make money.

According to regulators, there are a number of ways investors can protect themselves against retirement scams. Basically, these break down to the four basic red flags. Number 1, if it sounds too good to be true, it probably is. Number 2, guaranteed returns aren't. Number 3, beauty isn't everything (a fancy-looking website doesn't mean the party behind the site is credible); and number 4, pressure to send money right away. If you spot any one of these themes in a sales pitch, the SEC says, be skeptical about the legitimacy of the investment.

Equally important is to know the salesperson. The Financial Industry Regulatory Authority (FINRA) is the largest non-governmental regulator for all securities firms doing business in the United States. Registration and disciplinary information about an individual broker or brokerage firm can be verified by using FINRABrokerCheck at http://www.finra.org/Investors or calling them toll-free at (800) 289-9999. If the broker is registered, check to see if there's any type of employment or disciplinary history. To double-check the background of an investment adviser, state securities regulator may also be contacted.

Finally, before committing to any type of retirement strategy, FINRA recommends consulting with a financial professional instead of immediately signing on with someone make the initial contact or solicitation.

One additional common-sense point to avoid scams: don't isolate yourself from people who usually provide advice, such as a known attorney or accountant. The person who is going to commit fraud is usually someone unknown or new who persuades the retiree to do something that, if logically thought about it, probably wouldn't be done. It is very important to get a second opinion and thoroughly check out offerings, options or 'opportunities'.

Delivering the Messages

Many of the subjects addressed in this brochure are complex. In order to be effective, the challenge is to develop written communications that are targeted and concise, while inspiring action.The messages may also need constant repeating. Consider addressing the complexities in person, whether at group meetings or in one-on-one sessions.