Investing For Your Best Years: Retirement

Facilitators Manual

Introduction

To accomplish your goal of having a financially stable retirement you need to carefully plan your investments and start as early as possible. No longer can you only depend on Social Security income alone. Other forms of income will be necessary to cover your future financial needs. As in any investment strategy, you will need to explore the options available to you from your employer and from other forms of personal investment options. As in any investment strategy, it is important to diversify your investments to secure your future.

In this module you will learn your investments options, including Social Security, employer programs, individual retirement accounts and other options. In addition, you will learn how you could save on taxes by investing for your retirement.

Module Objectives

After completing this module you should be able to:

- Understand how to define retirement goals
- Understand how to reach your retirement financial goals
- Understand what is life expectancy and how it will impact your retirement financial goals
- Recognize how much Social Security might contribute to your retirement income
- Recognize the various employer pension and retirement options available
- Recognize retirement savings plans for the self-employed
- Understand how individual retirement accounts (IRA) works

Recommended Time on Task by Lesson

Lesson No.	Lesson Title	Time Required
	Introduction and Ice Breaker	20 minutes
M4.1	How to reach your retirement goal	40 minutes
M4.2	Social Security retirement benefits	40 minutes
M4.3	Employer pension and retirement plans	45 minutes
M4.4	Retirement savings plans options for the self-employed	20minutes
M4.5	Individual retirement accounts (IRAs)	45 minutes

Suggested Module Instructional Duration: 3.25 hours

About This Manual

This manual contains the same information provided in the instructional manual that the participants will have during the workshop. For each section we provide specific suggestions and resources selected to help you deliver the classroom instruction. These include teaching tips, questions to generate classroom discussion, and a module PowerPoint presentation. In addition every section or subject has additional reference materials which provide supplementary online instructional materials and resources. These were selected to provide the facilitator more information about the subject or materials which could be used to enhance the delivery of instruction.

Before the workshop session:

- Before conducting the workshop, take time to familiarize yourself with the participant manual, exercises, additional learning resources, teaching tips and questions to generate discussion and PowerPoint presentation.
- For classroom use it is highly recommended to secure a flip chart, color markers, projector, and laptop. Familiarize with setting up the equipment and with its operation.

At the workshop:

- Welcome the participants Ask participants to introduce themselves, and share what their expectations are for this program, and what they hope to get out of the seminar. Write these down on a flip chart as they share. (This activity will help participants get to know each other and feel more comfortable and give you an idea of what they are expecting from the session.)

- Review the objectives of the session and the agenda. If applicable, hand out materials to participants. Using the module PowerPoint presentation review the module objectives:

- Use this time to listen as well as to manage expectations as to what will be accomplished during the lesson. Let participants know that their specific personal situations may not be able to be addressed directly in the lesson but that the information should be valuable to them.
- Make sure to schedule breaks after 1.5 hours of instruction.
- Encourage participants to ask questions; try to create an interactive-participatory learning environment. If you do not have the answer to a question, be honest and say: "*I don't know the answer but I will research it for you".* Bring the answer next day and explain where and how you found the answer.
- Do not ask personal questions to participants which could potentially disclose personal or confidential financial information. It is strongly recommended to always use hypothetical scenarios.
- Always use a flip chart to write down key concepts, at the end of the day review the key learning concepts.

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Key Terms

Annuity: In finance, an annuity is a series of fixed payments, which might be over a fixed number of years, over the lifetime of an individual or both. The most common use of annuities is to provide a pension for people in retirement.

Deductible: A flat amount the enrollee must pay before the payer will make any benefit payments for selected covered benefits.

Deferred Compensation: Earnings that an employer deducts from an employee's earnings and places in a qualified retirement plan, such as a 401(k). The money is distributed at a future date, usually at retirement, because of IRS rules. The money is not taxed until the employee receives the distribution from the plan.

Disability: Federal law defines a "Disability" as a physical or mental impairment that substantially limits or restricts the condition, manner, or duration under which an average person in the population can perform a major life activity, such as walking, seeing, hearing, speaking, breathing, learning, working, or taking care of oneself. An impairment or its diagnosis, in and of itself, does not necessarily constitute a disability: it must "substantially limit" these activities.

Equity: Equity is the difference between the price for which a property could be sold and the total debts registered against it.

Internal Revenue Code: United States tax law consisting of rules and regulations to be followed by taxpayers and is continually revised and amended.

Life Expectancy: The average number of years a person is expected to live based on a national average per age group and other factors.

Lifestyle: Lifestyle is a way of living based on identifiable patterns of behavior based on an individual’s choice, influenced by the individual’s personal characteristics, their social interactions, and socioeconomic and environmental factors.

Match: Provide funds complementary to: "The company matched the employees' contributions." (Usually by the same amount)

Mutual Funds: Typically consist of a group of stocks, bonds, or money-market securities from more than one source. There are three types—income funds (for people who need money to live on); growth funds (pay low dividends or none—works

best for investors who can leave money in the fund so it can grow over a long period of time); and balanced funds (combination of stocks and bonds).

Penalty: A specific cost to be assessed against a party for breach of a term of an agreement, contract, or law.

Pension: An annual income, usually associated with the period after retirement, but not necessarily so. A pension fund is a general term used to describe an investment fund built up during working life and used at retirement to purchase an annuity to provide a continuing income.

Simplified Employee Pension Plan: Is an employer sponsored retirement program available to partnerships, corporations, not-for-profit organizations, government organizations and self-employed individuals. The employer can contribute up to 15% of an employee's compensation into Individual Retirement Accounts (IRAs) established for each employee. The maximum allowed contribution for business partners, officers, and highly compensated employees are regulated by the IRS.

Social Security Administration: The United States Social Security Administration (SSA) manages the United States' social insurance program, consisting of retirement, disability, and survivors' benefits. To qualify for these benefits, most American workers pay Social Security taxes on their earnings; future benefits are based on the employees' contributions.

Tax Deferred: Means taxes will be paid on something at a later date.

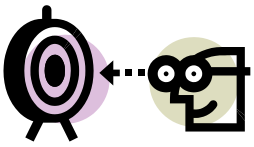
Trustee: The word trustee is a legal term that refers to a member of a trust, which can be set up for any of a variety of purposes, and is entrusted with the administration of property on behalf of others. With respect to most private trusts, the trustee holding legal title to the trust property, is the representative of the trust, and has the capacity to sue and be sued on behalf of the trust.

U.S.C.: United States Code. A compilation of all federal legislation organized into 50 titles. Revised every six years with supplementary volumes issued in intervening years.

Will: In the law, a will or testament is a documentary instrument by which a person (the testator) regulates the rights of others over the testator's property or family after their death.

How to Reach your Retirement Income Goal

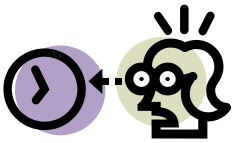
Lesson No. M4.1



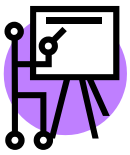
Lesson Objectives:

After completing this lesson participants should be able to:

- Recognize the options they have for saving for retirement
- Understand how to assess how much income would they need for their retirement years
- Understand how to calculate their retirement expenses



Time Required: 40 Minutes

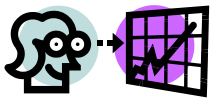


Lesson Teaching Tips

- Try to connect your computer to the Internet to access a number of online resources to be used during this lesson.
- Prior to the lesson, visit each of the proposed online resources and get familiar with them.

Questions to Generate Discussion

- When would you like to retire?
- How much income you will need for your retirement years?
- How long do you expect to live after retirement?



PowerPoint Slides Thumbnails

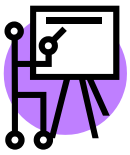
Slide Notes

- A significant number of our community members is planning on depending almost solely on Social Security (SS) retirement benefits. Identify other options to participants. SS is not enough.

- Start by asking participants: how much income they will need for their retirement years?
- Develop the discussion by following the slide bullets.

- Because we do not know how long we will live after retirement, we should plan for 100 years.
- If Internet access is available on the room, visit the suggested Web sites.

- Ask participants to complete the retirement expenses projection. Discuss results.



Closure:

- Review lesson objectives with participants.
- Reaffirm the notion that we cannot depend solely on Social Security retirement benefits and need to plan on investing on several other options to reach our retirement goals.

Learning Assessment:

- Ask participants to list investment / savings options available to reach their retirement goals.

Reference Materials

- Financial Planning and Retirement - AARP
  http://www.aarp.org/money/financial_planning/

Have you ever heard the saying: "there are 101 ways to skin a cat"? This is also true when considering the question of how we will reach our retirement income goal if there is not a single source of funding that will help us reach that goal. Unless you win the Mega Lottery, you will have to look into several income sources to reach your retirement financial goals.

Examine the following list and make a check mark on those potential retirement income sources you are currently seeking or contributing.

Social Security:

_____**Social Security:** Social Security is a social insurance program funded through dedicated payroll taxes called FICA, which provides for retirement and disability income.

Personal Savings and Investment Options:

_____**Mutual Fund:** Typically consist of a group of stocks, bonds, or money-market securities from more than one source (to be discussed in Module 3).

_____**Individual Retirement Account (IRA):** A retirement savings plan you set up yourself at a bank or investment company. An IRA is made up of a variety of investments, such as mutual funds and stocks. There are many different types of IRAs.

_____**Savings Account:** It typically pays compound interest. Savings accounts are safe, but interest rates are usually low (discussed in Module 1).

_____**Certificate of Deposit (CD):** A CD is a safe savings account where you leave your money for a specific period of time—from three months to six years. A CD pays higher interest than a savings account but you cannot take your money out early without paying a penalty.

_____**Real Estate:** With a little luck, an investment in property will increase in value over time. Real estate may be costly to maintain, but many expenses, such as repairs to a rental unit, are tax-deductible. Consider also, the equity accumulated in your home.

Employer Sponsored Savings and Retirement Plans:

_____**401(k):** A retirement savings plan set up by your employer, in which money is automatically taken out of your paycheck and invested in mutual funds, stocks, and other kinds of investments. Some employers contribute to their workers' accounts.

_____**403 (b):** This plan is similar to a 401(k) and is offered by educational organizations and certain nonprofits.

_____**457**: Is a type of tax advantaged defined contribution retirement plan that is available for governmental and certain nongovernmental employers.

_____**Pension:** A program of fixed retirement income set up by a company or labor union.

Self-Employed Savings Plans:

_____Keogh Plan: A retirement savings program for self-employed persons.

This program will help you understand all of the options available to help you reach your retirement income goal.

Retirement Financial Planning: How Much Income Should I Project for My Retirement Years?

”How much money will I need when I retire?” This is the question almost everyone wants answered when they start thinking about retiring. This is one of the most asked questions and the hardest one to answer. No one answer fits all. Everyone requires a different answer depending on their lifestyle and retirement goals. A conservative rule of thumb is to set your goals as on needing at least 80% of your current income when you retire.

In addition, when planning how much to invest and how there are several other questions needed to be answered, for some you can have definite answers, for other you can only speculate. Here are some of them:

- How many years will I live after I retire?
- What will my expenses be when I retire?
- How much can I expect to receive from Social Security?
- How much do I have in my company or government retirement account and what will it be worth when I decide to retire?

Let us help you in providing answers to the questions above.

How many years will I live after I retire?

Here is a difficult one to answer. Your life expectancy is influenced by a number of factors, from your family history to your personal lifestyle. As a rule of thumb, plan for living 100 years and receiving retirement income throughout this period. If you live less than 100 years plan to have a will to leave your financial assets to your heirs.

If you would like to speculate a bit about your life expectancy there are several life expectancy calculators available on line, among them you can use the following:

- Living to 100
- MSN Money Life Expectancy Calculator
- How long would I live?

These calculators will not give you definite answers, but the results might help you make lifestyle changes that might help you live longer and healthier.

What will my expenses be when I retire?

Answering this question along with your life expectancy will help you define your retirement financial goal. This is where you will need to project what your lifestyle

will be and what your wants and needs might be once you retire. You will need to develop a retirement budget to help you project what your expenses might be. You will need to figure your net worth and project what your retirement income and expenses might be so that you can decide how much you might need to cover expenses in retirement.

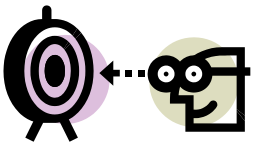
Exercise: Your retirement expenses:

Using the following spreadsheet make an educated guess of the expenses you will have at retirement age (65 or 66 years).

Expenses	Amount
Fixed Expenses	
Savings and Investments	$
Rent/Mortgage	$
Property Taxes	$
Utilities (gas, water, electricity)	$
Telecommunications (cable, cell phone, telephone, and Internet)	$
Insurance (Life, health, and vehicles)	$
Credit Obligations (2nd mortgage, credit cards, student loans and loan payments)	$
Variable Expenses	
Health care, (doctors, dentist, prescriptions, etc.)	$
Clothing	$
Dry Cleaning	$
Food	$
Transportation (gas, public transportation, tolls, garage, etc.)	$
Flexible Expenses	
Entertainment (movies, video rentals, dining, concerts, etc.)	$
Newspapers, books, magazines, etc.	$
Personal (beauty shop, barber, etc.)	$
Other	$
Total Monthly Expenses	$

Your Social Security Retirement Benefits

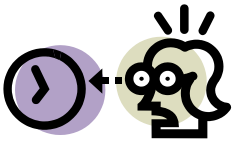
Lesson No. M4.2



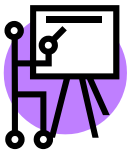
Lesson Objectives:

After completing this lesson participants should be able to:

- Understand that we cannot depend exclusively on the Social Security retirement benefits to reach our retirement goals.
- Understand where to find more information about the Social Security retirement benefits.
- Understand the impact of retirement age and the Social Security benefits.



Time Required: 40 Minutes

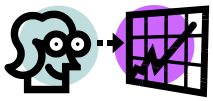


Lesson Teaching Tips

- Prior to the lesson, ask participants to research how much they are expected to receive from Social Security at retirement age.

Questions to Generate Discussion

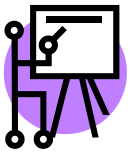
- Do you know how much you will receive from Social Security if you retire at full-retirement age?
- What percentage will this amount represent of your projected retirement monthly income?
- Can you depend exclusively on Social Security income to fulfill your retirement income needs?



PowerPoint Slides Thumbnails

Slide Notes

- Using the slide bullets discuss the SS benefits and the pros and cons of retiring before full retirement age.



Closure:

- Review lesson objectives with participants.
- Reaffirm the notion that we cannot depend exclusively on Social Security retirement benefits to reach our retirement goals.

Learning Assessment:

- Ask participants what percentage of their monthly retirement income their Social Security benefits will represent.

Reference Materials

- Social Security Benefits - http://www.pueblo.gsa.gov/cic_text/fed_prog/ssundben/ssundben.pdf
- Retirement Planner: Social Security - http://www.ssa.gov/retire2/

Social Security in the United States is a social insurance program funded through dedicated payroll taxes called FICA (Federal Insurance Contributions Act). Tax deposits are formally entrusted to Federal Old-Age and Survivors Insurance Trust Fund, or Federal Disability Insurance Trust Fund, Federal Hospital Insurance Trust Fund, or the Federal Supplementary Medical Insurance Trust Fund. The main part of the program is sometimes abbreviated (OASDI), in reference to its three beneficiaries (OA for retirement, S for widows and survivors income, D for the disabled, and I for insurance). When initially signed into law by President Franklin D. Roosevelt in 1935, the term *Social Security* covered unemployment insurance as well. The term, in everyday speech, is used only to refer to the benefits for retirement, disability, survivorship, and death, which are the four main benefits provided by traditional private-sector pension plans. In 2004 the U.S. Social Security system paid out almost $500 billion in benefits. By dollars paid, the U.S. Social Security program is the largest government program in the world.

How Much Should I Expect to Receive from Social Security?

While you shouldn't rely on Social Security alone for your retirement income, it can supplement your savings, pension, and retirement plan income. Every year, you should receive a copy of your projected Social Security benefits for the Social Security Administration (SSA). Look at this carefully to make sure there are no mistakes and then use the projected benefit amount to add to your other projected retirement income.

Exercise: Estimating Your Social Security Income

To estimate your Social Security benefits, please visit the SSA Social Security Quick Calculator page at http://www.ssa.gov/OACT/quickcalc/index.html Follow the instructions and provide the required information.

Suggestion:

You can request your Social Security statement by phone, in writing, or online. For more information, call 1-800-772-1213 toll-free or go to www.ssa.gov.

Social Security Benefits by Year of Birth

You can retire at any time between age 62 and full retirement age. However, if you start benefits early, your benefits are reduced a fraction of a percent for each month before your full retirement age. The chart below lists age 62 reduction amounts and includes examples based on an estimated monthly benefit of $1000 at full retirement age[1].

Year of Birth[1]	Full (normal) Retirement Age	Months between age 62 and full retirement age	At age 62[2]			
			A $1,000 retirement benefit would be reduced to:	The retirement benefit is reduced by[3]:	A $500 spouse's benefit will be reduced to:	The spouse's benefit is reduced by[4]:
1937 or earlier	65	36	$800	20.00%	$375	25.00%
1938	65 and 2 months	38	$791	20.83%	$370	25.83%
1939	65 and 4 months	40	$783	21.67%	$366	26.67%
1940	65 and 6 months	42	$775	22.50%	$362	27.50%
1941	65 and 8 months	44	$766	23.33%	$358	28.33%
1942	65 and 10 months	46	$758	24.17%	$354	29.17%
1943-54	66	48	$750	25.00%	$350	30.00%
1955	66 and 2 months	50	$741	25.83%	$345	30.83%
1956	66 and 4 months	52	$733	26.67%	$341	31.67%
1957	66 and 6 months	54	$725	27.50%	$337	32.50%
1958	66 and 8 months	56	$716	28.33%	$333	33.33%
1959	66 and 10 months	58	$708	29.17%	$329	34.17%
1960 and later	67	60	$700	30.00%	$325	35.00%

[1] Source: Social Security Administration: Retirement Planning
http://www.ssa.gov/retire2/agereduction.htm

Notes:

1 If you were born on January 1st, you should refer to the previous year.

2 If you were born on the 1st of the month, we figure the benefit as if your birthday was in the previous month. You must be at least 62 for the entire month to receive benefits.

3 Percentages are approximate due to rounding.

4 The maximum benefit for the spouse is 50% of the benefit the worker would receive at full retirement age. The % reduction for the spouse should be applied after the automatic 50% reduction. Percentages are approximate due to rounding.

Social Security: Pros and Cons of Retiring before Full Retirement Age

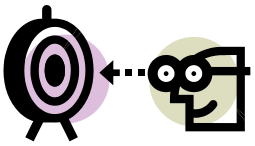
As a general rule, early retirement will give you about the same total Social Security benefits over your lifetime, but in smaller amounts to take into account the longer period you will receive them.

There are advantages and disadvantages to taking your benefit before your full retirement age. The advantage is that you collect benefits for a longer period of time. The disadvantage is your benefit is permanently reduced. Each person's situation is different, so:

- check out the Social Security Administration (SSA) "Break-Even Age" calculator to find out whether early retirement is better for you,
- keep in mind that there are other things to consider when making the correct decision about your retirement benefits, and
- contact Social Security before you decide when to retire.

Employer Sponsored Pension and Retirement Plans

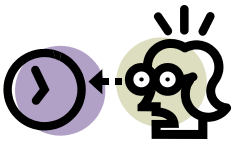
Lesson No. M4.3



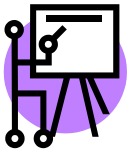
Lesson Objectives:

After completing this lesson participants should be able to:

- Understand what pensions are
- Understand what defined benefits plans are
- Understand what defined contribution plans are
- Recognize what are 401(K) plans and how they work
- Recognize what are 403(b) plans and how they work
- Recognize what are 457 plans and how they work
- Recognize what are SEP plans and how they work



Time Required: 45 Minutes

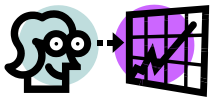


Lesson Teaching Tips

- The objective of this lesson is to provide participants with information about retirement investment options benefits that can be discussed with their employers. Prior to this lesson, ask participants to seek information at their employer Human Resources Office about the retirement benefits available for them.

Questions to Generate Discussion

- What are some of the retirement benefits you have available from your employer?
- How many of you are investing in a 401(k) or 403(b) plan?
- Do you know what these plans are?



PowerPoint Slides Thumbnails

Slide Notes

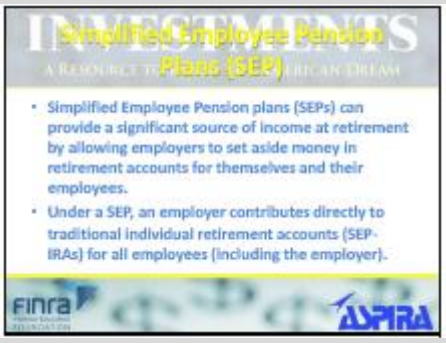
- Discuss the two broad categories of employer sponsored pensions and retirement plans.

- Discuss what are 401(k) plans.
- Remind participants that they will need to manage the plan allocations. Review the concept of allocation strategy.

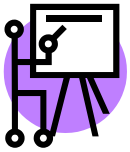
- Make participants aware of the annual contribution limits.
- Define what is rollover.

- Discuss what are 403(b) plans.
- Remind participants that they will need to manage the plan allocation strategy.

- Discuss what are 457 plans.
- Remind participants that they will need to manage the plan allocations.



- SEPs are pension programs that employers can set up as part of the retirement benefits for their employees.
- Employers can benefits from tax benefits when setting up this plan.



Closure:

- Review lesson objectives with participants.
- Recommend participants to visit their Human Resources Office to inquire about their retirement benefits and the employer sponsored retirement plans.
- Emphasize on the importance of starting investing for their retirement as soon as possible and as much as possible.
- Remind participants of the tax benefits related to investing in employer sponsored retirement plans.

Learning Assessment:

- Ask participants how many of them will visit their Human Resources Office to inquire about employer retirement sponsored programs.

Reference Materials

- Smart 401(k) Investing – FINRA http://apps.finra.org/Investor_Information/Smart/401k/000100.asp
- What are 403b plans? http://beginnersinvest.about.com/od/403bplan/403b_Plan.htm
- 457 Plans http://en.wikipedia.org/wiki/457_plan

There are many options for investing for your retirement. In many ways they depend on who you work for: the private sector or government. If you are

already employed ask your Human Resources Department what retirement benefits or investment options they have available for you and when you have access to them (usually after the probation period). Now, if you are seeking a new job, one of the parameters when selecting jobs options should be the retirement benefits offered as part of the benefits or fringe benefits package. On the other hand, if your current employer does not offer retirement benefits you might want to consider seeking another job that provides such benefit. Remember, it is your future!

In this section, you will learn the different pensions and retirement plans potentially available for you.

What are Pensions?

A pension is a steady income given to a person (usually after retirement). Pensions are typically payments made in the form of a guaranteed annuity (regular payments) to a retired or disabled employee. Some retirement plans accumulate a cash balance (through a variety of investment mechanisms) that a retiree can draw upon at retirement, rather than promising annuity payments. These are often also called “pensions.” In either case, a pension created by an employer for the benefit of an employee is commonly referred to as an occupational or employer pension. Labor unions, the government, or other organizations may also fund pensions.

Occupational pensions are a form of deferred compensation, usually advantageous to employee and employer for tax reasons. Many pensions also contain an insurance aspect, since they often will pay benefits to survivors or disabled beneficiaries, while annuity income insures against the risk of longevity.

Retirement pension or superannuation plans

Through arrangements an employer (for example, a corporation, labor union, and government agency) provides income to its employees after retirement. Pension plans are a form of "deferred compensation" (usually after retirement) and

became popular in the United States during World War II, when wage freezes prohibited outright increases in workers' pay.

Pension plans can be divided into two broad types: **Defined Benefit** and **Defined Contribution** plans. The defined benefit plan had been the most popular and common type of pension plan in the United States through the 1980s; since that time, defined contribution plans have become the more common type of retirement plan in the United States and many other western countries.

Some plan designs combine characteristics of defined benefit and defined contribution types, and are often known as "hybrid" plans. Such plan designs have become increasingly popular in the United States since the 1990s. Examples include **Cash Balance** and **Pension Equity** plans.

In most plans, members (employees) have to become vested in order to receive pension benefits. Becoming vested means when a member earns enough service credit (years in service) to guarantee retirement benefits even if he or she leaves covered employment and keeps his or her contributions with the System. For example: an employee who is a member of the Oklahoma Teachers' Retirement System and has completed five years of service has a vested program. In other words a vested member will receive retirement benefits at full retirement age.

Defined Benefit Plans

Under 26 U.S.C. § 414(j), a defined benefit plan is any pension plan that is not a defined contribution plan (see below). A defined contribution plan is any plan with individual accounts. A traditional pension plan that *defines* a *benefit* for an employee upon that employee's retirement is a defined benefit plan.

The benefit in a defined benefit pension plan is determined by a formula that can incorporate the employee's pay, years of employment, age at retirement, and other factors. A simple example is a *flat dollar* plan design that provides $100 per month for every year an employee works for a company; with 30 years of employment, that participant would receive $3,000 per month payable for their lifetime. Typical plans in the United States are **final average plans** where the average salary over the last three or five years of an employees' career determines the pension.

Defined Contribution Plans

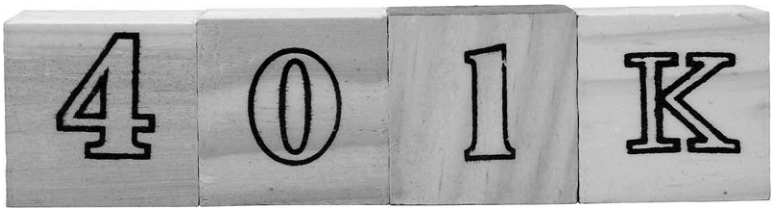
In a defined contribution plan, contributions are paid into an individual account for each member (employee). The contributions are invested, for example in the stock market, and the returns on the investment (which may be positive or negative) are credited to the individual's account. On retirement, the member's

account is used to provide retirement benefits, often through the purchase of an annuity that provides a regular income. Defined contribution plans have become more widespread all over the world in recent years, and are now the dominant form of plan in the private sector in many countries. For example, the number of Define Benefits plans in the United States has been steadily declining, as more and more employers see the large pension contributions as a large expense that they can avoid by disbanding the plan and instead offering a defined contribution plan.

Examples of defined contribution plans in the United States include Individual Retirement Accounts (IRAs) and 401(k) plans (to be discussed in the following sections). In such plans, the employee is responsible, to one degree or another, for selecting the types of investments toward which the funds in the retirement plan are allocated. This may range from choosing one of a small number of predetermined mutual funds to selecting individual stocks or other securities. Most self-directed retirement plans are characterized by certain tax advantages, and some provide for a portion of the employee's contributions to be matched by the employer. In exchange, the funds in such plans may not be withdrawn by the investor (employee) prior to reaching a certain age.

What are 401(k) Plans?

The **401(k)** plan is a type of a private employer-sponsored retirement plan in the United States and some other countries, named after a section of the U.S. Internal Revenue Code. A 401(k) plan allows a worker to save for retirement while deferring income taxes on the saved money and earnings until withdrawal.



The employee elects to have a portion of his or her wage paid directly, or "deferred", into his or her 401(k) account. In *participant-directed* plans (the most common option), the employee can select from a number of investment options, usually an assortment of mutual funds that emphasize stocks, bonds, money-market investments, or some mix of the above. Many companies' 401(k) plans also offer the option to purchase the company's stock. The employee can generally reallocate money among these investment choices at any time. In the less common *trustee-directed* 401(k) plans, the employer appoints trustees who decide how the plan's assets will be invested.

All assets in 401(k) plans are tax deferred. Before the January 1, 2006 effective date of the designated Roth account provisions, all 401(k) contributions were on a pretax basis (i.e., no income tax is withheld on the income in the year it is contributed), and the contributions and growth on them are not taxed until the money is withdrawn. With the enactment of the Roth provisions, participants in

401(k) plans that have the proper amendments can allocate some or all of their contributions to a separate designated Roth account, commonly known as a Roth 401(k). Qualified distributions from a designated Roth account are tax free, while contributions to them are on an after-tax basis (i.e., income tax is paid or withheld on the income in the year contributed). In addition to Roth and pretax contributions, some participants may have after-tax contributions in their 401(k) accounts. The after-tax contributions are treated as after-tax basis and may be withdrawn without tax. The growth on after-tax amounts not in a designated Roth account is taxed as ordinary income.

401 (k) Contribution Limits

There is a maximum limit on the total yearly *employee* pretax salary deferral. The limit, known as the "402(g) limit", is $15,500 for the year 2007. For future years, the limit will be indexed for inflation, increasing in increments of $500. Employees who are 50 years old or over at any time during the year are now allowed additional pretax "catch-up" contributions of up to $5,000 for 2006 and 2007. The limit for future "catch-up" contributions will also be adjusted for inflation in increments of $500. In eligible plans, employees can elect to have their contribution allocated as either a pretax contribution or as an after-tax Roth 401(k) contribution, or a combination of the two. The total of all 401(k) contributions must not exceed the maximum contribution amount.

If the employee contributes more than the maximum pretax limit to 401(k) accounts in a given year, the excess must be withdrawn by April 15th of the following year. This violation most commonly occurs when a person switches employers midyear and the latest employer does not know to enforce the contribution limits on behalf of their employee. If this violation is noticed too late, the employee may have to pay taxes and penalties on the excess. The excess contribution, as well as the earnings on the excess, is considered "nonqualified" and cannot remain in a qualified retirement plan such as a 401(k).

Plans set up under section 401(k) can also have employer contributions that (when added to the employee contributions) cannot exceed other regulatory limits. The total amount that can be contributed between employee and employer contributions is the Section 415 limit, which is the lesser of 100% of the employees compensation or $44,000 for 2006 and $45,000 for 2007. Employer matching contributions can be made on behalf of designated Roth contributions, but the employer match must be made on a pretax basis.

Governmental employers in the U.S. (that is, federal, state, county, and city governments) are currently barred from offering 401(k) plans unless they were established before May 1986. Governmental organizations instead can set up a Section 457(g).

What Could Happen to My 401(k) If I Change Jobs?

If you're changing employers, do you know what will happen to the funds in your 401(k)? Lots of people have that very same question. So let's take a look at the options.[2]

Generally, when you change jobs, you have three choices regarding 401(k) money:

- Leave it in the plan.
- Take it out and keep it all.
- Move it to an IRA.

Unless you have at least $5,000 in your account, most plans will force you to move your money out of the plan when you stop participating. If you have $5,000 or more, though, you may leave the money in your 401(k) until the normal retirement age specified by that plan. If you're satisfied with the investment choices you have in that plan, if your investment costs are lower than you can get elsewhere, or if you need the bankruptcy protection provided by qualified retirement plans, then leave your money right where it is. Otherwise, it's usually best to move the money. By doing so, you will most probably gain a wider choice of investment options at a lower cost.

You should almost never take the money and run. If you do, it may never again be placed in a retirement plan. You will lose all those years of tax-deferred compounding, and that could seriously jeopardize your income in retirement. You will also have to pay income taxes on what you keep. And worse, if you don't turn 55 by the year's end, you must pay a 10% early withdrawal penalty on that amount as well.

For example, this year, a married 35 year-old person with a joint income of $75,000 is in the 28% federal income-tax bracket. Perhaps this person is in a 4% state bracket as well. If so, and if the person kept his or her 401(k) money upon changing jobs, he or she would lose 42% of those proceeds to income taxes and the early withdrawal penalty. That means this person would keep only $580 out of every $1,000 paid from his or her plan. A $4,000 401(k) withdrawal would turn into just $2,320!

Given the potential tax loss they face by keeping the money, most folks will move their 401(k) to a traditional IRA. There are two ways to do that -- a "rollover" and a "direct rollover," or trustee-to-trustee transfer. Of the two ways to

[2] Source: The Motley Fool: Personal Finance-Changing Jobs? Take Care of your 401(k). http://www.fool.com/personal-finance/general/2006/09/25/changing-jobs-take-care-of-your-401k.aspx

move plan money to an IRA, the direct, trustee-to-trustee transfer method is usually best. Let's look briefly at both methods.

In a regular rollover, you receive your plan assets via a check made out in your name. You may cash that check and do whatever you wish with the proceeds. But to avoid any taxation and penalty, you have 60 days from the day you receive that check to get that money to an IRA. Unfortunately, though, the check you get will be for only 80% of the 401(k) account balance. That's because, by law, the plan must withhold 20% of your account balance to pay for any possible income taxes on the amount that gets distributed from the plan directly to you.

To complete a 100% rollover of your 401(k) money, you must come up with the missing 20% from other assets, probably by removing money from your bank account. You would then add that 20% to the 80% you got from the plan and deposit those proceeds into an IRA within 60 days.

If you fail to add those extra funds, then at the end of your tax year, the Internal Revenue Service will call the missing 20% a taxable distribution -- even though you never actually received that money! You must declare the missing 20% as income. Worse, you will also pay a 10% early withdrawal penalty on that sum when you're younger than 55 in the year you changed jobs. However, if you add that missing 20% to your IRA rollover, the government will refund the 20% withheld from your 401(k) check when you file your income tax return for the year -- assuming, of course, that you otherwise owe no more income taxes for the year.

That tax issue is why most people prefer the direct transfer method of moving money from a 401(k) plan to an IRA. In a trustee-to-trustee transfer, nothing is withheld for income taxes when the 401(k) account is closed. Any check, whether it goes to the IRA custodian or to you, will be made out in a form that prevents you from cashing it. Only your new IRA custodian can do so. And that means you will have no potential problems with the tax man, nor must you pull assets from other sources to make up for any money withheld from the 401(k) distribution for a potential tax bill.

Worried about how to arrange such a transfer? Don't be. Both your plan custodian and your desired IRA custodian do it all the time, so both can guide you through the process. Just tell them what you want to do, then follow the administrative instructions they provide.

The following table summarizes your options.

Option	Pros	Cons
Roll over to new employer's plan	• Avoid early withdrawal penalties. • Money continues to grow tax-deferred.	• May have a limited number of investment choices. • May have limited ability to make exchanges among funds in your plan.
Roll over to an IRA	• Avoid early withdrawal penalties. • Money continues to grow tax-deferred. • Offers more options than employer plan.	• Can't borrow against the assets. • May have to pay an annual fee.
Leave in former employer's plan	• Avoid early withdrawal penalties. • Money continues to grow tax-deferred. • Retain the ability to roll over to an IRA or new employer's plan at a later date.	• Can no longer contribute to former employer's plan. • May have a limited number of investment choices. • May have limited ability to make exchanges among funds in your former plan.
Take a cash distribution	• Can provide cash when facing extraordinary financial difficulties.	• If you are younger than age 59½, you'll face a 10% early withdrawal tax penalty and a 20% federal mandatory tax withholding. • Money no longer grows tax-deferred. • You may face goal short-fall risk—the risk that you won't have enough money for retirement.

What are 403(b) Plans?

A **403(b)** plan is a tax advantaged retirement savings plan available for public education organizations (secondary and postsecondary education institutions), some nonprofit employers (only U.S. Tax Code 501(c)(3) organizations) and self-employed ministers (man or woman who is authorized by a church or religious organization to perform clergy functions) in the United States. It has tax treatment extremely similar to a 401(k) plan, especially after the Economic

Growth and Tax Relief Reconciliation Act of 2001. Simply put, employee salary deferrals (contributions) into a 403(b) plan are made before income tax is paid on it, and allowed to grow tax deferred until the money is taxed as income when taken out of the plan. Beginning in 2006, 403(b) and 401(k) plans may also include designated Roth contributions, i.e., after-tax contributions, which, if certain requirements are met, will allow tax-free withdrawals. Primarily the designated Roth contributions have to be in the plan for at least five taxable years. Roth plans will be discussed in the following section.

What are 457 Plans?

The **457 plan** is a type of tax advantaged defined contribution retirement plan that is available for governmental and certain nongovernmental employers in the United States. The employer provides the plan and the employee defers compensation into it on a pretax basis. For the most part, the plan operates similarly to a 401(k) or 403(b) plan most people are familiar with in the U.S.. The key difference is unlike a 401(k) plan, there is no 10% penalty for withdrawal before the age of 59 1/2 (although the withdrawal is subject to ordinary income taxation).

Simplified Employee Pension Plans (SEP)

Simplified Employee Pension plans (SEPs) can provide a significant source of income at retirement by allowing employers to set aside money in retirement accounts for themselves and their employees. Under a SEP, an employer contributes directly to traditional individual retirement accounts (SEP-IRAs) for all employees (including the employer). A SEP does not have the start-up and operating costs of a conventional retirement plan and allows for a contribution of up to 25 percent of each employee's pay.

Advantages of a SEP

- Contributions to a SEP are tax deductible, and your business pays no taxes on the earnings on the investments.
- You are not locked into making contributions every year. In fact, you decide each year whether, and how much, to contribute to your employees' SEP-IRAs.
- Generally, you do not have to file any documents with the government.
- Sole proprietors, partnerships, and corporations, including S corporations, can set up SEPs.
- You may be eligible for a tax credit of up to $500 per year for each of the first 3 years for the cost of starting the plan.
- Administrative costs are low.
- As you read through this booklet, here are some definitions you will find helpful:

SEP Definitions

Employee – An "employee" is not only someone who works for you, but also may be a self-employed person as well as an owner-employee who earns income. In other words, you can contribute to a SEP-IRA on your own behalf. The term also includes employees of certain other businesses you and/or your family own and certain leased employees.

Eligible Employee – An eligible employee is an employee who:

- is at least 21 years of age, and
- has performed service for you in at least 3 of the last 5 years.

All eligible employees must participate in the plan, including part-time employees, seasonal employees, and employees who die or terminate employment during the year.

Your SEP may also cover the following employees, but there is no requirement to cover them:

- employees covered by a union contract;
- nonresident alien employees who did not earn income from you; and/or
- employees who received less than $450 in compensation during the year (subject to cost-of-living adjustments).

Compensation – The term generally includes the pay an employee received from you for a year's work. As the owner/employee, your compensation is the pay you received from the company. Employers must follow the definition of compensation included in the plan document.

Savings Incentive Match Plan for Employees (SIMPLE)

Small businesses have a new vehicle to help their employees save for retirement. Called the SIMPLE plan—Savings Incentive Match Plan for Employees of Small Employers—it gives businesses with 100 or fewer employees an affordable way to offer retirement benefits through employee salary reductions and matching contributions (similar to those found in a 401(k) plan).

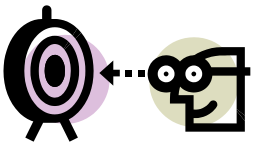
SIMPLE plans are authorized by the Small Business Job Protection Act of 1996. They offer employees of small businesses—which comprise over 38 percent of the nation's private workforce—a convenient and inexpensive way to save. Having a SIMPLE plan may also offer another advantage: it can provide small employers with a new incentive to attract and retain qualified employees in a competitive environment.

A SIMPLE plan is ideally suited as a start-up retirement savings plan for small employers who do not currently sponsor a retirement plan. Some advantages are:

- Eligible employees can contribute up to $6,000 each year through convenient payroll deductions.
- Employers offer matching contributions equal to employee contributions (up to 3 percent of employee wages) or fixed contributions equal to 2 percent of employee wages.
- SIMPLE plans eliminate many of the administrative costs associated with larger retirement plans.
- Model plan documents, employee notices and salary reduction agreements are available from the IRS.

Retirement Savings Plan Options for the Self-Employed (Keogh Plans)

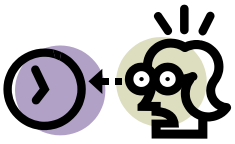
Lesson No. M4.4



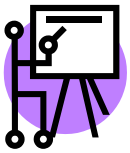
Lesson Objectives:

After completing this lesson participants should be able to:

- Recognize available retirement savings plans for the self-employed
- Recognize what are Keogh retirement savings plans



Time Required: 20 Minutes

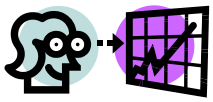


Lesson Teaching Tips

- In your group, you might have a significant number of participants that could be self-employed, construction contractors, home services providers, etc. They will need to recognize all available retirement savings programs (Keogh and IRAs) available to them. Make sure they also understand the tax income benefits associated with investing on these plans.

Questions to Generate Discussion

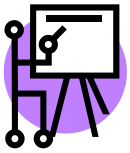
- Who are self-employed?
- Do you have a retirement savings plan?
- How many of you know that if you are self-employed you can have a retirement savings plan?



PowerPoint Slides Thumbnails

Slide Notes

- Use the slide information to discuss what Keogh retirement savings plans are.



Closure:

- Review lesson objectives with participants.
- Reaffirm participants that if they are self-employed they also have retirement savings plans available for them.
- Recommend participants to talk to their friends or relatives who are self-employed to seek information about this type of plan.

Learning Assessment:

- Ask self-employed participants how many of them will look for information regarding Keogh retirement savings plans.

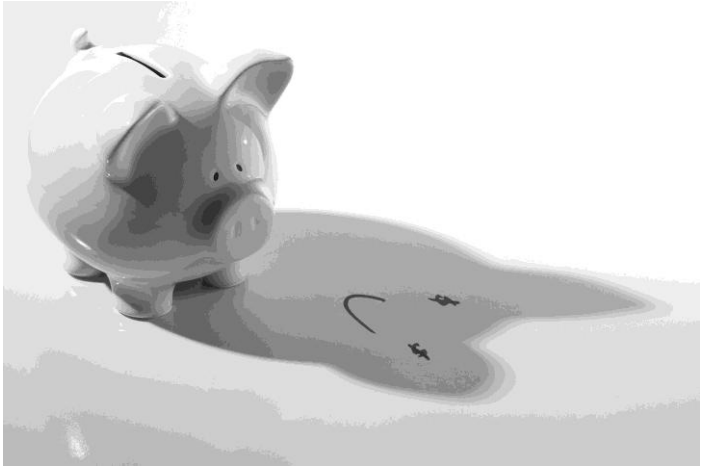
Reference Materials

- Retirement planning for the self-employed. http://retireplan.about.com/cs/retirement/a/aa_plan_a8.htm

A self-employed person can establish a Keogh Plan, simplified employee pension (SEP), or SIMPLE Plan and make tax-deductible contributions entered on Form 1040, **Line 28**. SEP's and SIMPLE's are less complicated than Keogh's. The tax-deductible contributions and any interest or gains thereon are not taxed until withdrawn.

A self-employed person can establish and make tax-deductible contributions to a Keogh Plan even if the person also works as an employee and is covered by that employers tax-qualified retirement plan. You can also establish an IRA under the same tax rules as other taxpayers.

The two types of Keogh Plans are defined contribution plans and defined benefit plans. Retirement benefits received from a defined contribution plan are based on the tax-deductible contributions and accumulated interest and gains.



Retirement benefits received from a defined benefit plan are based on a benefit formula. Tax-deductible contributions are adjusted to provide the required benefit.

The maximum tax-deductible contribution to a defined contribution plan is the lesser

of **$44,000** or **100%** of compensation.

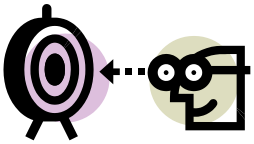
The maximum tax-deductible contribution to a defined benefit plan is the amount needed to produce the required benefits under the formula. For **2006** the maximum annual retirement benefit that may be funded may not exceed the lesser of **100%** of the participant's average compensation for the highest three consecutive tax years as an active participant or **$220,000**.

Provided the Keogh Plan is established by the last day of the tax year, you can make tax-deductible contributions up to the due date of your tax return.

Many other tax rules apply and you should seek the help of a qualified professional before establishing a tax-deductible Keogh Plan.

Individual Retirement Accounts (IRA)

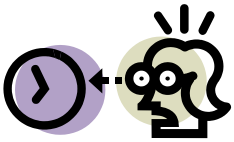
Lesson No. M4.5



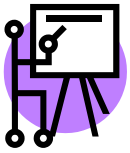
Lesson Objectives:

After completing this lesson participants should be able to:

- Understand what Individual Retirement Accounts (IRAs) are
- Recognize the differences among the various types of IRAs
- Recognize the contributions limits of each type of IRA



Time Required: 45 Minutes

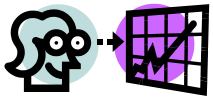


Lesson Teaching Tips

- Make sure participants understand that IRAs are available to all individuals regarding of their employment status.
- Self-employed individuals can save for retirement using IRAs.

Questions to Generate Discussion

- How many of you know what IRAs are?
- How many of you have IRAs?



PowerPoint Slides Thumbnails

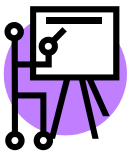
Slide Notes

- Discuss what IRAs are.
- IRAs can be setup at banks.
- In order to use the tax benefits for a particular tax period (year) they need to be purchased before December 31st of that particular tax year.

- Discuss the different types of IRAs and their particulars.

- IRAs have an impact on the tax payers' income tax, as a result they have annual contributions limits.

- This table presents the annual contribution limits for IRAs, 401k plans, and others.



Closure:

- Review lesson objectives with participants.
- Remind participants that IRAs are another of the various types of investment options available for reaching their retirement financial goals.

Learning Assessment:

- Ask participants to list the benefits of investing on IRAs to accomplish their retirement financial goals.

Reference Materials

- Traditional IRA - Individual Retirement Accounts - http://beginnersinvest.about.com/od/iras/Traditional_IRA_Individual_Retirement_Account.htm

What is an Individual Retirement Account (IRA)? An IRA is a personal savings plan that provides income tax advantages to individuals saving money for retirement purposes.

There are a number of different types of IRAs, which may be either employer-provided or self-provided plans. The types include:

- **Roth IRA** - contributions are made with after-tax assets, all transactions within the IRA have no tax impact, and withdrawals are usually tax-free. Named for Senator William Roth.
- **Traditional IRA** - contributions are often tax-deductible (often simplified as "money is deposited before tax" or "contributions are made with pretax assets"), all transactions and earnings within the IRA have no tax impact, and withdrawals at retirement are taxed as income (except for those portions of the withdrawal corresponding to contributions that were not deducted).
- **SEP IRA** - a provision that allows an employer (typically a small business or self-employed individual) to make retirement plan contributions into a Traditional IRA established in the employee's name, instead of to a pension fund account in the company's name.
- **SIMPLE IRA** - a simplified employee pension plan that allows both employer and employee contributions, similar to a 401(k) plan, but with lower contribution limits and simpler (and thus less costly) administration. Although it is termed an “IRA,” it is treated separately.
- **Self-Directed IRA** - a self-directed IRA that permits the account holder to make investments on behalf of the retirement plan.

How Does an IRA Work?

You invest money in an IRA, up to the amounts allowable under the tax law. These investments are termed "contributions." In many instances an income tax deduction is available for the tax year for which the funds are contributed. The contributions, as well as the earnings and gains from these contributions, accumulate tax-free until you withdraw the money from the account. You therefore enjoy the ability to generate additional earnings, unreduced by taxes on these earnings, each year the funds remain within the IRA.

The withdrawals of the funds from the IRA are termed "distributions." Distributions are subject to income taxation, generally in the year in which you receive them. (Remember that in most cases you received an income tax deduction when you contributed the money to the IRA.) As with most things involving the government, the rules for distributions are more complicated than they need to be.

Since the original purpose of the IRA is to assist you in providing for your own retirement, there is a disincentive for withdrawing your IRA funds prior to an assumed retirement age of 59 1/2. This disincentive takes the form of a tax "penalty" in the amount of 10 % of the distributions received by you prior to age 59 1/2, unless certain exceptions apply. Given the complexity of this issue alone, professional advice should be obtained whenever significant amounts of distributions are needed prior to age 59 1/2. The fact is that many times the penalty can be avoided with proper planning. Obviously these distributions, whether before age 59 1/2 or later, are subject to income taxation upon receipt. Once you are age 59 1/2 this penalty, termed a "Premature Distribution" penalty, is no longer applicable.

On the flip side of the government not wanting you to withdraw your money at too young an age, it also has rules to prevent you from not withdrawing the money soon enough. (This is done in order that the government can tax it.) You usually need to begin taking money from your IRA no later than April 1 of the calendar year following the date you attained age 70 1/2. The rules established by the government regarding these Required Minimum Distributions, their timing, the amounts, the recalculations, and the effect various beneficiary designations have on them, are among the most complex of the Internal Revenue Code. The penalty is 50 % of the shortfall between what you should have withdrawn and the amounts you actually withdrew by the proper date. This punitive penalty is matched only by the civil fraud penalty in severity. The necessary calculations are therefore not something that most individuals should attempt on their own.

The following presents a summary of the different IRAs available:

1. **Tradition IRA**
   You can contribute up to $2,000 per year into an IRA. The amount of this contribution that is deductible on your income tax return depends on your Adjusted Gross Income (AGI) and whether you are covered under an employer sponsored qualified retirement plan. Thus, depending on your filing status (Single, Joint, etc.), and your AGI, your contributions may range from fully deductible to totally nondeductible. So even though you are eligible to

contribute to your IRA, you may be in a position where none of these contributions are in fact deductible.

2. **Education IRA**
   You can put away up to $500 per year into an education IRA, the money grows tax-free and has preferential tax treatment upon distribution to the beneficiary who uses it for authorized education expenses. These plans are not very common in that they are very restrictive on who can make contributions to them, the amount of total contributions allowable each year, and the limitations on what exact education expenses qualify. Your financial planner should be able to assist you in evaluating what savings plan you should undertake to prepare for higher education costs, as well as in reviewing many of the tax-sheltered savings plans now sponsored by the various states, even for benefits of out of state residents.

3. **SEP IRA - Simplified Employee Pension**
   This is an employer established and funded Simplified IRA, where the employer can put up to 15% of your compensation into a special IRA account. Sole proprietors may establish these plans for their own benefit. They are sometimes used instead of Keogh retirement plans because they have fewer administrative and tax filing requirements.

4. **SIMPLE IRA**
   This is a rather new creation, but rapidly becoming more popular. It's another employer sponsored and administered retirement plan. The attractive features of this plan includes not only the ability for the employer to establish and fund a retirement plan for the benefit of him/herself and his/her employees, but it also permits employees to contribute up to 100 %, but no more than $6,500 per year, into an IRA. Separate rules relative to required employer contributions and premature distributions apply.

5. **Roth IRA**
   Contributions are NOT deductible when the funds are contributed, but the Roth IRA earnings accumulate tax-free and remain tax-free upon distribution. To be eligible to contribute, your Adjusted Gross Income must be under $95,000 for singles and $150,000 for married couples, as of December 2000. You cannot withdraw your funds within the first 5 years after the establishment of the Roth without a penalty. Given that this 5-year testing period can successfully be addressed by proper tax planning, the establishment and at least partial funding of a Roth IRA account should be on the discussion list of the financial advisor of every taxpayer who qualifies to open such a plan.

How Retirement Accounts Help You Save on Taxes?

Can you ever save enough? With mortgage, car, and credit card payments, and even everyday expenses, saving for the future may be an afterthought. Here are some ideas -- which you may not have thought about -- to help you save more. And they are probably easier than you think.

One potential way to save more: maximize tax-advantaged savings accounts such as Traditional IRAs and 401(k)s. (Subject to retirement plan participation status and adjusted gross income limits.) This will reduce the bite Uncle Sam takes from your paycheck and investment earnings, allowing more of the money you earn the potential to grow. For many people, an easy way to increase saving is to max out their retirement plans, including IRAs, and workplace savings plans like 401(k)s, and 403(b)s. At the very least, you should contribute enough to retirement accounts to capture any available matching contributions from your employer.

For a Traditional IRA, full deductibility of a contribution for 2007 is available to active participants whose 2007 adjusted gross income (AGI) is $83,000 or less (joint) and $52,000 or less (single); partial deductibility for AGI up to $103,000 (joint) and $62,000 (single). In addition, full deductibility of a contribution for 2007 is available for working or nonworking spouses who are not covered by an employer-sponsored plan whose AGI is less than $156,000; partial deductibility for AGI up to $166,000.

IRAs and Retirement Accounts Annual Contributions Limits

When considering making use of individual retirement plans you must take into consideration the contribution limits when performing your planning. Federal legislation passed in 2001 increased the maximum annual contribution limits on individual retirement plans, such as 401(k) and IRAs as shown below.

Year	401(k) & 401 (b) Plan Limit	457 Plan Limit	IRA Limit	401(k), 401 (b) &457 Catch-Up	IRA Catch-Up
2002	$11,000	$11,000	$3,000	$1,000	$500
2003	$12,000	$12,000	$3,000	$2,000	$500
2004	$13,000	$13,000	$3,000	$3,000	$500
2005	$14,000	$14,000	$4,000	$4,000	$500
2006	$15,000	$15,000	$4,000	$5,000	$1,000
2007	Indexed for inflation at $500 increments	Indexed for inflation at $500 increments	$4,000	Indexed for inflation at $500 increments	$1,000 in later years not indexed for inflation
2008			$5,000		
2009			Indexed for inflation at $500 increments		
2010					

Additional Learning Resources

Please visit the following online resources to learn more about the subjects presented on this module:

- Online Social Security Handbook Your Basic Guide to Social Security Programs
- Internal Revenue Service: Retirement Plans FAQ Regarding IRAs
- Retirement planning for the self-employed
- Traditional IRA - Individual Retirement Accounts
- Smart 401(k) Investing – FINRA
- What are 403b plans?
- Basics of 457 Plans