10 - Retirement Planning

**1 - The Retirement Loss Exposure and Achieving Financial Goals**

When planning for retirement, individuals and families should calculate the financial resources needed to pay expense once income from full-time employment ends. Investing is one way to achieve this and other financial goals.

Many individuals look forward to retiring from the active workforce. Retirement, however, means that regular earnings cease while living expenses continue. This gap forms the basis for the retirement loss exposure. Increased costs for age-related expenses such as healthcare, long-term care, and inflation – along with finite financial resources – can create potentially ruinous effects.

**Factors that Influence the Retirement Loss Exposure**

The essence of the retirement loss exposure is reduced or eliminated regular income, which makes retirees vulnerable to economic peril. **The objective of retirement planning is to accumulate sufficient funds to meet expenses and maintain an acceptable standard of living.**

The planning involves estimating the living expenses that will arise after income from full-time employment ceases, along with the anticipated length of retirement. Planning should consider the potential costs of healthcare, long-term care, and expenses related to spending more time on a hobby, or recreational activity, or travel. Failure to carefully plan for these needs can result in a lower standard of living and the need to continue working past a planned retirement age.

Social Security is once source of retirement income. However, **individuals should supplement the minimal retirement income Social Security provides with additional sources, such as employer-sponsored retirement and pension plans. In addition to Social Security benefits and qualified employer-based retirement plan, individuals may use personal savings and investments, annuities individual retirement accounts, and cash value from life insurance policies to supplement their retirement savings**. The benefits received from Social Security will not affect any of the retirement plans!

Planning for retirement – a defined contribution plan – William contributes 9% of his salary annually to a defined contribution plan, a tax-deferred 401(k) plan. His employer matches up to 4% of all contributions; therefore, William’s annual defined contribution is 13%. Under this plan, William is responsible for making decisions on allocating funds among different investment options. Unlike a defined benefit plan, William’s actual payout at retirement is not predetermined and will depend on how long the plan is funded, the investment returns earned, and age at which William decides to retire.

As the baby boom generation (those born between 1946 and 1964) continues to age, the proportion of the United States population over the age of 65 will increase dramatically. This growth in the number of older individuals threatens to place a strain on the Social Security and healthcare systems. Because Social Security benefits provide only a minimum level of income, and retirement funds must sustain individuals longer than previous generations, retirees must use other methods to accumulate the savings required to meet retirement expense needs.

The ability of baby boomers to increase their retirement savings is also affected by what is sometimes referred to as the “sandwich generation” effect. Expenses related to the care of elderly parents, and, as the same time, support or pay for college tuitions for adult children.

Inflation is an increase in the prices of goods and services. Rising prices are especially problematic for retirees whose income is fixed. Interest rates tend to rise, which can negatively affect the overall economy.

Three-Legged Stool of Retirement Savings

Individuals cannot rely on only one source, such as Social Security, to fully fund retirement needs. When planning for retirement, individuals must take advantage of employer-sponsored retirement plans or establish traditional or Roth IRAs, as well as build personal savings accounts, certificates of deposit, or money market accounts. An effective mix of these three sources can establish sufficient funds to meet retirement needs and maintain a desired standard of living.

**Investing to Achieve Financial Goals**

Investors have various objectives. What may be a primary objective for one investor may be a secondary or nonexistent objective for another. Each investor must decide what he or she most wants to accomplish when investing for retirement. Such decisions depend, in part, on the age of the investor and how many years remain until retirement.

Investment Goals

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| Investment Goal | Description |
| Capital Appreciation | The increase in value of investments over a relatively long period, often intended to help investors pay for long term goals |
| **Preservation of Capital** | **Conservative objective that focuses on maintaining the value of investments, rather than on increasing their value. Selecting investments that have low risk of losing value but result in low rate of return. Investors pursuing this objective should select investments with a rate of return that at least matches the rate of inflation.** |
| Current Income | Some investors prefer to place a higher priority on generating income from their investments than on long-term capital appreciation. Attractive to investors who are retired and may need to supplement Social Security benefits or former employer’s pension plan to pay living expenses. |
| Growth and Income | Some seek both capital appreciation (growth) and current income(income). This can result in a high total rate of return but comes with a higher level of risk that the investment can lose value. |
| Liquidity | The ability to quickly sell an investment with minimal loss of principle can allow an investor to meet sudden obligations that require cash (example – savings account) |
| **Minimizing Taxes** | **Often objective for high-income investors. Placing a priority on investments whose earnings are not taxed even though the rate of return may be lower. The purpose is to obtain a tax savings large enough to offset the lower rate of return, which would result in a higher net rate of return after taxes.** |

All investments entail risk. It’s possible to earn substantial income, or lose some or all of the original investment. Certain investments offer a guaranteed investment outcome. Investments with little risk have a correspondingly low rate of return. Stock in a new company, can be speculative because the company does not have an established track record. The financial reward can be high if the company’s performance exceeds expectations, but, there is also a high probability the company may not perform as expected. Some of the common risks that affect investors include these:

* Purchasing power (or inflation) risk- the risk associated with the purchasing power of an investment’s proceeds
* Market risk – the risk associated with fluctuations in prices of financial securities, such as stocks and bonds
* Interest-rate risk – the risk associated with price changes of existing investments de to changes in the general level of interest rates in the capital markets
* **Maturity risk – the risk associated with securities that may mature at a time when interest rates in the capital markets are lower than those provided by the maturing investments, causing the investor to reinvest at a lower rate of interest**
* Financial (or credit) risk – the risk that issuers of investments may have financial difficulties and, as a result may not pay investors as expected
* Business risk – risk associated with the nature of the industry in which the issuer of an investment operates and the management of the issuer itself
* Liquidity risk – the risk that an asset may not be easily or quickly converted into cash at a reasonable price
* Investment manager risk – the risk associated with the variability in performance of persons responsible for managing an investor’s assets

**Types of Investments**

**Savings Instruments** – Commercial banks and other financial institutions offer a variety of savings instruments that are free of market risk; interest rate risk; and when insured by the Federal Deposit Insurance Corporation (FDIC), financial (or credit) risk, which makes them a safe haven for funds that are available for emergencies and short-term financial goals. However, purchasing power (or inflation) risk must be considered. **Four commonly used form of this type of investment are savings accounts, certificates of deposit (CDs), money market mutual funds, and money market deposit accounts**.

**Stocks –** Investors who purchase stock in a corporation hold an ownership interest in the corporation and share a portion of its profits. **Because stock prices can go up or down dramatically in a relatively short period, stocks are the most risky of the commonly used types of investment**. Investors expect that they will be compensated for this higher risk with a higher rate of return than they would receive on a more conservative investment. Because of the high risk inherent in stock investment, many investors nearing retirement will reduce the portion of stocks in their individual retirement portfolios and increase the portion of bonds

**Bonds –** Governments and corporations sell bonds to raise funds to finance projects. Bonds are certificates of debt that include the seller’s promise to pay investors a fixed amount on a fixed maturity date. The promise typically includes interest payments at fixed intervals at a fixed (coupon) rate of interest. Corporate bonds are more risky than savings accounts because of the risk that corporations may run into financial difficulty and default on their promise; however, bonds retain less risk than stocks. As a result, the expected rate of return earned on a bond is higher than that of a savings account but lower than that of stock. Government issued bonds earn a lower rate of return than corporate bonds. Investors in bonds enjoy low liquidity risk because bonds can be sold before their maturity date. However, the sales price is subject to the current market conditions and interest rate and could, therefore, be lower than the original price.

**Mutual Funds** – Normally, a mutual fund is an actively managed pool of funds from a group of investors. Because a mutual fund own a variety of investments, the risk associated with any one investment are dilutes. This dilution, referred to as diversification, is a major advantage of mutual funds. Some mutual funds, such as index funds and lifecycle (or target date) funds, are passively managed. The mangers of these funds do not invest in individual securities in an attempt to outperform the market, index funds are considered to be passively managed because the fund manager tries only to follow an index such as Standard & Poor’s 500 or Wilshire 5000 rather than individual stocks. Lifecycle funds typically invest in a combination of stocks and bonds that gradually shifts more toward bonds as the investor approaches retirement, thus resulting in a more conservative investment objective.

**Annuities** – Because average life span continues to increase, retired persons have a higher likelihood of exhausting their financial assets to pay expenses. Annuities, which are contracts sold by insurance companies, address this problem with their promise of lifetime income. In return for a lump sum payment or series of payment to the insurance company, the investor receives lifelong income through regular payments, usually after retirement

**Real Estate** – Despite the variations and uncertainty of the housing market, an investor will benefit from shelter and security provided by a house. However, those benefits typically are not provided by other real estate investments such as commercial office buildings, shopping centers, residential rental property, mortgages, and real estate investment trust (REITS). In fact, such investments can create burdens beyond the initial investment, such as dealing with complex tax issues and difficult tenants.

**2 – Individual Retirement Accounts**

Traditional and Roth individual retirement accounts (IRAs) provide alternative investment options when an employer’s retirement plan does not fit an individual’s needs, and when an individual is seeking a tax deduction or wants to reduce his or her tax burden in retirement.

The Employee Retirement Income Security Act (ERISA) of 1974 created a traditional IRA so individuals without employer sponsored pension plans could save for retirement. The Taxpayer Relief Act of 1997 created the Roth IRA, which boats many of the same advantages of the traditional IRA and few disadvantages. Many individuals chose to invest in an IRA in addition to other retirement investment plans.

In order to contribute to either traditional or Roth IRAs, an investor must have earned taxable income during the year. Taxable compensation includes wages, salaries, tips, commissions, fees, bonuses, self-employment income, taxable alimony, and separate maintenance payments. Investment income, taxable alimony income, and rental income do not qualify**. A traditional IRA restricts eligibility based on the investor’s age; A Roth IRA does not. However, unlike a traditional IRA, a Roth IRA limits contributions base on the investor’s modified adjusted gross income. This income limitation is periodically increased to account for inflation**.

Annual contribution limits for a Roth IRA are the same as those for traditional IRA. However, unlike a traditional IRA, contributions to a Roth IRA are made with funds that have already been taxed.

**Contributions to a traditional IRA can be deducted from federal income tax under two circumstances. First, and individual who is not currently a participant in an employer-sponsored retirement plan can make an IRA contribution that is deductible up to the maximum annual limit. Second, an individual who is a participant in an employer’s retirement plan can deduct up to the maximum annual limit for an IRA contribution if his or her modified adjusted gross income is below a certain limit, which, like the Roth IRA’s income limitation, is periodically adjusted to account for inflation**. If an individual has income above the phase out limits, he or she can still contribute to a traditional IRA, but will not be able to deduct his or her contributions when calculating the amount owed in federal income taxes. By contrast, annual contributions to a Roth IRA are not income tax deductible, regardless of participation in an employer-sponsored retirement plan or the individual’s level of income.

IRA’s are intended to be retirement investment plans. **Therefore owners of IRA’s are penalized if they withdraw funds from the account before they are 59 1/2. Conversely, to avoid other penalties, an owner must start receiving distributions no later than 71 ½. Roth IRA’s impose no penalty if the owner does not start receiving distributions before reaching age 71 ½. In fact, during the lifetime of a Roth IRA owner, there are no required distributions. This unique feature of a Roth IRA allows the owners funds to accumulate tax-free**.

The funds in a traditional IRA appreciate and earn interest on a tax-deferred, not tax-free basis. As such, distributions are taxed as ordinary income if no penalty applies. If a distribution is made before the owner of the IRA has reached age 59 ½, a 10% tax penalty will be applied. This penalty may be waived if one of several, primarily health-related exceptions applies

**Because the contributions, but no earnings, to a Roth IRA consist of after tax dollars, they can be withdrawn without subjecting the investor to any additional federal income tax or penalty, even if he or she has not reached 59 ½. The earning made on the contributions can also be withdrawn tax free and without penalty, but only if the IRA has been in existence for 5 or more years and the owner is at least 59 ½. If these conditions are not met, the earnings withdrawn will be taxed as ordinary income and a 10% penalty will be applied**.

**3 - Types of Tax-Deferred Retirement Plans**

The federal government has created multiple qualified (tax-deferred) retirement plans with unique characteristics to meet the different needs of employees or employers.

Qualified, or tax-deferred, retirement plans are those plans described in the Internal Revenue Code that are given special tax advantages if they comply with certain legal requirements.

**401(k) Plan**

Section 401(k) of the Internal Revenue Code allows employees to contribute a portion of their pretax salary to a qualified retirement plan. Employers often match their employee’s contributions. **Payment of income tax on contributions, and the earnings from those contributions, is deferred until withdrawals are made, which usually occurs during retirement.** Employees contributions are automatically deducted from their salary.

An inflation-adjusted limit applies to annual contributions. However, employees over 50 can make additional catch-up contributions (also limited to an inflation-adjustment maximum). Like most tax-favored retirement plans, 401(k) restrict withdrawal of funds. Withdrawal of funds is allowed only for one of these reasons:

* Attainment of age 59 ½
* Separation from employment
* Death or disability
* Hardship for the employee as defined by the IRS

**Profit Sharing Plan**

The purpose of a profit-sharing plan is to distribute a percentage of an employer’s profit among participating employees. **An employer’s contributions are discretionary and are allocated to an individual employee’s accounts according to a preestablished formula, often based on a participant’s compensation.** In such a case, each participation employee would receive a uniform proportionate share. Alternatively, the formula could be based on the amount of compensation and the age of each participant. Whichever basis is used, total contributions cannot exceed 25% of the employees total covered compensation. **Because of their discretionary and unpredictable nature, profit-sharing plans are often used in conjunction with other retirement plans**.

**Thrift Plan**

A thrift (or savings) plan allows an employee to contribute **a certain percentage** of his or her salary, which **the employer will then match with a percentage of what the employee contributed**. If the employer limits the amount it will match, employees will be allowed to make an additional contribution that is unmatched by the employer. Thrift plans can be partially funded with before or after-tax contributions, which are usually deducted from the employee’s salary. If the plan is funded with before-tax contributions, it is subject to the same withdrawal restrictions as a 401(k) plan.

**Keogh Plan**

**Keogh plans were developed to give owners of unincorporated businesses and other self-employed individuals the same advantages as their employees when investing for retirement.** The employees of such employers can also participate in a Keogh plan. To be eligible to participate, a self-employed individual must have earned income in the current year (earned income is essential the net earnings-or net profit- for a business, determined by subtracting business expenses from net revenues). The resulting amount, if positive, can be inserted into a formula provided by the IRS to calculate the amount that may be contributed to each employee’s and self-employed individual’s plan.

**403(b) Plan**

**Section 403(b) of the IRS Code allows an employee of a tax-exempt organization that operates solely for charitable, religious, scientific, or educational purposes to invest in a tax-sheltered annuity**. The annuity is tax-sheltered because the contributions are made with before-tax compensation. Further, the contributions and the earnings on the contributions are not taxed until withdrawal, which is usually during retirement. Contributions are treated much the same as a 401(k) plan; they are subject to the same annual limit on their amounts and are typically made through payroll deductions.

**SIMPLE**

**Savings Incentive Match Plan for Employees (SIMPLE) is intended to encourage employers with fewer than 100 employees to establish qualified retirement plans.** These employers are exempt from administrative requirements that other plans impose. Employees contribute before-tax compensation through payroll deductions. Employee eligibility is subject to a minimum salary requirement, and, as with 401(k) plans, annual contributions are limits. When offering a SIMPLE plan, employers may not sponsor another qualified retirement plan.

**ESOP**

Employee Stock Ownership Plans (ESOP) are qualified retirement plans that operate much like profit-sharing plans with 2 primary differences:

* IN an ESOP, the employer’s contributions are not dependent on whether it has made a profit
* ESOP employer contributions may be in the form of cash or employer’s stock, and the value of either form of contribution is limited to 25% of payroll. If the contribution is in the form of stock and it cannot be easily sold on an established market, the employee must be allowed to sell it back to the employer at its fair market value

**SEP Plan**

A Simplified Employee Pension (SEP) plan is essentially a form of a traditional individual retirement account (IRA) that enables employers to contribute to their employee’s retirement accounts or allows the self-employed to fund their own retirement accounts. SEPs differ from traditional IRAs in several ways. First **the annual contribution limit is much higher for a SEP than for an IRA**. Also, unlike for an IRA, an employer must contribute to the employee’s SEP if the employer is at least 21 and has worked for the employer in the current year and in 3 of the last 5 years.

**4 – Employer-Sponsored Retirement Plans**

The global financial crisis starting in 2008 decimated many previously sound retirement accounts. Employees should carefully examine the characteristics of the retirement plans offered by their employer to minimize the impact of such events on their retirement plans.

Two main types of employer-sponsored retirement plans are defined benefits and defined contribution plan. A third type is a combination of those two. It is referred to as defined benefit 401(k) plan. Each of these types of plans has distinguishing characteristics in terms of what is contributed, the benefits paid, and the risks and advantage to the employee and employer.

**Defined Benefit Plans**

**A defined benefit plan is sponsored by an employer, who is responsible for providing a fixed monthly benefit at the time of an employee’s retirement. The amount the employer must contribute varies depending on the investment earnings on the contributions. Typically, the employee makes no contributions**.

The amount of the benefit is usually based on a formula that takes into account the number of years and employee has worked for the employer. The amount of salary used in the formula varies from employer to employer. Payment of benefits starts when the employee retires and continues for as long as he or she lives. Ancillary benefits may also be provided. These include funds for early retirement, termination, death, disability, or another event that ends employment before the normal retirement age of 65.

**There are risks that an employee will not receive the full benefit amount promised by the employer. For example, the employee might not remain employed by the employer until retirement age, the plan could be terminated by the employer, or the employer might not contribute sufficient funds. Many of these risks are outside the employee’s control but can be a least partially mitigated through ancillary benefits, placing contributions in a pension trust, or having terminated plan benefits guaranteed by the Pension Benefit Guaranty Corporation.** Overall, the employee risks involved with a defined benefit plan are much lower than those of most other qualified employer sponsored retirement plans.

**Defined Contribution Plans**

**Defined contribution plan – The employer contribution is defined but the retirement benefit is variable**

In a defined contribution plan, the sponsoring employer is responsible for contributing a fixed matching percentage of the contributions an employee makes. A common example of a defined contribution plan is a 401(k) plan, in which an employer might match up to 50% of an employee’s 4% salary contribution.

**The employer does not promise that a fixed monthly benefit will be available upon the employee’s retirement. The employer’s contribution remains the same, and it is the benefits received by the employee that vary.** If an employee wants a benefit that is high enough to replace a certain percentage of his or her earnings decrease on retirement, the employee, not the employer, will have to increase contributions to make up the difference.

**Defined contribution plans force employees to assume the investment risk of earning volatility**. When the economy and investments markets are down, it tends to affect older workers more because they have less time to recover before they retire.

**Defined contribution plans do not provide the ancillary benefits found in many defined benefit plans**. No additional funds are payable by the employer if the employee dies, becomes disabled, or is terminated before retirement age. The risk of mortality, disability, or another event that cause early termination is transferred to the employee.

**If is often easier for employers to administer and explain the benefits of defined contribution plan than that of a defined benefit plan. For this reason, among other, defined contributions plans are becoming more common than defined benefit plans. Even before the global financial crisis that began in 2008, Congress found this trend disturbing because it had created defined contributions plans to supplement, not replace, defined benefit plans**.

**Defined Benefit 401(k) Plans**

**A defined benefit 401(k) plan, also called the DB(k), is a combination of a defined benefit plan and a defined contribution plan that offers the benefits of a 401(k) savings plan along with a guaranteed flow of income. To be eligible, the employer must have between 2 – 500 employees. The plan must have a defined benefit portion of 1% of an employee’s average salary per year of service, up to twenty years of the employee’s final average pay. On the defined contribution or 401(k) side, the plan must have a provision that automatically enrolls employees with a 4% employee contribution unless they decline to participate. The employer must match at least 50% of the employee’s 401(k) contribution, up to 4% of the employee’s compensation (or a total of 2% match of the employee’s salary).**

Vesting for the defined benefit portion occurs after 3 years of service. As a result, the funds stay with the employer if an employee is terminated before 3 years. For the defined contribution 401(k) portion, vesting occurs immediately.

Some advantages for employers are less paperwork, few regulations, and less cost compared to operating a defined benefit plan and a 401(k) separately. This plan also does not have a top-heavy rule meant to prevent highly paid employees from receiving a larger percentage of benefits or contributions than other employees. These advantages are meant to encourage employers to offer these plans to their employees. Employers can offer a defined benefit 401(k) plan as an incentive to attract and retain workers in a “scarce resource” (employee) environment – an additional reason for employers to adopt the plan.

**5 – Individual Annuities**

Annuities have become popular vehicle for retirement investing. They can be purchased individually or on a group basis from a life insurance company, and regardless of the source, they generally provide periodic payments to the recipient for as long as he or she lives.

**The owner of an annuity (who can be an individual or an entity) pays a specified premium to an insurer in exchange for a promise that the insurer will make such payments at a specified interval in return on the principal, plus interest, to the individual insured (annuitant**).

The period during which the benefits are paid is called the payout period. The payout amount, or cash value, is made up of the premium (principal) and the interest earned over the life of the annuity. Each periodic payment (benefit) includes a portion of both principal and interest, and it might include a survivor benefits amount as provided by the annuity contract. When the annuitant dies, the premium is entirely liquidated and nothing or very little remains for the heirs. This is called the mortality risk of life annuities.

Annuities can be classified by the starting date of the annuity, the party that determines the investment and bears the investment risk, or the premium payment method.

Types of Annuities

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| **Annuity Types Based on the Date Benefits Begin** | **Deferred Annuity: Benefits paid at specified future point.**  **Immediate Annuity: Benefits typically paid within 30 days of premium payment** |
| **Annuity Types Based on the Party Bearing the Investment Risk** | **Fixed-dollar Annuity: Insurer bears risk**  **Variable Annuity: Investor bears risk**  **Combination Plan: Investor bears risk**  **Equity Indexed Annuity: Insurer bears risk** |
| **Annuity Types Based on Premium Payment Method** | **Flexible-Premium Annuity: Premium amount and frequency determined by investor**  **Single-Premium Annuity: Premium is one lump sum payment** |

**Annuity Types Based on the Date Benefits Begin**

The period between the annuity owner’s purchase of the annuity and the annuitant’s age at which benefit payments begin is called the accumulation period. **Deferred annuity benefits are not payable until a specified time in the future. Under an immediate annuity, benefit payments begin soon after the annuity owner purchases the annuity. Because the accumulation period for immediate annuities is shortened for early payouts, immediate annuities typically do not earn as much interest as the earnings from deferred annuities.**

**Deferred annuity – Primary advantage is that it is more effective instrument for retirement planning, as it enables the annuity owner to make premium payments during the accumulation period – which accumulate tax-deferred interest – for periodic payout over the annuitant’ lifetime. If the annuitant dies before ay payout is made, the beneficiaries pay income taxes on the earnings, as opposed to inheritance tax.**

Immediate annuity – Primary advantage is that it enables an individual to receive periodic payments while also investing for future earnings and payouts. It provides fewer tax-deferred interest earnings, but the annuitant pays less ordinary income tax on the early payouts when they are received.

**Annuity Types Based on the Party Bearing the Investment Risk**

Generally, the party that bears an annuity’s investment risk can be either the annuity owner or the insurer that provides the annuity. Annuities classified in this fashion fall into four categories: Fixed-Dollar Annuity, Equity Indexed Annuity (EIA), Variable Annuity (VA) Combination Plan.

Fixed-Dollar Annity – Insurer invests its customers’ annuity premiums in securities such as bonds, real estate, and mortgages in exchange for a fixed rate of return. Value of the annuity does not fluctuate with market performance, but interest rate earnings may. Considered a more conservative investment than other types of annuities and has a lower rate of return.

Equity Indexed annuity (EIA) – Fixed-dollar annuity linked to a stock market index. Insurer guarantees payment of minimum principal amount and minimum interest rate. Value of the return can increase with the marked, based on indexed values, but if the market fares poorly, the premium and interest rate will never droop below the guaranteed rates. EIAs can exceed their guaranteed value at maturity.

Variable Annuity (VA) – Owner invests annuity premiums in diversified subaccounts with various objectives (such as growth or fixed income) to optimize returns according to an investment time horizon. Insurer hires experts to manage subaccounts, which are separate from insurer’s general assets. Subaccounts are protected from the insurer’s creditors if the insurer becomes insolvent. When the payout period begins, the current value of the investment fund is converted into units. The annuity guarantees that a specified number of units will be paid periodically, but the value of each unit will vary as determined by the performance of the subaccounts.

**Combination Plan – Combines features of fixed-dollar and variable annuities. Insurer might make the investment decisions in the interest for the annuity owner, but the annuity owner bears the investment risk**.

**Annuity Types Based on Premium Payment Method**

**Two types of annuities are classified based on the premium payment method:**

* **Flexible-premium annuities**
* **Single-premium annuities**

**Flexible-premium annuities enable the annuity owner to decide when to pay periodic premiums.** Most flexible-premium annuities require a minimum payment amount, if a payment is made during a given period (such as monthly or annually).

**The owner of a single-premium annuity purchases the annuity using one lump-sum payment.** This single premium may be paid well in advance of the payout period (called a single-premium deferred annuity, or SPDA), or it may be paid shortly before the payout begins (Called a single-premium immediate annuity. A single-premium immediate annuity might be purchased by an individual at retirement to enable him or her to begin receiving the lifetime benefits available through the annuity. **For example, the heir to a large estate or a looter winner might purchase an immediate annuity to provide tax-deferred safekeeping of the assets while still receiving periodic payouts throughout his or her lifetime**.

**6 – Social Security Program (OASDHI)**

The Unites States Federal Social Security Program, also known as OASDHI (old age, survivors, disability, and health insurance system) was designed to provide benefits to qualified individuals upon their retirement or if they become disabled and are unable to work, and to supplement medical care. Eligibility for insured status under OASDHI extends not only to covered workers; benefits may also be provided to their families. Most Social Security benefits that are paid are retirement benefits; however, additional benefits can include survivor’s death benefits, and Medicare benefits.

**Basic Characteristics of OASDHI**

Most working individuals are covered under the SS program for some benefits, and most currently paying or will pay SS taxes based on their earnings. Workers are entitled to SS retirement benefits if they were fully insured at the age which the retired**. SS defines “fully insured” as having earned forty quarters of coverage. a quarter of coverage is earned for each quarter of a year that an individual works. Effectively, an individual is fully insured after ten full years of work. The quarters do not need to be consecutive**.

Calculation of SS benefits is complicated; however, the SS administration mails a benefit estimate statement to the insured individuals every year. It also offers a website with tools to help individuals estimate their future financial needs, to identify the SS programs for which they might be eligible, to learn how their age at retirement and other types of earnings and pensions affect their SS benefit, and to answer many other questions.

**Covered Occupations**

**Individuals in most occupations, including self-employed individuals who earn $400 or more in one year, pay social security taxes and earn social security benefits**. Certain occupations have special rules for calculating SS taxes and benefits. Some types of work are not covered, including federal workers; foreign agricultural workers, students performing service for a school, college, or university, nursing students; Job Corps workers; work not in the course of the employer’s trade or business; new paper delivery workers; work covered by the Railroad Retirement Act; and employment by a foreign government, international organization, or an instrumentality of a foreign government.

**Eligibility Requirements**

Individuals must be insured under the Social Security program to receive retirement, survivors, or disability benefits. To receive Social Security benefits, an individual must have insured status. “Fully insured status” is one requirement for particular types of benefits; however, some benefits may apply if the individual qualifies as “currently insured”. To qualify for disability benefits, and individual must have “disability-insured status”.

The government uses an individual’s lifetime earnings record, reported under his or her Social Security Number, to assign Social Security credits for a specified amount of work (a quarter) and to determine insured status. Alien workers are subject to special rules.

To be fully insured, an individual must have at least 6 credits and meet certain age requirements based on various dates at the time of retirement; however, no more than 40 credits are required, regardless of the individual’s birth date. An individual may earn no more than 4 credits in a year. The full retirement age is currently 66. However, in 2003, the full retirement age began increasing from 65 to 67 starting with individuals born in 1938.

**An individual who has current insured status can receive certain Social Security benefits. To qualify for currently insured status, he or she must have a least 6 Social Security credits during the full 13 quarter period that ends the year he or she dies, most recently becomes entitled to disability benefits, or becomes entitle to retirement benefits**. Periods of disability are generally not counted when computing SS credits.

An individual who has disability-insured status qualifies for certain disability benefits. To qualify, the individual must have at least 20 credits during a 40-calendar quarter period (called the 20/40 rule). The 40-calendar quarter period ends in the quarter the individual is determined to be disabled, and he or he is fully insured in that calendar quarter. Individuals who are disabled before the age of 30 can qualify for disability insurance benefits as an option to the 20/40 rule, called “special insured status”, such as a blind worker.

**Types of Benefits Provided by Social Security**

Social Security provides several possible benefits to insured individuals and/or their dependents. These benefits are most often provided under the Social Security law:

* Retirement (old age) benefits are paid to insured workers and their eligible dependents
* Survivors (death) benefits are paid to surviving dependents of insured workers
* Disability benefits are paid to insured workers and their eligible dependents
* Health insurance benefits (Medicare) are paid to insured persons age 65 or older and to certain other beneficiaries.

Except for Medicare, Social Security benefits are based on the individual’s Primary Insurance Amount (PIA). The PIA is calculated by applying a formula to the worker’s average monthly earnings over a specified number of years. A family maximum benefit (FMB) is also calculated from the PIA to limit the benefit amount that may be paid to a worker and his or her eligible dependents.

**Retirement (Old Age) Benefits**

**An individual can receive retirement (old age) benefits when he or she reaches age 62 and has attained fully insured status.** The retirement insurance benefit equals the individual’s PIA. In certain cases, a special minimum benefit is provided to some individuals who have had low earnings.

For workers born in 1937 and earlier, the full benefit retirement age is 65. Starting with workers born in 1938, the full benefit retirement age gradually increases to age 67 for workers born in 1960 and later. A fully insured worker may begin receiving retirement benefits at age 62, but the benefit amount would be permanently reduced. Optionally, a worker can elect to delay retirement until age 70 and receive increased benefits starting at age 70.

The spouse of a retired worker who has reached age 62 can receive a lifetime reduced retirement benefit that is 50% of the fully insured worker’s PIA, up to the FMB. If the worker retires at age 65, the full spousal retirement benefits can be paid to the spouse. If the spouse is entitled to a personal retirement benefit, then the spouse would receive the larger of his or her personal benefit or his or her spousal benefit.

If the spouse cares for any unmarried child, stepchild, or grandchild of the worker under age 16 for a disabled child, stepchild, or grandchild of the worker, additional benefits may also be provided for each qualified dependent.

**Survivors (Death) Benefits**

Survivors (death) benefits may be paid to the surviving spouse and other qualified dependents of a deceased worker who was fully insured at the time of his or her death.

**The Surviving spouse qualifies for survivors benefit if he or she is at least 60 or is disabled and at least age 50.** The surviving spouse can receive 100% of the deceased worker’s PIA if that spouse if full-benefit retirement age.

Unmarried children and qualifying grandchildren of a deceased worker can receive a child’s monthly survivor benefit. This benefit is generally 75% of the decease parent’s PIA. The child must be under the age of 18, or 18 and an elementary or secondary student, or 18 and older but disabled before age 22.

A parent who was dependent on the insured worker before his or her death and who has reached the age of 62 can also receive a survivor benefit. The surviving parent’s benefit is generally 82.5% of the deceased worker’s PIA. If 2 parents are entitled to surviving parent’s benefits, the benefit is generally 75%

**Additionally, the surviving spouse who cares for an eligible child or grandchild receives a mother’s or father’s surviving spouse benefit.** This benefit is generally 75% of the deceased worker’s PIA. Note that all of these benefits combined are subject to the FMB.

Finally, a lump-sum death benefit may be paid to the survivors of a worker who dies having met the fully insured or currently insured status. This lump sum of $255 is paid in addition to any monthly survivor benefits.

**Disability**

**The Social Security disability income (SSDI) Monthly Cash Benefits are designed to replace a portion of a wage earner’s income for a short period of time if the wage earner becomes disabled because of an injury or illness**. A 5 month waiting period apples before any benefits will be paid. Auxiliary benefits may be paid to the spouse and other dependents of the insured worker.

Establishment of a Social Security disability period is essential for determination of numerous Social Security benefits. A “period of disability” under the Social Security law is a continuous period during which an individual is disabled. The established period of disability is not counted when determining an individual’s insured status under Social Security and is not counted in determining the monthly benefit amount payable to the worker and his or her dependents. The period of disability is also used in determining other types of Social Security benefits for the worker’s family.

**Heath Insurance (Medicare)**

**Under Social Security, people age 65 or older, those under 65 with certain disabilities, and people of all ages with specified medical conditions can qualify to receive federal Medicare health benefits including hospital insurance, medical insurance, and prescription drug coverage.** Medicare beneficiaries can also choose to take advantage of Medicare Advantage plans that offer higher benefit levels and include managed care plans and private fee for service plans.