Retirement Income Planning

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Important Notice

This report is intended to serve as a basis for further discussion with your other professional advisors. Although great effort has been taken to provide accurate numbers and explanations, the information in this report should not be relied upon for preparing tax returns or making investment decisions.

Assumed rates of return are not in any way to be taken as guaranteed projections of actual returns from any recommended investment opportunity. The actual application of some of these concepts may be the practice of law and is the proper responsibility of your attorney.

Sources of Retirement Income

Most retirees derive their retirement income from three primary sources: Social Security retirement benefits, qualified retirement plans, and individual savings and investments.

Social Security Retirement Benefits

Social Security retirement benefits are intended to provide only a portion of an individual's retirement income. Traditionally, retirement benefits began at age 65. For those born after 1937, however, the age at which full benefits begin will increase gradually, until it reaches age 67 for those born in 1960 and later. A reduced benefit is available, beginning at age 62. The monthly benefit amount is based on an individual's past earnings record. A worker can earn a larger retirement benefit by continuing to work past full retirement age, up to age 70. Up to 85 percent of a retiree's Social Security retirement benefits may be taxable as ordinary income. Retirement benefits are subject to adjustment for inflation on an annual basis.

Qualified Retirement Plans

A retirement plan is considered to be "qualified" if it meets certain requirements set by federal income tax law. In general, employer or employee contributions to a qualified plan are currently deductible and the earnings are tax deferred until paid out of the plan. Mandatory distribution rules typically apply and taxable withdrawals before age 59½ may be subject to an additional 10% penalty tax.[1]

- **Employer-sponsored qualified plans:** Employer-sponsored plans can generally be classified as either defined benefit or defined contribution. Defined benefit plans specify the benefit amount a participant will receive at retirement; an actuary estimates how much must be contributed each year to fund the anticipated benefit. The investment risk rests on the employer. Benefits are generally taxable. Defined contribution plans, such as 401(k), 403(b) or SEP plans, typically put a percentage of current salaries into the plan each year. The retirement benefit will

[1] The rules and regulations surrounding qualified plans are complex. This discussion is intended to be only a brief, general description. State or local law may vary.

depend on the amount contributed, the investment return, and the number of years until a participant retires. The investment risk rests on the participant. Benefits are generally taxable.

- **Individual qualified plans:** Include the traditional Individual Retirement Account (IRA) and the Roth IRA. Contributions to a traditional IRA may be deductible and earnings grow tax deferred. Distributions from a traditional IRA are taxable to the extent of deductible contributions and growth. Contributions to a Roth IRA are never deductible and earnings grow tax deferred. If certain requirements are met, retirement distributions from a Roth IRA are tax free.[1]

- **Nonqualified retirement plans:** An employer may set up a plan, often in the form of a deferred compensation plan, which does not meet federal requirements to be considered "qualified." Benefits are generally taxable when received. Such plans are often used as a supplement to qualified retirement plans.

Individual Savings

Individual savings and investments are the third primary source of retirement income. An individual can choose to accumulate funds using a wide range of investment vehicles. The appropriate type of investment will depend on a number of factors such as an individual's investment skill and experience, risk tolerance, tax bracket, and the number of years until retirement. Below are listed some of the more commonly used choices.

- **Savings accounts:** Including regular savings accounts, money market funds, and certificates of deposit (CDs) at banks, savings and loans and credit unions.

- **Common stock:** May also include other forms of equity ownership such as preferred stock or convertible bonds. Stock can be owned directly, in a personal portfolio, or indirectly through a mutual fund.

- **Bonds:** Includes corporate, government or municipal bonds. Bonds can be directly owned in a personal portfolio or indirectly held in either a mutual fund or unit investment trust.

[1] The discussion here concerns federal income tax law; state or local tax law may vary.

- **Real estate:** Individually owned investment real estate or indirect investment through a real estate investment trust or limited partnership.
- **Precious metals:** Such as gold or silver, in the form of coins, bullion, or in the common stock of mining companies.
- **Commercial deferred annuities:** Commercial, deferred annuities are purchased from a life insurance company and can provide tax-deferred growth through a variety of investment choices.

Other Income Sources

Other retirement income sources include the following:

- **Immediate annuity:** An "immediate" annuity is purchased from a life insurance company, typically with a single, lump-sum payment. Within one year after purchase, the annuity begins to make regular, periodic payments to the annuity owner.
- **Continued employment:** On either a full or part-time basis. Wage and salary income is usually taxable and before-full-retirement-age[1] earnings above a certain level may affect the amount of Social Security retirement benefits received.
- **Home equity:** If a home is completely paid for, a reverse mortgage may provide additional income, without giving up home ownership.

[1] "Full retirement age" is the age at which an individual is entitled to "full" Social Security retirement benefits – 100% of an individual's Primary Insurance Amount. Under current law, this age will vary from 65 to 67, depending on an individual's year of birth.

Social Security Retirement Benefits

One of the original motivations for the Social Security system was the need to provide income for retired workers. Today, the retirement benefits available through Social Security provide income not only to retired workers, but to qualifying dependents as well.

Qualifying For Retirement Benefits

To qualify for Social Security retirement benefits, a worker must meet two primary requirements:

- **Fully insured:** To be "fully" insured, a worker must have earned 40 Social Security "credits," generally by working 10 years in "covered" employment.[1] In 2019, an individual must earn $1,360 in covered earnings to receive one credit and $5,440 to earn the maximum of four credits for the year.
- **Age:** Be at least age 62.

Primary Insurance Amount

In general, Social Security benefit amounts are based on the worker's lifetime earnings record. Using this earnings record, the Social Security Administration (SSA) calculates a number known as the "Primary Insurance Amount," or PIA. The PIA is the basic value used to determine the dollar amount of benefits payable.

When to Take Social Security Retirement Benefits?

Once retirement payments begin, the benefit amount generally does not change, except for annual "cost-of-living" adjustments. Thus, the decision as to when to begin to take Social Security retirement benefits is a key one. Full Social Security retirement benefits are paid at "full retirement age" (FRA). A worker who elects to receive Social Security retirement benefits at his or her FRA can expect to receive 100% of the PIA. For those born in 1937 or earlier, FRA is age 65. For those born after 1937, FRA gradually increases until it reaches age 67 for those born in 1960 and later.

[1] Wages or self-employment income where the earnings are subject to Social Security tax (OASDI) and the Medicare (HI) tax. For those working less than 10 years, an alternative test to determine fully-insured status may apply.

- **Early retirement (less):** Reduced retirement benefits may begin as early as age 62. For each month (up to 36 months) that a worker is under FRA, benefits are reduced by 5/9 of 1% of the PIA. For each month in excess of 36 months, benefits are reduced an additional 5/12 of 1% of the PIA.

- **Delayed retirement (more):** A worker who delays receiving retirement benefits beyond FRA can receive a larger benefit. For each year of delay up to age 70, the benefit is increased by a specific percentage of the PIA. The amount of extra credit for each year of delay will vary depending on the year of birth. No additional credit is given for delaying receipt of benefits past age 70.

Retirement Benefits for Family Members

Other individuals may receive retirement benefits based on a worker's account:

- **Spouse's benefit:** Beginning at age 62 (or younger, if caring for a child described below), a spouse is eligible for a retirement benefit based on the worker's earnings record. The spouse's benefit is generally equal to 50% of the worker's PIA, at the spouse's FRA. Unless the spouse is caring for a child, the benefit amount is reduced if the spouse begins receiving benefits before FRA. If the spouse is entitled to a larger benefit based on his or her own work record, the larger benefit is paid.

- **Child:** A monthly retirement benefit is available to a dependent child. For this purpose, a child must be under age 18, or age 18 or 19 and a full-time elementary or high school student, or 18 or over and disabled before age 22, and unmarried. The benefit is equal to 50% of the worker's PIA.

- **Divorced spouse:** If a prior marriage lasted at least 10 years, at age 62 a divorced spouse may be entitled to retirement benefits based on the worker's record. Generally, the retirement benefit amount is 50% of the worker's PIA. The divorced spouse must not be married and benefits are reduced for early retirement.

Maximum Family Benefit

If the total benefits payable based on a retired worker's Social Security account exceed certain limits (which change each year) the individual dollar amounts for a spouse and any dependent children are proportionately reduced to bring the total within the family maximum limit.[1] Neither the worker's benefit amount nor any benefit payable to a divorced spouse is reduced because of the family maximum limit.

Federal Income Taxation of Social Security Benefits

Under federal income tax law, Social Security benefits may be subject to income tax. If one-half of Social Security benefits plus "modified adjusted gross income" (often the same as adjusted gross income) exceed a specified threshold, then a portion (up to 85%) of social security benefits is taxable. For married couples filing jointly this threshold is $32,000; for most others it is $25,000.[2] State or local income tax treatment of Social Security benefits can vary.

Reduced Benefits Because of Excess Earnings

If an individual begins receiving retirement benefits before reaching FRA, and also works, the retirement benefit will be temporarily reduced if earnings exceed certain limits. For this purpose, "earnings" generally include wages received as an employee or the net income received from self-employment. The reduction amount is calculated on a monthly basis and varies depending on the individual's current age in relation to his or her FRA.

- **Under FRA:** One dollar of benefits is lost for every two dollars earned over an annual total of $17,640 ($1,470 monthly).[3]
- **The year FRA is reached:** One dollar of benefits is lost for every three dollars earned over $46,920 ($3,910 monthly).[3]
- **At FRA:** Once FRA is reached, there is no reduction in an individual's benefit, regardless of how much is earned. Any benefits that were withheld earlier because of excess earnings are credited to the individual's account, resulting in a larger retirement benefit beginning at FRA.
- **Special rule for the first year of retirement:** A special rule applies to the first year of retirement, to benefit an individual who, before just retiring, earns more than the

[1] The family maximum benefit is based on a formula and ranges from 150% to 180% of the worker's benefit.
[2] The threshold is $0 for those who are married filing separately and who lived with their spouse any time during the year.
[3] 2019 values. These "exempt" amounts are subject to adjustment for inflation each calendar year.

annual limit. Under this rule, unreduced Social Security benefits are paid for any month after benefits begin that an individual does not earn more than the monthly exempt wage amount.

Verifying Social Security Records

Because Social Security benefits are based on a worker's lifetime earnings history, it is important to insure that all covered earnings are accurately listed on SSA records. There are several ways to do this:

- **Paper statements:** Workers age 60 or older and who are not receiving Social Security benefits automatically receive a paper Social Security Statement each year, listing the worker's earnings as well as providing estimated retirement, disability, and survivors benefits. A paper earnings statement may also be requested by completing Form SSA-7004, *Request for Social Security Statement*, and mailing it to the address on the form. The statement will arrive by mail in four to six weeks.
- **Online statements:** The same information previously provided on the paper statements is now available on an electronic statement. These electronic statements include a summary of a worker's earnings, as well as providing estimated retirement, disability, and survivor's benefits. To obtain a statement, an individual will need to create an account on the Social Security website at https://www.ssa.gov/myaccount. Each person who wishes to sign up must be at least age 18 and have a valid Social security number, e-mail address, and United States mailing address.
- **Telephone:** Earnings information may also be verified by calling the SSA directly at (800) 772-1213; TTY (800) 325-0778, Monday through Friday, from 7:00AM to 7:00PM.

Estimating Social Security Retirement Benefits

The Social Security administration, on its website, offers a calculator which allows an individual to estimate his or her retirement benefits, using the individual's own earnings history, taken directly from Social Security records. This calculator can be reached at: https://www.ssa.gov/planners/retire

Seek Professional Guidance

For many Americans, the retirement benefits provided by Social Security form an important part of their retirement income. A qualified financial professional can answer many Social Security questions. Social Security questions can also be answered by directly contacting the SSA.

How Work Affects Social Security Benefits

Monthly Social Security benefits are paid to individuals for a number of reasons, including retirement, disability, and death. If a Social Security recipient also works, some of the benefits may be reduced if the income earned exceeds certain dollar amounts.

However, the month an individual reaches "Full Retirement Age," or FRA, Social Security benefits are no longer reduced, regardless of the amount of income earned.

FRA is the age at which an individual can expect to receive 100% of his or her normal retirement benefit, without reduction for early retirement. For those born in 1937 or earlier, FRA is age 65. For those born after 1937, FRA gradually increases until it reaches age 67 for those born in 1960 or later.

Age of Social Security Benefits Recipient	Annual Exempt Amount[1]		One Dollar of Benefits Is Lost for Every Two or Three Dollars You Earn Over the Exempt Amount
	2018	2019	
Under FRA	$17,040	$17,640	Every Two Dollars
Year FRA Reached	$45,360	$46,920	Every Three Dollars
Month FRA Reached	No Limit	No Limit	No Loss of Benefits

Example (1): An individual begins receiving Social Security benefits at age 63 in January 2019, with an entitlement of $500 per month. If the retiree works and earns $27,640 during the year, he or she would have to give up $5,000 of Social Security benefits ($1 for every $2 over the $17,640 limit), but would still receive $1,000.

Example (2): Assume an individual reaches FRA in November 2019. Also assume the individual earns $59,904 during the year, with $49,920 of this amount being received in the first 10 months of the year. The individual would give up $1,000 in benefits, $1 for every $3 earned above the $46,920 limit. Assuming a Social Security retirement benefit of $500 per month, the individual would still receive $4,000 out of $5,000 for the first 10 months of the year. Full benefits of $1,000 ($500 per month) would be received for November and December, after FRA was reached.

[1] Source: Social Security Administration

What Counts as Earnings?

Any wages earned after retirement from work as an employee and any net earnings from self-employment count as earnings. Wages include bonuses, commissions, fees, vacation pay, pay in lieu of vacation and cash tips of $20 or more in a month.

What Doesn't Count as Earnings?

- Investment income, including stock dividends, interest from savings accounts, income from annuities, limited partnership income and rental income from real estate you own (unless you are a real estate dealer).
- Income from Social Security, pensions, other retirement pay and Veterans Administration Benefits.
- Gifts or inheritances.
- Royalties received after age 65 from patents or copyrights obtained before that year.
- If you are a retired partner, retirement payments from partnerships don't count if:
    - The payments continue for life under a written agreement which provides for payments to all partners or a class of them; and
    - You rendered no services to the partnership during the taxable year the retirement payments were received; and
    - Your share of the partnership capital was paid to you in full before the end of the partnership's taxable year and there is no obligation to you other than retirement payments.
- Income from self-employment received in a year after the year a person becomes entitled to benefits. This refers to income which is not attributable to services performed after the month of entitlement.

Benefits Withheld Restored at Full Retirement Age (FRA)

When an individual has had benefits withheld as a result of the Social Security retirement earnings test, these "lost" benefits are later restored, beginning at FRA. In the benefit re-computation at FRA, the actuarial reduction that was applied in the initial computation (because the individual applied for benefits early) is adjusted (lessened) to reflect the number of months that he or she received no or partial benefits as a result of the earnings test. A larger benefit is then paid, beginning at FRA.

For example, assume a worker claims Social Security retirement benefits at age 62. He then takes a part-time job which, over time, results in 12 months of benefits being withheld. Once the worker reaches FRA, his retirement benefit will be re-calculated, in this case as if he had first taken Social Security retirement benefits 12 months later, at age 63, rather than at age 62. This recalculation effectively "recaptures" the benefits earlier withheld.

If spousal benefits are withheld under the earnings test, they will be adjusted upward when the spouse (not the worker) attains FRA. For a spouse who has already reached FRA, there is no subsequent adjustment to benefits to take into account months for which no or a partial benefit was paid as a result of the earnings test.

Online Information

The Social Security Administration has a great deal of information available on its website at:

https://www.ssa.gov/.

When to Take Social Security Retirement Benefits

Research by the Federal government indicates that Social Security retirement benefits typically make up almost one-third of the income of Americans age 65 or older.[1] Thus, the decision as to when to begin to take Social Security retirement benefits is an important one. Once you decide to begin receiving Social Security retirement benefits, the initial benefit will generally serve as the "base" amount for the rest of your life, subject only to adjustment for increases in the cost of living.

The question is made a little easier to answer if you separate when you want to retire from when you want to begin receiving Social Security retirement benefits; these two events don't necessarily have to occur at the same time. An understanding of how your benefits are calculated, how they are taxed, and what happens if you continue to work after beginning to receive benefits, is also important.

"Full" Retirement Age – "Full" Benefits

For many years, full retirement age (FRA), the age at which "full" benefits – 100% of an individual's Primary Insurance Amount[2] (PIA) – are available was set at age 65. This is still true for those born in 1937 or earlier. However, for those born in 1938 or later, FRA gradually increases until it reaches age 67 for those born in 1960 or later.

Early Retirement – Reduced Benefits

Age 62 is generally the earliest age that someone can begin to receive Social Security retirement benefits. However, if retirement benefits begin before the "full" retirement age, the benefit paid is reduced to reflect the income that will be paid over a longer period of time. The amount of the reduction varies with the year of birth. For example, an individual born in 1937 (FRA = age 65) who began receiving benefits at age 62 had his or her retirement benefit reduced to 80% of what it would have been had they chosen to wait until FRA. However, for a worker born in 1962, for whom FRA is age 67, choosing to receive retirement benefits at age 62 results in an initial benefit reduced to 70% of what it would have been had the individual waited to age 67.

[1] See: "Income of the Aged Chartbook, 2014." Social Security Administration, April 2016, page 16.

[2] The PIA is calculated by the Social Security Administration based on a person's lifetime earnings record.

When to Take Social Security Retirement Benefits

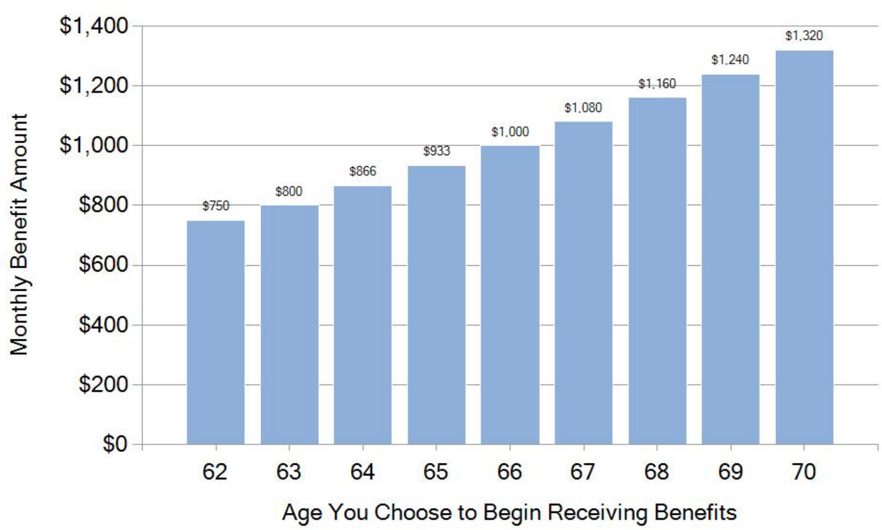
Delay Retirement – A Bigger Benefit

What happens if you decide to wait and take your retirement benefits later than your FRA? You get paid for waiting, in the form of a larger retirement benefit. For each year beyond your FRA that you delay receiving retirement benefits, up to age 70, your benefit is increased by a specified percentage of the PIA. The amount of the credit for each year of delay beyond FRA will vary depending on the year of birth. For example, an individual born in 1935 who delayed receiving benefits until age 70 had his or her benefit increased by 6% for each year (five years in this case) beyond the FRA of age 65. For those born in 1943 and later, delaying retirement increases their benefit by 8% per year for each year they wait beyond their FRA.

Which Is Better? – Early or Late?

One way to answer this question is to perform a “break-even” analysis which estimates the age at which the total value of higher benefits (from delaying retirement) is greater than the total value of lower benefits (from starting retirement early).

If you expect to live longer than this break-even age you would likely benefit from delaying the start of Social Security retirement benefits. If you are in poor health, or if members of your family tend to die at relatively young ages, you will likely receive a greater benefit by beginning your benefits early.



This example assumes a monthly benefit of $1,000 at a full retirement age of 66.

When to Take Social Security Retirement Benefits

Federal Income Taxation of Social Security Benefits

Under federal law, Social Security benefits may be subject to income tax. If one-half of your Social Security benefits plus your "modified adjusted gross income" (often the same as adjusted gross income) exceed certain limits, then a portion (up to 85%) of your benefits is taxable. For married couples filing jointly this threshold is $32,000; for all others it is $25,000.[1] State or local tax treatment of Social Security benefits can vary.

If You Continue Working

If you begin taking Social Security retirement benefits early and also continue working, your retirement payments will be temporarily reduced if your earnings exceed certain limits. For this purpose, "earnings" generally include wages received as an employee or the net income received from self-employment. The amount of the reduction will vary:

- **Under FRA:** One dollar of benefits is lost for every two dollars you earn over $17,640 ($1,470 monthly).[2]
- **The year you reach FRA:** One dollar of benefits is lost for every three dollars you earn over $46,920 ($3,910 monthly).[2]

Once you reach FRA there is no reduction in your retirement benefits, regardless of how much you earn.

Seek Professional Guidance

The decision as to when to take Social Security retirement benefits is an important one. A wrong decision can cost a retiree literally thousands of dollars. The guidance of financial professionals, to insure that all relevant issues are considered, is highly recommended.

[1] The threshold is $0 for those who are married filing separately and who lived with their spouse at any time during the year.
[2] 2019 values. These "exempt amounts" are subject to adjustment for inflation each calendar year.

Annuities in Retirement Income Planning

For much of the recent past, individuals entering retirement could look to a number of potential sources for the steady income needed to maintain a decent standard of living:

- **Defined benefit (DB) employer pensions:** In these plans the employer promises to pay a specified monthly amount for the life of the retiree and/or spouse.
- **Social Security:** Designed to replace only a part of an individual's working income, Social Security provides a known benefit for the life of a retiree and his or her spouse.
- **Defined contribution (DC) plans:** Such as 401(k), 403(b), or 457[1] plans, which allow for contributions from the employee (in some cases from the employer as well) to a retirement account. The funds in the account, whatever they amount to at retirement, provide retirement income.
- **Individual retirement plans:** Such as Traditional IRAs or Roth IRAs. These are "individual" versions of employer-sponsored DC plans. The funds in the IRA at retirement, whatever the amount, are used to provide retirement income.

The Changing Face of Retirement

The saying that "life is what happens when you're making other plans" is particularly true when it comes to retirement income planning, for several key reasons:

- **Fewer employer pensions:** Over the past several decades, many employers have changed from defined benefit to defined contribution plans. From 1985 to 2000, for example, the rate of participation in defined benefit plans by full-time employees of medium and large private firms dropped from 80% to 36%.[2] A survey by the Bureau of Labor Statistics, published in 2017, found that only 23% of civilian workers in the U.S. participated in defined benefit pension plans.[3]

[1] These refer to the sections of the Internal Revenue Code which authorize these different types of retirement plans.

[2] See, "Employee Participation in Defined Benefit and Defined Contribution Plans, 1985-2000." U.S. Bureau of Labor Statistics, updated June 16, 2004.

[3] National Compensation Survey: Employee Benefits in the United States, March 2017, Table 2.

- **Social Security:** Social Security is a "pay-as-you-go" system, with current workers supporting those already receiving benefits. As the baby boom generation retires, the number of individuals remaining in the workforce to support them grows smaller. Although politically unpleasant, fiscal reality may force higher payroll taxes, reductions in benefits, or both.

- **We're living longer:** A child born in 1900 had an average life expectancy of 47.3 years. For a child born in 2014, however, average life expectancy had increased to 78.8 years.[1]

With the stable, lifetime income stream from employer pensions and Social Security playing an ever shrinking role, retirement income planning demands that each individual accept a higher degree of personal responsibility for both accumulating and managing the assets needed to pay for retirement. And managing these assets has to be done in a world where constant inflation, fluctuating interest rates, and sometimes volatile financial markets are a fact of life.

Longer lives mean the money has to last longer, although exactly how long is unknown.

One Possible Answer – Immediate Annuities

Life insurance is designed to help solve the problems created when someone dies prematurely. An annuity, on the other hand, is designed to protect against the possibility of living too long. An "immediate" annuity is a contract between an individual and an insurance company. In exchange for a single, lump-sum premium, the insurance company agrees to begin paying a regular income to the purchaser for a period of years or for life. The periodic payment amount depends on a number of factors:

- **Premium paid:** Generally the larger the payment, the larger the income stream.

- **Age:** Older individuals typically receive larger periodic payments.

- **Payout period selected:** A shorter payout period usually results in a larger payment.

- **Underlying investment medium:** Generally, either a fixed or a variable annuity.

[1] Data for years 1900-1965 is taken from National Vital Statistics Reports, Volume 47, Number 28, United States Life Tables, 1997, December 13, 1999, Table 12. For the years 1966-2014, see National Vital Statistic Reports, Volume 65, Number 4, Deaths: Final Data for 2014, June 30, 2016, Table 7.

FIXED ANNUITY	VARIABLE ANNUITY
A fixed annuity pays a fixed rate of return. The insurance company invests in a portfolio of debt securities such as mortgages or bonds and pays out a fixed rate of return. Generally, this rate of return is guaranteed for a certain period of time after which a new rate is calculated. Most insurance companies offer a guaranteed minimum rate throughout the life of the contract. Such guarantees are based upon the claims-paying ability of the issuing insurance company.	A variable annuity offers the potential for higher returns in exchange for assuming a higher level of risk. You can choose from among several types of investment portfolios, such as stocks or bonds. The amount of each annuity payment will fluctuate depending on the performance of the underlying investments. Variable annuities are long-term investments designed for retirement purposes. They have certain limitations, exclusions, charges, termination provisions, and terms for keeping them in force, and are sold by prospectus only.[1]

Annuities are not insured by the FDIC or any government agency. Since an annuity may be payable far into the future, dealing with a financially solid insurer is essential. Credit rating companies such as A.M. Best, Standard and Poor's, or Moody's can provide an objective measure of a firm's financial stability.

Seek Professional Guidance

For many individuals, an immediate annuity can form an important part of their retirement income planning. Because an immediate annuity is a complex product, the advice and guidance of a trained financial professional is highly recommended.

[1] The prospectus for a variable annuity contains complete information including investment objectives, risk factors, fees, surrender charges, and any other applicable costs.

Immediate Annuities

Immediate annuities are long-term contracts issued by a life insurance company. Typically purchased with a single, lump-sum payment, an immediate annuity can provide an income stream for a set period of time or for the rest of your life.

How Much Income Can I Receive?

The amount of income will vary, generally depending upon the following factors:

- **Amount of your purchase payment:** Generally, the larger the payment, the larger the income stream.
- **Your age:** Older individuals typically receive larger periodic payments.
- **Length of payout period selected:** A shorter payout period will usually result in a larger payment.
- **The underlying investment medium:** Usually either a fixed or variable annuity.

Funding the Annuity – Fixed or Variable

As the name implies, a “fixed” annuity pays a fixed rate of return. The insurance company invests in a portfolio of mortgages and bonds and pays out a specified rate of return. Generally, this rate is only guaranteed for a certain period of time, after which a new rate is calculated based upon then prevailing market conditions. However, most insurance companies offer a guaranteed minimum rate throughout the life of the contract.

Bear in mind that annuities are not insured by the FDIC or any other government agency. All guarantees are based upon the credit worthiness of the life insurance company.

The other primary alternative is the variable annuity, which offers the potential for higher returns in exchange for your willingness to assume a greater level of risk. A typical variable annuity contract will give you a choice among several types of investment portfolios, such as stocks or bonds, or a combination. As the markets move up and down, your annuity’s value will also rise and fall. Consequently, the amount of each annuity payment will fluctuate depending upon the performance of the underlying investments.

Variable annuities are sold by prospectus only. The prospectus contains more complete information including investment objectives, risk factors, fees, surrender charges, and any other applicable costs. Study the information in the prospectus carefully before investing.

Federal Income Taxation of Annuity Income

Because immediate annuities are purchased with after-tax dollars, the income received is prorated between ordinary income, which is taxable, and a return of principal, which is not taxable. This calculation takes into account your life expectancy and the amount of each payout. Please remember that state and local income tax law can vary. See your tax advisor for guidance.

Deferred Income Annuities

Retirement income planning in today's world needs to deal with several key realities:

- **We're living longer:** A child born in 1940 had an average life expectancy of 62.9 years. For a child born in 2014, however, average life expectancy had increased to 78.9 years.[1]
- **We're on our own, more and more:** Over the past few decades, many employers have changed from defined *benefit* plans, providing predictable, stable lifetime income, to defined *contribution* plans, such as 401(k), 403(b), or 457[2] plans. A worker can also have an individual retirement account, either a traditional IRA or a Roth IRA. In defined contribution plans, the individual contributes (in some cases the employer also contributes) to a tax-deferred retirement account. At retirement, the accumulated cash, whatever it amounts to, is used to generate retirement income.[3] This change from defined benefit to defined contribution plans has effectively shifted the risk involved in managing these retirement assets from the employer to the *employee*.
- **Social Security? Maybe, maybe not:** Social Security is a "pay-as-you-go" system with current workers supporting those already receiving benefits. As the baby boom generation retires (the "Silver Tsunami"), the number of individuals left in the workforce to support them will grow smaller. Although politically unpleasant, fiscal reality may force higher payroll taxes, retirement benefit cuts, or both.

Unless these retirement assets are very carefully managed, it is possible to literally "run out of money." How, then, does a retiree create a stable income stream that will last a lifetime? One possible answer is a type of life insurance annuity contract known as a "Deferred Income Annuity."

What's an Annuity?

The word "annuity" derives from a Latin term meaning "annual" and generally refers to any

[1] Source: National Vital Statistics Reports, Volume 66, Number 4 – United States Life Tables, 2014, Table 19. August 14, 2017.
[2] These refer to the section of the Internal Revenue Code which authorizes these different types of retirement plans.
[3] From 1985 to 2000, the rate of participation in defined benefit plans by full-time employees of medium and large private firms dropped from 80% to 36%. (See "Employee Participation in Defined Benefit and Defined Contribution Plans, 1985-2000. U.S. Bureau of Labor Statistics, update June 16, 2004). A survey by the Bureau of Labor Statistics, published in 2018, found that only 22% of workers in the U.S. participated in defined benefit plans. See: National Compensation Survey: Employee Benefits in the United States, March 2018, Table 2.

circumstance where principal and interest are liquidated through a series of regular payments. A commercial annuity is a special type of contract issued by a life insurance company. In a typical situation, the contract owner contributes funds to the annuity. In return, the insurance company agrees to make periodic payments over a specified period of time, the life of an individual, or the joint lives of two individuals. In essence, an annuity allows the contract owner to shift the investment risk to the insurance company.

The dollar amount the annuity pays depends on a number of factors, including:

- **Premium paid:** Generally, the larger the payment, the larger the income stream.
- **Age:** Older individuals (with shorter life expectancies) typically receive larger periodic payments.
- **Deferral period:** Waiting a longer period of time before beginning annuity payments usually results in a larger periodic payment.
- **Payout period selected:** A shorter payout period usually results in a larger payment.

Deferred Income Annuities

For many individuals, a "deferred" annuity (one which begins payments at a future date) provides part of their retirement income. In many cases, the annuity contract owner purchases the annuity while relatively young, and then structures the contract so that annuity payments begin at the same time as retirement, receiving payments over his or her remaining lifetime. Since the individual's retirement years may extend over a lengthy period of time, for each dollar invested in the contract, the periodic payments will generally be less than if the contract covered a shorter period of time.

Recently, individuals close to retirement age have begun to utilize a deferred annuity that begins paying not at the beginning of retirement, but at a more advanced age, such as 75, 80, or 85. These annuities are known as "deferred income annuities," or, more popularly, "longevity annuities." When planning for not running out of money in retirement, deferred income annuities have several advantages:

- **Security:** Once the annuity is purchased, the income is guaranteed for the rest of your life, no matter how long that may be. The income amount is fixed and is not subject to change based on market fluctuations.

- **Higher payment amounts:** Monthly income payments are generally higher than those available from traditional deferred annuities.

- **Simplicity:** Once the annuity is purchased, there is nothing more to do or decide. The income will automatically begin on the specified future date.

For a number of years, deferred income annuities were paid for exclusively with funds that had already been taxed.

Qualified Retirement Plans and Deferred Income Annuities

An alternative source of funds to purchase a deferred income annuity is the cash saved in individual retirement plans such as a traditional or Roth IRA, or in employer-sponsored qualified[1] retirement plans such as 401(K), 403(b), or 457 plans. In the past, a key roadblock to using these funds was the federal income tax requirement that the money be distributed (generally beginning at age 70½), known as a Required Minimum Distribution, or RMD.[2] However, regulations published in July, 2014[3] by the Internal Revenue Service provide a way to purchase a deferred income annuity with qualified plan funds without tripping over the RMD requirements. These changes reflect an IRS concern that long-lived retirees might exhaust their qualified retirement plan funds too soon, due to the RMD requirements.

Under these regulations, if a deferred income annuity purchased with qualified plan funds meets certain requirements, the funds invested in the contract are *excluded* from the normal RMD requirement calculations prior to the date annuity payments begin, even if the start date is beyond age 70½. Such a contract is referred to a “Qualified Longevity Annuity Contract,” or QLAC. In general, these requirements are as follows:

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[1] These plans are termed “qualified” as they meet certain requirements in the Internal Revenue Code.

[2] The discussion here concerns federal income tax law. State or local income tax law may differ. These RMD distributions can be made either as a lump-sum distribution or periodic payments made over the life or life expectancy of an account owner or an account owner and spouse. Roth IRAs are not subject to the RMD rules during the lifetime of the account owner. There are RMD requirements for *inherited* Roth IRA accounts.

[3] See Treasury Decision 9673, published on July 1, 2014, effective for contracts purchased or exchanged on or after July 2, 2014.

- **Limitations on premiums:** No more than the *lesser* of $130,000 (2019 value) or 25% of the account balance may be used to purchase the deferred income annuity. The $130,000 premium limitation is subject to adjustment for inflation in future years.

- **Maximum age at commencement:** The annuity starting date must be no later than the first day of the month following the month the employee reaches age 85. This maximum age may be adjusted by the IRS for future changes in mortality experience.

- **Return of premium:** A QLAC may provide for a return of premium (ROP) feature. With this provision, if the employee and/or a designated beneficiary die before the entire premium has been returned in the form of annuity payments, a single, lump-sum payment of the un-recovered difference may be made.

- **Underlying investment:** A deferred income annuity will be considered a QLAC only if the earnings under the contract are derived from contractual guarantees. Such an arrangement is commonly referred to as a "fixed" annuity, an annuity which pays a known rate of return. Generally, this rate is guaranteed[1] for a certain period of time after which a new rate is calculated, based on market conditions. Most insurance companies offer a guaranteed[1] minimum rate of return throughout the life of the annuity contract.

- **Other points:** The contract must be identified as a QLAC and the employee must be so notified. Because Roth IRAs are not subject to the RMD requirements during the owner's lifetime, a deferred income annuity purchased within a Roth IRA is not considered to be a QLAC.

Seek Professional Guidance

For many individuals, a deferred income annuity can play an important role in their retirement income planning. However, because annuities are complex products, the advice and guidance of a trained financial professional is highly recommended.

[1] Such guarantees are based upon the claims-paying ability of the issuing insurance company.

Required Minimum Distributions

Lifetime Distributions from IRAs and Qualified Plans

Both traditional IRAs[1] and qualified retirement plans enjoy significant federal tax benefits.[2] Contributions are generally tax deductible and growth inside an account is tax-deferred. Federal law requires that certain amounts be paid out, generally beginning with the year an account owner turns age 70½. Funds become taxable when distributed.

- **Required minimum distributions (RMD):** These are the specified, minimum withdrawals that an account owner must make. The account owner is free to take larger amounts if desired.
- **Required beginning date:** This is the date by which an account owner must begin to make his or her required minimum distributions.
- **Penalty tax:** If an account owner does not make distributions that are large enough, or if distributions are not made at all, a penalty tax of 50% of the amount that should have been distributed is generally due.

Item	Traditional IRAs	Qualified Plans
Required beginning date	By April 1 of the year following the year you attain age 70½.	By April 1 of the year following the later of (a) the year you reach age 70½, or (b) the year you retire. More than 5% owners must begin to receive distributions by April 1 of the year following the year they reach age 70½.
Initial distributions	If a required first withdrawal for 2019 is made by April 1, 2020, the required distribution for 2020 must be made by December 31, 2020. In effect there are two taxable distributions made in 2020. Each year thereafter, a distribution is required on or before December 31.	

[1] For required minimum distribution purposes "traditional IRAs" include SIMPLE IRAs and SEP IRAs. Roth IRAs are subject to different rules.

[2] This discussion concerns federal law only. State or local law may vary.

Item	Traditional IRAs	Qualified Plans
More than one IRA or qualified retirement plan	If an individual has more than one IRA, the required minimum distribution must be determined for each IRA. However, the total required distribution may be made from any one or a combination of the IRAs. The IRAs may not be aggregated with employer-sponsored qualified retirement plans.	Generally, each plan must make its own separate required minimum distribution.
Other	The minimum distribution rules do not apply to Roth IRAs during the owner's lifetime.	Qualified plans include TSA 403(b), Keogh, 401(k), SIMPLE 401(k), and pension and profit sharing plans.

Calculating Required Minimum Distributions[1]

The actual amount that must be distributed each year is determined using:

- The balance in the account as of the previous December 31, and;
- The age of the account owner (and spouse, if married) at the end of the year.

The required minimum distribution is calculated by dividing the account balance by a theoretical life span taken from life expectancy tables provided by the Internal Revenue Service (IRS). The life expectancy table used will vary depending on the age of the account owner and, if married, his or her spouse. An individual's marital status is determined as of January 1 of the calendar year.

Single owner/spouse no more than 10 years younger: An IRA owner, age 75, has $100,000 in an IRA as of December 31 of the prior year. The required minimum distribution for the current year would be $4,366.81, ($100,000 divided by 22.9). The divisor of 22.9 is taken from the Uniform Lifetime Table for an individual age 75. The calculation is the same for a single individual or a married individual with a spouse no more than 10 years younger than the IRA owner.

[1] The rules reviewed here are those contained in the final regulations issued by the Treasury Department on April 16, 2002, in Treasury Decision 8987. Annuity contracts providing benefits under qualified plans, individual retirement plans, and IRC Sec. 403(b) contracts are subject to special rules. See Treasury Decision 9130.

Spouse more than 10 Years Younger[1]: If the participant's spouse is more than 10 years younger than the participant, the minimum distribution factor used in calculating the required minimum distribution is found in the Joint and Last Survivor Table.

An IRA owner, age 75, has $100,000 in the IRA as of December 31 of the prior year. His wife is age 63. The required minimum distribution would be $4,115.23, $100,000 divided by 24.3, the Joint and Last Survivor Table factor for an owner age 75 and a spouse age 63.

Seek Professional Guidance

Given the complex and frequently changing nature of tax law, individuals faced with the need to make required distributions from IRAs or qualified retirement plans should seek the guidance of qualified professionals.

[1] The spouse must be the sole beneficiary of the account.

Reverse Mortgages

Many retired individuals find themselves living on a fixed income. Many also own a home which is either paid for, or which has a very small mortgage, a situation often described as "house-rich-and-cash-poor." In the past, there were few acceptable ways to take advantage of this home equity, apart from selling the home. Recently, however, a different financial tool – the reverse mortgage – has been growing in popularity. A reverse mortgage provides qualified individuals access to the equity in their homes, while allowing them to retain ownership of the home.

What Is a Reverse Mortgage?

Most homeowners are familiar with the traditional home mortgage. An individual buys a home, and, over time, as the monthly payments are made, the balance due on the mortgage is gradually reduced. A homeowner's equity – the difference between what is owed and the market value – is also increased if a home's market value increases. In the traditional, *forward* mortgage, as debt decreases, equity increases:

A *reverse* mortgage, as the name implies, works in the other direction. With a reverse mortgage, cash flows from a lender to a borrower. Over time, the balance due increases. In a reverse mortgage, as debt increases, equity decreases.

- **General Requirements:** All borrowers must be at least 62 years of age. The home must be owner-occupied and be the borrower's principal residence. Qualifying residences generally include single-family detached homes, 2-4 unit owner-occupied homes, condominiums, and manufactured homes. Only first mortgages are permitted. Any other debt secured by the home must be first paid off, or paid off with proceeds from the reverse mortgage.

- **Ownership:** During the term of the mortgage, the borrower remains the owner of the home and is responsible for payment of property taxes, insurance, utilities, fuel, maintenance, and other expenses.

- **Repayment:** No payments are required as long as at least one borrower lives in the home. The outstanding loan balance, plus accrued interest and any loan costs, is due when the last borrower sells the home, permanently leaves (an absence of 12 months or more), dies, or fails to carry out an obligation such as paying insurance or property taxes when due. Typically, the loan is repaid by either selling or refinancing the home. Any remaining equity is paid to the borrower, the borrower's estate, or heirs.

- **Maximum loan balance:** A borrower can never owe more than the value of the home at the time the loan is repaid. Reverse mortgages are generally nonrecourse loans, which means the lender can only look to the value of the home for repayment.

The Pros and Cons of Reverse Mortgages

There are a number of reasons why a reverse mortgage may not be appropriate:

- **Not needed:** Some retired individuals will not want to consider a reverse mortgage simply because it is not needed; their financial needs during retirement are already adequately met.

- **Security:** Reflecting long-held attitudes toward savings and debt, some individuals may not be comfortable with the idea of placing any type of mortgage on the home, once it is paid for.

- **Legacy for heirs:** Rather than using the equity in the home for current needs, a homeowner may want the equity to pass to family members or other beneficiaries, such as a charity.

There are also a number of situations where a reverse mortgage can help:

- **Enjoy life:** For some, the extra dollars provided by a reverse mortgage may make it easier to pay routine monthly expenses. For others, it may allow an occasional splurge.

- **Pay off debt:** Funds from a reverse mortgage can be used to pay off other types of personal debt that require monthly payments, such as credit card balances.

- **Maintain independence:** Some may wish to make improvements to the home, or pay for in-home care, to allow them to remain independent as long as possible

- **Provide for the future:** Even though the present financial situation is stable, a reverse mortgage can provide a way to deal with unexpected future problems.

Choosing a Reverse Mortgage

Unlike just a few years ago, a wide range of reverse mortgage programs is available today. Further, the specific details of each program can vary greatly. A standard series of questions can be used to compare and contrast each program:

- **How much cash?** In general, the amount of cash which can be borrowed will generally depend on the lender's policies, the age of the youngest borrower, the value of the home, the home's condition and location, and the interest rate. The amount of available cash can vary greatly from one lender to the next.

- **How will the cash be paid?** The cash from a reverse mortgage is typically available to the borrower in one of three ways. In some cases a combination of payment methods may be available:

  - **Lump sum:** The loan proceeds can be paid with one check, usually at the time the loan is closed.

  - **Periodic advances:** Cash payments of a fixed amount are usually made monthly. Term advances are made for a specified period of time; tenure advances continue as long as at least one borrower lives in the home.

  - **Credit line:** This is a line of credit the borrower can use when needed, up to the loan limit.

- **Cost of the loan:** Federal law requires reverse mortgage lenders to provide prospective borrowers with a loan cost analysis. The total annual loan cost (TALC) analysis looks at the cost of a loan under a specified set of circumstances, over the entire length of the loan. The standardized nature of the TALC makes it easy to compare the cost of loans from different lenders.

- **Remaining equity:** If a borrower decides to sell the home after only a few years, how much equity would be left?

Reverse Mortgage Programs

There are a number of types of reverse mortgage programs, varying by lender, purpose, and security:

- **Single-Purpose Reverse Mortgages:** These are mortgage offered by some state and local government agencies, as well as non-profit organizations. Such loans are typically used to pay for home repairs, improvements, or property taxes.
- **Proprietary Reverse Mortgages:** Reverse mortgages issued by private companies. These loans are usually considered when higher-value homes are involved.

The most widely available reverse mortgage program is operated under the auspices of the federal government:

- **Home Equity Conversion Mortgage (HECM):** The Federal Housing Administration (FHA) part of the U.S. Department of Housing and Urban Development (HUD) insures reverse mortgage loans made by private lenders under its Home Equity Conversion Program. If a lender fails to make the promised payments, the FHA takes over responsibility for fulfilling the lender's obligations. The HECM program has specific loan limits and borrowers under this program can expect to pay origination fees as well as mortgage insurance premiums.

In 2015, HUD put into effect a series of eligibility standards designed to reduce the possibility that a reverse mortgage borrower might default on a loan. These new standards included (1) limiting the amount a borrower could receive at closing as well as the amount a borrower could receive during the first 12 months of a loan; (2) requiring a "financial assessment" of a borrower, including verifying past credit history, current income, other debt owed, and a borrower's record of meeting recurring home obligations such as taxes and insurance, and (3) if needed, setting aside a portion of the loan proceeds to make required insurance and property tax payments if the borrower fails to make them.

- **Home Equity Conversion Mortgage (HECM)for Purchase:** HUD also insures reverse mortgages which allow qualified borrowers to sell their existing (usually larger) home and then use the proceeds from a "HECM for Purchase" to buy a new (usually smaller) home. In effect, this program allowed qualified individuals to "downsize" in a single transaction, with only one set of closing costs.

Additional Resources

The federal government, through several of its agencies such as the FHA, the Consumer Financial Protection Bureau (CFPB), and the Federal Trade Commission (FTC), have freely available information on reverse mortgages. Further, the FHA requires consumer education as a part of the lending process. Reverse mortgage resources on the web include:

- **U.S. Department of Housing and Urban Development (HUD):** https://www.hud.gov/
- **Consumer Financial Protection Bureau:** https://www.consumerfinance.gov/
- **Federal Trade Commission:** https://www.ftc.gov/
- **American Association of Retired Persons (AARP):** The AARP provides publications on reverse mortgages. On the Internet, the AARP maintains a website at: https://www.aarp.org

Seek Professional Guidance

Because they are relatively new, reverse mortgages are unfamiliar to many. Also, those most likely to consider a reverse mortgage are usually at a point in life where long-term commitments must be very carefully considered. Individuals considering a reverse mortgage are strongly advised to seek professional guidance before entering into a loan contract.

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