



# CREATING A PROSPEROUS RETIREMENT

Your Retirement Planning Guide



Northern Trust





## RETIRE WITH CONFIDENCE

You've probably been saving for your retirement for years. But if your goal is to have a prosperous, active and secure retirement – one in which you can continue to enjoy the lifestyle you have today – saving isn't enough. You need to create a retirement plan that focuses on long-term liquidity and flexibility.

Clearly, retirement planning isn't as simple as it used to be. People are creating their own definitions of retirement that reflect their goals and values. We can help you create a strategic plan for your retirement, whether you are approaching retirement or are already there, that will help you achieve your goals and give you peace of mind.

Use this guide when meeting with your professional advisors to feel confident you've addressed the issues that will help ensure your retirement years truly will be golden.



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## ASSESSING YOUR PLANNING SO FAR

You probably have been preparing for your retirement since you began working – setting aside money in various personal accounts and employer-sponsored plans like those described in the following plan overview. Or maybe you've been less aggressive about saving specifically for retirement, focusing instead on your investment portfolio or your business. Regardless of how much you've saved or where you've saved it, the first step for developing an overall retirement strategy involves determining where you are today.

### Retirement Savings Plan Overview

In addition to your investment portfolio and other savings and assets, all of which can be used to fund your retirement, Congress has created several tax-advantaged ways to save for retirement. Here is an overview of the four most common retirement savings vehicles: the traditional IRA, Roth IRA, 401(k) plan and pensions. Other savings plans may be better geared for business owners or the self-employed, and are covered later in this guide.

- 1. Traditional IRA.** In 2005 and 2006, you can contribute the lesser of your earned income or \$4,000 (\$4,500 in 2005 or \$5,000 in 2006 if you are over 50) to a traditional IRA. Whether the contribution will be deductible from your income taxes depends on a number of factors. If you are eligible to participate in an employer-sponsored retirement plan, such as a 401(k), your IRA deduction likely will be limited by your adjusted gross income. Regardless of whether your contributions are deductible, earnings in the account will grow free from any income tax until withdrawn. All deductible contributions you make also will be taxed when withdrawn. Traditional IRA accounts are subject to required minimum withdrawals starting when you reach age 70½, and you cannot make contributions to an IRA after the year in which you reach age 70½.

#### TRADITIONAL IRA DEDUCTION PHASE-OUT LEVELS

*If you are covered by your employer's retirement plan, the deductibility of your contributions to a traditional IRA is reduced as your adjusted gross income increases according to the table below. If your income exceeds the top amount, your contributions are not deductible at all.*

YEAR	MARRIED FILING JOINTLY	SINGLE
2005	\$70,000–\$80,000	\$50,000–\$60,000
2006	\$75,000–\$85,000	\$50,000–\$60,000
2007 and after	\$80,000–\$100,000	\$50,000–\$60,000

#### ASK YOUR ADVISORS

##### **Do I need to file a Form 8606 for nondeductible contributions to my traditional IRA?**

If you make annual nondeductible contributions to a traditional IRA, you may need to file Form 8606. This form notifies the IRS of your after-tax contributions so when you later take a distribution, you won't pay tax on your initial contributions. Any distribution of earnings, however, will be taxable.

**2. Roth IRA.** The Roth IRA has some significant differences from its traditional counterpart. Although both accounts share the same

contribution limits (\$4,000 in 2005 and 2006 with an allowed catch-up contribution of \$500 in 2005, \$1,000 in 2006), a Roth has a higher adjusted gross income limit for contributing.

Contributions to a Roth IRA are never deductible, but assets in the account can grow tax-free, rather than tax-deferred. And a Roth IRA has no required minimum distributions or age restrictions on making contributions, both of which make a Roth IRA a potential option for people who want to maximize the assets in their retirement plan to eventually leave to their heirs.

If you are still working and your income precludes you from making contributions to a Roth IRA, you may qualify after you retire if you plan to continue working part-time.

**3. Employer-sponsored plans.** The 401(k) plan and related employer-sponsored plans (such as profit sharing plans, 403(b)s, 457s and simplified employee pensions [SEPs]) are by far the most popular retirement savings vehicles available today. Contribution limits are higher than for an IRA, and the plans typically offer several mutual funds from which to choose for your investments. Your 401(k) contributions are made pre-tax, and plan assets grow tax-deferred. You must begin taking minimum annual distributions in the year after you retire or turn 70½, whichever is later.

**4. Pensions.** What is typically referred to as a “pension” is technically a defined benefit plan. These plans promise a specific annual amount the employee will receive at retirement based on actuarial calculations. For 2006, the maximum future annual benefit a pension can provide is the lesser of \$175,000 or 100% of the average amount of the employee’s three highest consecutive years of compensation (up to \$220,000).

#### ROTH IRA CONTRIBUTION PHASE-OUT LEVELS

Your allowable contribution to a Roth IRA is limited by your modified adjusted gross income (AGI).

	SINGLE TAXPAYERS WHOSE AGI IS ...	MARRIED TAXPAYERS FILING JOINTLY WHOSE AGI IS ...
Full contribution allowed	< \$95,000	< \$150,000
Reduced contribution allowed	\$95,000–\$110,000	\$150,000–\$160,000
No contribution allowed	\$110,000	\$160,000

## Taking Inventory of Where You Are Now

A good place to start when developing your retirement income strategy is by taking inventory of your current retirement savings and savings potential. To do this, compile a list of each of the following plans you have, and the balance in each account.

DEFINED CONTRIBUTION PLANS	ACCOUNT BALANCE	CURRENT CONTRIBUTION
Company-sponsored 401(k) plans. If you still have a plan with a former employer, be sure to include the balance for each account.		
Traditional IRA(s)		
Roth IRA		
Other employer-sponsored plans (403(b), 457, SEP)		
DEFINED BENEFIT (PENSION) PLANS		
If you have a company-sponsored pension plan or another type of annuity product, what income stream do you expect to receive during retirement?		
Does your pension plan have an inflation adjustment?	Yes	No
NONQUALIFIED DEFERRED COMPENSATION PLANS		
If you have a nonqualified deferred compensation plan, how much do you have in that account?		
Will it pay out as an annuity when you retire?	Yes	No

Next, if you are still working, write down how much you currently contribute to each of these plans. Also note, for any company-sponsored plans, if your employer makes a matching contribution.

### Determining Your Current Allocation Strategy

Experienced investors know a diverse portfolio is often an effective strategy for reducing risk and increasing return over the long term. In your overall investment portfolio, you likely have put this into action and spread your investments across the traditional asset classes of stocks, bonds, cash and cash equivalents; real estate (through your home, vacation home or other investments); international equities; alternative asset classes, such as hedge funds and private equity; and artwork or other collectibles.

### How Northern Trust Can Help

If you enjoy doing preliminary calculations on your own, you may want to visit [northerntrust.com](http://northerntrust.com) and refer to the basic retirement and IRA Calculators. Click on "Resources" on the top button bar and then click on "Calculators" to access these free financial tools.

## ASK YOUR ADVISORS

### Are my accounts allocated tax-efficiently?

Tax considerations can play an important role in your overall allocation strategy. Because of the potential tax impact, the investments you make through your IRA or other retirement plans versus those you make in your taxable accounts can have a significant effect on your overall portfolio returns.

Typically, in a period of normal investment returns, from a tax perspective most investors would be better off keeping investments that generate ordinary income, such as taxable bonds, in their retirement plan accounts. Investments that generate capital gains or losses would be better held in taxable accounts.

Money set aside for your retirement should be allocated according to your projected cash flow needs and timeframe. But to better position your savings to help maximize your cash flow potential, you need to coordinate the asset allocation strategies of each retirement account you have, as well as with the allocation strategy of your taxable investment accounts.

If you don't look at all of your investments together, you may find you have inadvertently taken on too much risk overall. Or, you may be too conservatively invested and face the risk of losing buying power over time.

We discuss asset allocation in more detail starting on page 20. But having the information about your current allocation – both for your retirement plans and your taxable portfolio – can be useful when you work with your advisors to create your cash flow strategy.

### *Do You Have a Concentration of Employer Stock?*

Another important planning consideration is the amount of employer stock you hold within your employer-sponsored retirement plans. Many successful employees approach retirement with a significant portion of their net worth tied up in their employer's stock. Fortunately, a variety of strategies exist that can help you minimize the risks of a large concentration of a single stock. But it's important to discuss the potential issues, as well as your feelings about holding or selling the stock, with your advisors early in the planning process.

### *Are You Planning to Use Real Estate as a Retirement Income Source?*

Nearly 60% of affluent individuals who have not yet retired plan to sell their primary residence when they retire. And another 54% will receive income from commercial or privately held real estate\*.

If you're thinking about using real estate as part of your retirement funding, several tax and legal considerations can make a difference in how much you will have available and when. To determine the role real estate may play in your retirement income strategy, consider the following issues:

- If you are considering downsizing your home after retirement, does it qualify as your "principal residence" for tax purposes?

\* Spectrem Group, 2005.

- If you split your time between two homes and are planning to sell one, which one currently qualifies as your principal residence? Can you make the changes necessary to qualify the home you plan to sell as your principal residence at least two years before you plan to sell it?
- Do you have a vacation home you are considering selling or converting to a rental property?
- Do you currently own or are you planning to purchase rental property (either commercial or residential) that will provide income during your retirement?
- How much income are you expecting from your rental property?

We discuss using real estate as a funding source of retirement income in more detail on page 24, but this inventory will provide a good starting point for your discussions with your advisors.

### *Taking Into Account Nonqualified Deferred Compensation Plans*

As a key employee in a larger organization, you may have a nonqualified deferred compensation plan as part of your overall compensation package. These plans offer several benefits:

- You can potentially reduce your overall tax liability by deferring current income or bonuses until retirement when you theoretically will be in a lower tax bracket.
- They have no annual limitations on contributions. You can potentially defer up to 100% of your eligible compensation if your company allows.
- You won't face penalties for early distributions or mandatory distributions at age 70½.
- You receive the same tax deferral you would through a qualified plan.

#### **PLANNING TIP**

**Before selling a home, determine whether it qualifies as your principal residence.**

If you are planning to relocate or downsize your home after retirement, you can exclude as much as \$500,000 of gain if you are married and file a joint return. Single taxpayers can exclude up to \$250,000 of gain.

To qualify for the gain exemption, you must have:

- Owned the home for at least two years,
- Used the home as your principal residence for at least two years in the aggregate during the five-year period prior to the sale date, and
- Not have excluded the gain on a home sale within the last two years.

**Retirement Alert! Review your nonqualified plan with your tax professional**

The American Jobs Creation Act of 2004 imposed significant new tax rules on nonqualified plans. The tax consequences of failing to comply with these new election, distribution and funding restrictions fall on the plan participants, rather than on the employer. These new rules generally became effective in 2005.

If you defer income under a plan that does not comply with the new restrictions, you will be subject to current taxation and penalties on all deferrals you've made to the plan. For this reason, it's crucial to review your situation with your tax professional to make sure everything is in order.

Although they are subject to fewer requirements than qualified retirement plans, nonqualified plans all must satisfy the following three requirements:

- You must enter into the irrevocable deferred compensation arrangement in a calendar year before the calendar year in which you earn the compensation you are deferring.
- You cannot have access to the compensation you've deferred until a previously agreed on future date or permitted distribution event under federal tax law.
- The amount of the deferred compensation must remain available to your employer's creditors (i.e., it can't be secured).

This means that if you participate in a nonqualified plan through your employer, your risk of heavy losses increases.

If you have a nonqualified plan, be sure to incorporate it into your inventory of retirement plan assets, and to discuss with your advisors how it may fit within your overall cash flow strategy.

**Make Sure You Are Protecting Your Current Income**

If you are still working, particularly if you have a number of years remaining before you plan to retire, protecting your current income is an important part of retirement planning. Many people overlook disability insurance when planning for retirement. This could lead to problems, because long-term disability insurance replaces your wage income, or a major share of it, if you suffer a disabling accident or illness.

In fact, disability insurance could be even more important to protecting your family's financial health than life insurance. Government statistics\* show that a 20-year-old has a 17% chance of dying before reaching retirement age, but a 30% chance of becoming disabled. And while Social Security covers most employees, its benefits are generally inadequate for people with a high standard of living.

\* Social Security Administration's Disability Benefits publication, 9/99; National Vital Statistics Report, 12/13/99.

If you currently have a disability insurance policy, review the policy's key features:

- What is the definition of disability in your policy? You generally want a policy with the least restrictive definition possible.
- How long do you have to wait after becoming disabled before you are eligible for benefits?
- How long will the policy pay benefits (generally to age 65 or for life)? Are the effects of inflation covered?
- Are the benefits taxable? The benefits may be excludable from income if you bear the cost of insurance.

Some planners view long-term care insurance as a supplement to the amount of disability income insurance for which you can qualify. In retirement, disability income insurance may provide protection against possible long-term care expenses – the primary purpose of long-term care insurance.

For this reason, you and your advisors may want to weigh which type of insurance will better meet your needs. Check if your disability insurance will pay based on the physical fact of disability or whether loss of income from an occupation is a required trigger. Also, consider the on-going premiums (which may rise after retirement age) against the shortened payment periods and possibly reduced benefits when you reach specified ages.

If you are a business owner, the potentially devastating effects of disability increase. To further protect yourself – and your business – you may want to consider overhead insurance and key person insurance as well.

Overhead insurance covers expenses like rent, wages, benefits, loan payments and taxes. Key person insurance protects against losses, including decreased sales, productivity and profits resulting from the disability of a key employee. Some key person plans pay benefits to the business. Others pay directly to the employee, freeing up the employee's salary. Key person premiums are not tax-deductible, but the benefits are tax-free.

If you don't have disability insurance today, you may want to discuss with your financial advisors what type of coverage may be most appropriate for you.

#### **How Northern Trust Can Help**

If you need an IRA or other retirement plan savings account, talk to your Northern Trust Relationship Manager to explore the variety of retirement plan solutions Northern offers.

### **How Northern Trust Can Help**

Are you using Private Passport now? Northern Trust provides you with a secure, online financial management tool that you can use 24 hours a day, 7 days a week to access both your Northern Trust accounts and non-Northern Trust accounts. Call the Private Passport Help Desk at 1-888-635-5350 or contact your Relationship Manager for more information.

## **Don't Overlook Benefits of Continued Life Insurance Coverage**

As you approach retirement, you may question what to do with your life insurance policies. With your source of income no longer linked to employment, you may feel you no longer need these policies. In some cases, however, you may be well served to keep your life insurance in place because of the many purposes it can serve in your retirement and estate planning.

In addition to replacing income, life insurance can allow you to equalize inheritances between children who are active in a family business and those who are not. Life insurance can provide leveraged funds that are free from estate taxes. And although the estate tax is decreasing and will be temporarily eliminated in 2010, your estate may very well face at least some death tax liability. Life insurance can provide liquidity to pay these estate taxes and other death-related expenses. Looking at the benefits of life insurance to transfer wealth to the next generation, you may find converting term policies or increasing payments on cash value policies makes sense.

## **Adding It All Up**

Working through the questions posed in this section should give you a good picture of what you have today for your retirement planning. From here, you can work with your advisors to determine how much you may need and when. This will be the basis for your retirement income planning strategy.

## DETERMINING YOUR CASH FLOW NEEDS AND SOURCES

According to the AARP, the average retirement age in the United States is now about 63 years old, while the average life expectancy has increased dramatically in recent years. The combination of earlier retirement and longer life expectancy means that while you may have many more years to enjoy your leisure and time with your family, your retirement savings also need to cover a much longer period of time.

At the same time, the number of retirees who will be receiving a guaranteed income stream during retirement from their company pension plans is declining. In fact, only 34% of affluent households surveyed will be receiving a monthly pension check from their employer after they retire.\* This has shifted the burden of providing retirement income to individuals.

How much cash flow will you need, before taxes, to meet your retirement needs? To determine the answer, you need to look at several issues.

### What Life Do You Envision?

You may have encountered formulas spelling out how much of your current income you will need in retirement, but these no longer necessarily hold true. Today, few people want to significantly scale down their lifestyle after retirement. In fact, many people end up doing more after they retire than they had time to do while still working.

When it comes to retirement planning, dreaming is an important first step. Spelling out your vision will help you and your advisors determine what your expenses and cash flow needs will be. And this will provide the foundation for your retirement planning strategy.

So dream a little: When you envision your retirement, what do you see? Do you picture being pampered at a private villa in Marrakesh, or relaxing in the garden with your grandchildren? Honing your golf skills at St. Andrews, or volunteering as a tutor to local school children? Do you want to stop working entirely, or would an unending vacation leave you feeling cast adrift?

It's important to be as specific as possible about your retirement goals and dreams. Are you planning any major purchases (like the yacht you've always dreamed about)? What obligations do you have beyond your personal household expenses (the children's or grandchildren's education, charitable commitments)?

### PLANNING TIP

**Defining your income needs is easier if your goals are clear.**

Take some time to think about retirement plans and goals before you meet with your advisors to develop a cash flow strategy. It will make it much easier to define your potential retirement needs if you can spell out your dreams.

\* Spectrem Group, 2005.

## PLANNING TIP

**Consider the following age-related milestones when choosing your retirement date.**

**Age 59½:** You can start taking penalty-free distributions from your qualified retirement plans. (You can start taking penalty-free distributions at age 55 from non-IRA accounts if you retired from the company running the plan on or after your 55th birthday.)

**Age 65:** You will be eligible for Medicare. If you retire before you turn 65, you will need to find and purchase health insurance to cover yourself (and your spouse and dependent children if they only have insurance coverage through you) until you are eligible.

**Ages 65 – 67:** You can start receiving full Social Security payments. This age is increasing gradually, but you can find out when you will reach “normal retirement age” by visiting [ssa.gov/retire2/agereduction.htm](http://ssa.gov/retire2/agereduction.htm).

Source: Northern Trust. For illustrative purposes only.

List out your current household expenses, travel budget, memberships and dues. Indicate which you expect to increase or decrease after you stop working. When you total everything up, be sure to indicate whether your calculations are based on before- or after-tax amounts. This will provide you with the basis for calculating your cash flow needs during retirement.

## Deciding When to Retire

When it comes to defining the perfect retirement age, there are many answers. A recent survey by the Spectrem Group shows that while only 40% of affluent individuals plan to retire during the “traditional” ages of 65 to 69; 20% plan to do so before age 60, and 17% don’t expect to retire until after they reach 70, if ever.

For some, choosing a retirement age may have to do with concerns about income or insurance. For others, it may revolve around a business succession plan or a desire to continue to be an active participant in the company they built.

Obviously, the age at which you retire can have a significant effect on your retirement income needs. It affects everything from the potential number of years your retirement will last to the amount of Social Security benefits you’ll be eligible for.

## Addressing Concerns About Healthcare Costs

People are living longer now than ever before. For this reason, rising healthcare costs loom large in the eyes of most affluent individuals – whether they have retired already or are still working. In fact, research done by Northern Trust shows that 92% of millionaires who have yet to retire are worried that rapidly rising healthcare costs will affect their ability to enjoy retirement. And nearly as many current retirees – 88% – share the same concern. These concerns are not insignificant. In fact, during the last five years, health insurance premiums rose more than twice as fast as inflation.\*

## Planning to Retire Early?

If you’re one of the 44% of affluent individuals who are planning to retire early, or if your spouse is younger, addressing healthcare costs becomes an important cash flow consideration. If you retire before you and your spouse turn 65 and both qualify for Medicare, health

\* According to the 2005 healthcare survey conducted by the Kaiser Family Foundation and Health Research and Education Trust. Based on premiums for employer-provided health insurance in the United States, from a survey of 2,013 randomly selected public and private employers with three or more workers between January and May of 2005.

insurance can be a big problem. If your former employer is large enough, both you and your spouse and any dependent children likely will qualify for COBRA coverage if you lose your employer-sponsored health insurance when you retire.

Health insurance coverage under COBRA is typically less expensive than finding a private policy. But it is generally more expensive than your coverage while you were employed because your employer no longer contributes toward the premiums. In addition, COBRA coverage only extends for a maximum of 18 months after your retirement date. So if you are planning to retire very early, you still will need to make other healthcare arrangements.

Because COBRA is available for only limited periods, finding other alternatives will be critical if your spouse is significantly younger and doesn't have his or her own employer-sponsored health insurance – especially if you also have dependent children. The good news is that individual health insurance costs may be lower for a younger person – how much lower will depend on how young your spouse is. But health is also a factor, and any pre-existing conditions may affect coverage availability and cost.

### *Healthcare Beyond Medicare*

Medicare is the primary health insurance program for most retirees. It is divided into Part A and Part B. Medicare Advantage replaces Part C, and is a managed healthcare alternative to Parts A and B offered by private insurers. Generally speaking, Part A is free to eligible recipients and helps pay for in-hospital care. Part B is optional and helps pay for regular medical care (e.g., doctor's bills, X-rays, lab tests). If you choose to enroll in Part B, you will pay a premium, deductible and co-payments as you would with any other insurance.

Beginning in 2006, Medicare provides a prescription drug benefit called Part D that is offered through private insurers for an extra premium (like Part B). Part D plans have a base benefit level that includes a maximum deductible of \$250, maximum coinsurance percentage of 25%, full coverage for between \$2,250 and \$3,600 of charges and then a 5% maximum coinsurance for expenses beyond that. You can select many benefit options beyond the base level, but you will pay additional premiums.

Current Medicare participants have until May 15, 2006, to elect a Part D plan. Otherwise, you will be able to join between November 15

### **Retirement Alert! Medicare coverage does not automatically extend to spouses**

Unlike Social Security benefits, Medicare coverage does not extend to your spouse and dependent children when you turn 65. If your spouse is younger and does not have health insurance coverage of his or her own, your spouse will need insurance coverage until he or she turns 65. Likewise, you will need to provide insurance for your children until they have coverage of their own.

and December 31 each year. Coverage begins January 1 of the following year. If you choose not to join when you are first eligible and later change your mind, you may pay a penalty.

Medicare covers many healthcare costs for retirees age 65 and older. But this isn't always sufficient, as demonstrated by the well-publicized prescription drug coverage problem. You may receive health insurance as a benefit from your (or your spouse's) former employer, which would be considered your secondary policy. If you don't receive health insurance as a retirement benefit, you'll want to consider purchasing supplemental health insurance yourself to fill in Medicare coverage gaps.

Because Medicare coverage has limitations, many people purchase supplemental insurance policies that are specifically designed to cover some of the gaps. Private health insurance companies provide this supplemental insurance, although it is typically called Medigap.

Federal government regulations stipulate that only 10 kinds of plans can be offered as Medigap plans, and all must cover certain services. The basic coverage is for your Medicare co-payments, and is found in Plan A Medigap coverage. Optional benefits may cover your Medicare deductibles, prescription drugs, skilled nursing facility care, preventative care and charges from a provider that are more than the Medicare-approved amount for a service. These options can be found in Plans B through J.

With the advent of Medicare Part D, sales of Medigap Plans H, I and J were discontinued. Two new benefit packages, Plans K and L, will

allow you to insure yourself against catastrophic costs for benefits covered under Medicare Parts A and B, while the new drug benefit will provide protection against catastrophic expenses for prescription drug costs.

## PLANNING TIP

### Calculating the costs of long-term care.

When considering how to best cover potential long-term care costs, the numbers below can help determine what the costs might be. Note, however, that many of these costs are increasing faster than the inflation rate.

#### Residential facilities:

Assisted living facility	
Room/board and assistance	\$1,500-\$3,500/month
Nursing home	
Room/board and skilled nursing care	\$2,000-\$6,000/month

#### Home care services and programs:

Custodial care (nonmedical)	\$10-\$30/hour
Registered nurse	\$20-\$50/hour
Nurse assistant/aide	\$12-\$25/hour
Adult day care programs	\$40-\$50/day

Sources: MetLife Mature Market Institute Survey of Nursing Home and Home Care Costs, September 2004; MetLife Mature Market Institute Survey of Assisted Living Costs, October 2004.

The best time to buy a Medigap policy is during your Medigap open enrollment period, which lasts for six months. It starts on the first day of the month in which you are both age 65 or older and enrolled in Medicare Part B.

### *Long-Term Care Insurance*

With life expectancies rising, more people are considering the prospect of needing extended care in a nursing home or other facility at some point. Without addressing this possibility, these costs can rapidly deplete your hard-earned wealth and possibly jeopardize your estate plans as well.

Long-term care insurance has become a viable way to keep assets safe for your heirs, rather than using them to fund nursing home costs. It also may provide daily benefits for home healthcare, institutional care or both.

Determining a precise combination of benefit amounts, elimination periods and inflation riders to meet your future needs can be challenging. Working with your advisors, you can determine how much of the long-term care risk you can reasonably cover without jeopardizing your estate and charitable plans, and then transfer the balance of the risk to an insurer.

Bear in mind that the costs for long-term care are rising faster than inflation. In fact, the U.S. General Accounting Office estimates that long-term care costs will triple during the next 20 years.

### **Projecting the Costs**

Giving some careful consideration to when you would like to retire and how you plan to spend your retirement years is just as important as calculating your current and anticipated expenses. Together, the answers to these questions can play an important role in crafting an income strategy that will not only meet your needs, but also help you realize your desires.

If your inventory and cash flow projections leave you fearing your retirement savings are coming up short, you may want to review the strategies on the next few pages that could help you bridge the gap. If you've saved enough, you're ready to begin developing and implementing your retirement cash flow strategy, which we discuss starting on page 19.

#### **PLANNING TIP**

**Don't forget that your retirement may last for 20 or more years.**

Allocated appropriately, the money invested in your retirement accounts could potentially continue to grow even after you've stopped working, and are no longer contributing to your retirement accounts.

## PLANNING TIP

### Take advantage of tax deferral.

Tax-deferred retirement plans offer you a powerful advantage over traditional investments: they reduce your taxable income dollar for dollar. This means you can invest more in a tax-deferred plan at the same cost.

## BRIDGING THE GAP

Maybe you haven't saved as much in your retirement plans as you should have. Perhaps during the booming markets of the '90s you focused on your taxable portfolio, and the recent market correction now has you concerned about your retirement funds. Or maybe your asset allocation has been too conservative, leaving you with less than you'd hoped for at this stage.

Whatever the reason, if you are coming up short after taking inventory of your current assets and determining your projected needs, it's time to focus on bridging the gap.

Before you panic about the state of your retirement savings, bear in mind your retirement may stretch for 20 or more years. And while this may mean your assets must last longer, it also means you have more time to let your retirement account balances work for you.

### Start by Maximizing Contributions

If you have extra money to invest and haven't maxed out your contributions to any tax-deferred plans you have, do that first. Why? Because tax-deferred retirement plans offer you a powerful advantage over traditional investments: they reduce your taxable income dollar for dollar. This means you can invest more in a tax-deferred plan at the same cost.

For example, let's say you have \$1,000 a month to invest in mutual funds for the long term, and are in the top federal tax bracket of 35% for 2006. If you invest directly in the mutual funds, it will cost you \$12,000 a year (not including taxes and fees).

If you invest that same \$12,000 through your 401(k) or other tax-deferred plan, however, your paycheck will be reduced by only \$650 a month because you will have an immediate tax savings of \$350. This adds up to an annual net cost of just \$7,800 (compared to \$12,000 with a taxable investment), and an annual tax savings of \$4,200. Your tax savings would be even greater if you also realize state tax savings.

Qualified retirement plan account balances also can increase faster than those in taxable accounts because all income taxes are deferred until distribution. When you retire, you may be able to take distributions while you're in a lower tax bracket. Or, if you have other sources of retirement income, you may be able to defer distributions until after age 70½, and then withdraw only the minimum required amount.

## Take Advantage of “Catch-Up” Contributions

If you’re a little worried about the size of your retirement savings nest egg, you aren’t alone. In 2001 Congress added new “catch-up” contribution limits to retirement plans out of concern that baby boomers hadn’t been saving enough for retirement. The catch-up contribution limits allow people who are age 50 or older to make contributions in addition to the standard allowed annual amounts to IRAs and certain employer-sponsored plans.

The catch-up contribution provisions are not mandatory for employer-sponsored plans, so not all plans may allow them. But if your company’s plan does, or if you have an IRA, taking advantage of the provision by making the extra contribution can allow you to increase the balance in your tax-deferred accounts more quickly.

### THE POWER OF TAX-DEFERRED COMPOUNDING

Roger is in the 35% federal tax bracket. For Roger, choosing to invest in a 401(k) account rather than a traditional account could make a difference of \$423,925 after taxes.

	AFTER-TAX RETIREMENT INVESTING	TAX-DEFERRED AMOUNT IN 401(k) PLAN ACCOUNT	AFTER-TAX AMOUNT OF 401(k) PLAN ACCOUNT
Amount Invested	\$ 26,000*	\$ 40,000	
Value after 10 years	43,684	88,785	\$ 57,710
Value after 20 years	73,395	197,072	128,097
Value after 30 years	123,313	437,429	284,329
Value after 40 years	207,183	970,935	631,108

\* \$40,000 before tax, minus 35% tax (\$14,000)

Assumptions: Roger is in the 35% federal tax bracket; the account earns 8.3% interest/ROI.

Source: Northern Trust. For illustrative purposes only.

## Consider a Defined Benefit Plan

If you are self-employed or a business owner, you may have spent many years putting all your extra capital into your business rather than your retirement savings. Fortunately, as the owner of your business, you can help yourself in your retirement savings goals by establishing a defined benefit plan for your company.

### RETIREMENT PLAN CONTRIBUTION LIMITS

YEAR	IRAS	ALLOWED CATCH-UP CONTRIBUTION*	401(k), 403(b) AND 457 PLANS	ALLOWED CATCH-UP CONTRIBUTION*
2005	\$4,000	\$ 500	\$14,000	\$4,000
2006	4,000	1,000	15,000	5,000

\* If you are age 50 or older, you may increase your contributions to your IRA or qualified retirement plan by the amount shown in this column.

## ASK YOUR ADVISORS

### What are the advantages of a defined benefit plan?

While defined benefit plans can be costly and complex to administer, they still offer several benefits that make them worth considering if you are a business owner:

- You can accumulate significant benefits in a relatively short period of time.
- As an employer, you can contribute (and deduct) more than under other retirement plans.
- The plan provides you with a predictable income stream during retirement.
- The plan can be used to subsidize early retirement benefits.

If you are getting close to retirement, a defined benefit plan will allow you to accumulate retirement funds faster than a profit sharing plan would. This is because contribution limits are determined actuarially based on a set future benefit and your age. For employees who are closer to retirement age, larger annual contributions would be needed to reach this savings goal. And your annual contributions to the plan typically are fully tax-deductible. The annual benefit limit for defined benefit plans is \$170,000 in 2005 and \$175,000 in 2006.

## Allocate Appropriately

Remember, you're not going to be withdrawing and spending your entire retirement savings in that first year. As with any investment, focus on your overall time frame.

Based on your health and family history, if you expect to live for 25 years after you retire, you may want to allocate your retirement savings as you would for any taxable investments you don't expect to need for a number of years. With a longer time horizon, you may feel comfortable being somewhat more aggressive because you have more time to recover from any market dips.

Taking too conservative an approach to your retirement fund allocation can expose you to risk just as too aggressive an approach would. For instance, you may think you should be investing conservatively in your retirement accounts because you want to protect that income. However, this approach could make your overall asset allocation too conservative and provide you with lower overall returns than you could otherwise realize. Taking an approach that is too conservative could even leave you exposed to the risk of losing buying power if your returns fall below inflation.

Obviously, you don't want to be too aggressive with your retirement savings – even if you are trying to make up a potential shortfall. But do talk to your advisors about finding the balance between risk and reward to help increase your retirement savings as much as possible within the risk level where you feel comfortable.

We discuss asset allocation in more detail starting on page 20. But working with a tax advisor and a financial advisor to develop an overall investment and retirement strategy will help you maximize your retirement savings potential.

## CREATING YOUR RETIREMENT CASH FLOW STRATEGY

How much cash flow do you need annually, before taxes, from all sources, to meet your retirement needs? This is probably the most important question you'll consider during your retirement planning. And now that you've reviewed your cash flow needs and sources, you're in a good position to answer this question and create a strategy that will help you meet these needs.

### What Will Your Portfolio Need to Generate?

You most likely determined your current and projected obligations based on after-tax amounts. However, most of your income during retirement won't be tax-free (except any withdrawals from your Roth IRA). You'll need to determine a before-tax number to start the cash-flow planning process. This will be your retirement cash flow target.

You'll have two types of income in retirement – income from accounts that will pay out a predetermined amount, like Social Security, pensions and annuities, and income from your personal investments. To determine how much of your target cash flow you need to come from your investment portfolios, first subtract out any retirement income you will be receiving from other sources. So, if you have a company pension in addition to Social Security, the calculation\* might look like this:

Annual Before-Tax Income Needed	\$80,000
Less: Pension	– 10,000
Less: Social Security	– 15,000
Before-Tax Portfolio Cash Flow Needed	\$55,000

### ASK YOUR ADVISORS

#### What is my retirement cash flow target?

Your retirement cash flow target is the amount of income you'll need during retirement to support the lifestyle you desire. To find this number, your advisors can help you convert your after-tax income needs to a before-tax number.

For instance, if you are in the 25% tax bracket, and have determined that you will need \$5,000 a month in retirement to meet your needs, we would calculate your before-tax needs like this:

Monthly Income Needed	\$5,000
	<u>× 12</u>
Annual Income Needed	\$60,000
	<u>÷ (1 - .25)</u>
Annual Before-Tax Income Needed	\$80,000

This is your retirement cash flow target, and will be the basis for determining an investment strategy designed to help you meet your income needs. In this example, we've determined that an annual income of \$80,000, before taxes, during retirement should meet your needs.

Source: Northern Trust. For illustrative purposes only.

\* For illustrative purposes only.

## PLANNING TIP

**Asset allocation is an important component of investment success.**

How you distribute your investments among various asset classes is important because it allows you to diversify risk and thus more safely seek higher potential return. In fact, studies show that asset allocation is the primary factor affecting both investment returns and the volatility of those returns.

Over time, different asset classes typically perform differently under the same market conditions. When stocks become volatile, for instance, bonds often perform better. Diversifying your investments among asset classes with different risk and return characteristics helps reduce overall portfolio volatility. This is important because volatility is a major source of investment risk and injects uncertainty into your planning.

Source: Based on two studies performed by Brinson and Beebower, et al, as reported in the *Financial Analysts Journal* in 1986 and 1991, and on Roger G. Ibbotson and Paul D. Kaplan, "Does Asset Allocation Policy Explain 40, 90, or 100 Percent of Performance?" *Financial Analysts Journal*, January/February 2000.

## Determining Which Assets Will Generate the Returns

Your assets typically fall into three distinct categories:

- **Tax-deferred assets.** These are the assets held in qualified plans, such as an employee stock ownership plan (ESOP) or your 401(k) or pension plans, and in nonqualified plans, such as a supplemental executive retirement plan (SERP), a deferred compensation plan or stock options. It also includes your IRA and SEP accounts and any annuities you have.
- **Taxable assets.** This would include your taxable investment portfolio.
- **Lifestyle assets.** Your homes, boats, cars, artwork and so on are all considered lifestyle assets.

Most likely, the assets you'll be looking at to generate your retirement income will fall into the first two categories (your tax-deferred and taxable investment accounts). Lifestyle assets usually are not taken into account for retirement income planning because you probably don't want to sell your home or boat to sustain your pre-retirement standard of living. However, real estate is playing an increasing role in retirement planning for affluent individuals.

The distinction between taxable and tax-deferred assets becomes important as we begin considering issues like how to take distributions from your retirement plans and IRAs. But for determining your cash flow strategy, it makes sense to consider your retirement accounts and taxable portfolio together.

## Developing a Stable Income

Like most people, you likely would prefer a stable income source during retirement. Having to depend on the whims of the market can intrude on your retirement and add anxiety you don't want – or need – to face. For this reason, when developing your retirement cash flow strategy, you'll want to consider the stability of your income sources. Relatively stable sources of retirement income include:

- Pensions,
- Dividends on stocks, and
- Interest on bonds,
- Social Security payments.
- Interest on cash and CDs,

Of course, none of these cash flow streams are completely stable – pensions can default, interest rates can rise and fall and dividends can be cut or raised – but in relation to the volatility of capital returns on stocks, they are fairly secure.

One simple way to have a relatively stable source of income during retirement would be to allocate your portfolio – including both your retirement and taxable accounts – so all of your income is coming from bonds and bond funds. But to do this and still maintain a reasonable asset allocation, you may need to have a fairly large total portfolio. If you don't have a reasonable allocation, your stable source of income may become less so if market conditions become unfavorable.

Realistically, when you determine how much you would need to have invested in bonds to generate your income needs solely from stable sources, you will discover one of three things: this allocation to bonds would be appropriate for your portfolio, it would be too high for your portfolio, or you don't have enough in your portfolio.

**Allocation to bonds is appropriate.** Using our hypothetical example in the box at right, if you had \$4 million in investable assets, an allocation of \$1.375 million to bonds would account for only 34% of your total portfolio. This would be a reasonable allocation to bonds.

**Allocation to bonds too high.** Another possible result is that the stable cash-flow calculation will show an allocation to bonds that is too high and not reasonable given your investment horizon and risk tolerance levels. For instance, if you're a 55-year-old retiree with a \$1.5 million portfolio, a \$1.375 million commitment to bonds results in an overall allocation of nearly 92% to bonds. This would leave your portfolio exposed to undue market risk and probably would not make sense in this situation.

**Not enough in portfolio.** If the calculation shows you would need an allocation to bonds that is greater than the total value of your investment portfolio, you need to make some bigger choices. For instance, you may want to consider reducing your cash flow goals (i.e., scale back on your retirement plans), postponing the start of your retirement,

#### ASK YOUR ADVISORS

##### Can I generate enough income from stable sources with my portfolio?

To determine if you have enough in your portfolio to generate all of your retirement income from stable sources, we would need to do a simple calculation.

For our illustration, we'll assume your target cash flow is \$55,000 and that bonds will generate a 4% return.

Target cash flow	\$55,000
	÷ .04
Amount allocated to bonds to meet 100% of cash flow needs	\$1,375,000

Obviously, this is a very simplistic analysis. But it will provide a starting point for creating your cash flow strategy.

Source: Northern Trust. For illustrative purposes only.

## ASK YOUR ADVISORS

### Should I consider adding private equity or hedge fund investments to my portfolio?

Private equity and hedge funds can offer another way to diversify your portfolio and potentially increase your overall returns. However, these types of investments require a high degree of financial sophistication to understand how they work.

Private equity and hedge funds also typically have a high minimum investment requirement and are considered relatively illiquid. For the right investor, however, this may be an acceptable trade-off for the potential long-term return advantages.

or investing more aggressively (thereby increasing the risk in your portfolio) in an attempt to increase the portfolio's returns.

Of course, if you have a very low tolerance for risk, you may want to increase your allocation to bonds. On the other hand, you might be a more aggressive investor and want a higher expected return as well as the tax efficiency of an all-equity portfolio. This is why it's important to consider your investment temperament when making allocation decisions.

## Diversify for Protection

As we mentioned above, it's important to balance your desire to have a stable source of income during your retirement with the need to allocate the assets in your portfolio to minimize your exposure to excessive market risk. Even a relatively "safe" investment such as bonds or cash faces risks – especially from inflation.

The ultimate goal of your asset allocation strategy should be to build an "efficient" portfolio – one that will provide you with the greatest possible return for the lowest risk based on your goals, time-frame and comfort level with different investment strategies. You also should consider how the tax implications of various investments may affect your situation.

Your retirement cash flow target will help determine the rate of return you need to aim for with your portfolio. From here, you and your advisors can work together to develop an allocation strategy among the various investment classes that will provide you with the best opportunity to reach this return within the risk level you are willing to accept.

Even though you are approaching retirement, you may want to remain open to considering a variety of investment strategies beyond a simple allocation to fixed income and cash. Remember that your retirement could last 25 years or more, so you still potentially have a long-term investment horizon for at least a portion of your portfolio.

## Considering Alternative Investments

Two of the most popular alternative investment types are private equity and hedge funds. Both have a low correlation with traditional investments, meaning they perform differently under the same market conditions. Adding alternative investment strategies to a

traditional asset mix can enhance returns and reduce the risk of your overall portfolio.

Although alternative investments may not be right for everyone, they can be appropriate for investors with significant investable assets. These are sophisticated investment strategies, so be sure to work with your financial advisor if you are interested in incorporating private equity or hedge funds into your investment portfolio.

**Private equity.** Since the mid-1990s, investments in privately held companies – a market once open primarily to larger, sophisticated institutional investors – have grown in popularity among high-net-worth individuals. Although private equity investments are relatively illiquid, they can offer your portfolio:

- **High return potential** – Over a long-term period (generally five to 10 years), private equity returns have exceeded those in the public marketplace, as represented by the S&P 500 Index, by as much as 6%.<sup>\*</sup>
- **Diversification** – Private equity performance historically has had a low correlation to the returns generated in the public marketplace.
- **Tax efficiency** – Because they are held long-term and typically exhibit very low turnover if any, private equity investments can be extremely tax-efficient.

**Hedge funds.** Hedge funds employ specialized strategies, such as arbitrage, equity hedging, leverage and short selling, in an attempt to capitalize on market inefficiencies. Some of the features that make hedge funds attractive to many investors include the following:

- Hedge funds typically pursue “absolute returns” – specific goals for positive annual return, rather than trying to outperform an index or other relative benchmark.
- Hedge funds traditionally have a low correlation with traditional investments.
- The sophisticated strategies hedge funds employ often allow them to benefit even when the market is going down.
- Investing in a hedge fund-of-funds can provide you with an even broader level of diversification than an investment in a single fund would provide.

#### PLANNING TIP

##### Consider investing in a private equity fund-of-funds.

A private equity fund-of-funds combines the diverse styles and talents of multiple fund managers. This can provide greater diversification than could be attained through a single manager or fund.

##### Retirement Alert! Don't forget to look at fees.

Hedge funds generally charge both a fixed management fee that covers portfolio management services and an incentive fee that rewards performance. These fees are higher than traditional mutual funds.

<sup>\*</sup> Source: Venture Economics and Callan Associates, December 2003.

### PLANNING TIP

**You may be able to exclude up to \$1 million in gains on the sale of your homes.**

If you are planning to sell both your principal residence and a vacation home, careful timing may allow you to exclude up to \$1 million in capital gains on the combined sales. If you are married and file a joint tax return and have lived in your principal residence for at least two years before the sale, you will be eligible to exclude up to \$500,000 in capital gains on the sale. If you then move into the vacation property for two years, you will be eligible to exclude an additional \$500,000 in gains.

### *Using Real Estate as an Income Source*

If you plan to use your investments in real estate as part of your retirement funding, several tax and legal considerations can make a difference in how much you will have available.

If you are planning to relocate or downsize your home after retirement, you can exclude as much as \$500,000 of gain if you are married and file a joint return. Single taxpayers can exclude up to \$250,000 of gain. To qualify for the gain exemption, you must have:

- Owned the home for at least two years,
- Used the home as your principal residence for at least two years in the aggregate during the five-year period prior to the sale date, and
- Not have excluded the gain on a home sale within the last two years.

If you spend time in more than one home and are considering selling one of the properties, work with your advisor to ensure that the home qualifies as your principal residence for tax purposes.

Taking advantage of this exclusion will provide you with a larger amount from the sale, which can then be invested into an income-generating investment to provide you with an income stream during your retirement.

### *Vacation Homes Offer Income Opportunities as Well*

If you own a vacation home you will no longer be using, it may also be able to provide you with a source of income during your retirement. As with the sale of a principal residence, the approach you choose to take with your vacation home can have significant tax implications and should be thought through carefully.

Perhaps the most obvious way an unused vacation property can provide you with income is by selling it and investing the proceeds in an income-producing investment. But with the strong housing market of the past few years, your property may have appreciated significantly, leaving you facing potentially large capital gains.

To minimize the taxes you'll face on the sale, consider whether one of the following strategies will work in your situation:

- **Make the home your principal residence.** If you move into the vacation home, convert it to your principal residence and live

there for at least two years, you will be eligible to exclude up to \$250,000 in gain if you are single. (If you are married and file a joint return, you may exclude up to \$500,000 in gain.) Note: if you rented the property out while you were not using it, this strategy may not be available. Be sure to discuss your options with your advisors.

- **Convert the vacation home to rental property.** If you have a vacation home you use infrequently and would like to sell it and purchase another, consider converting your vacation home into a rental property first. If you make the conversion at the beginning of the year and diligently follow the IRS's 14 day/10% personal use rules, you can then use the property in a tax-free exchange for a "like kind" property. This will allow you to defer all capital gains until you eventually sell the replacement property. If you own the replacement property until you die, your estate will receive a step-up in basis and will not owe capital gains tax on the property.

### Issues for Executives and Key Employees to Consider

If you are an executive or key employee of a larger company, you may find yourself facing decisions other retirees don't need to consider. For instance, you may have a large portion of your net worth in your employer's stock, or you may have nonqualified deferred compensation plans to integrate into your retirement strategy. As an executive approaching retirement, here are some situations you may find yourself in and some strategies to consider when creating your retirement income plan.

#### *Your Net Worth Is Mainly Held in Company Stock*

Many people who are approaching retirement or who have recently retired from a company still feel strong ties to their former employer. And for former executives who have a great deal of their net worth tied up in stock options, this can pose a dilemma: How can you balance your need to diversify with your desire to maintain involvement with the company and benefit from its future success?

If you find yourself in this situation, you may want to discuss with your advisors the possibility of developing a strategy to diversify a portion of your company stock options while still maintaining a

#### ASK YOUR ADVISOR

**Can I combine the individual gain exclusion with a tax-free exchange on my property?**

As of January 27, 2005, if you own a multi-unit property (such as an apartment complex) and live in part of it as your principal residence, you may be able to combine the gain exemption on the sale of a personal residence for the portion of the property you live in with a tax-free exchange on the remaining portion. Your advisor can help you determine if your property qualifies for this treatment.

## ASK YOUR ADVISOR

### Should I elect to recognize ordinary income when I receive restricted stock?

When you receive restricted stock, you can defer the recognition of income until your restricted stock is no longer subject to the risk of forfeiture or you sell the stock. However, it may be more beneficial to make a Section 83(b) election to recognize ordinary income when you receive the stock so you can convert future appreciation into long-term capital gains. Many factors affect whether this is the right option for you, so be sure to consult your tax advisor before making a Section 83(b) election.

substantial amount of upside potential in the stock's future appreciation. Fortunately, a number of strategies exist that can help you balance the need to diversify with your desire to minimize taxes, and that are within the context of your overall financial goals.

**Seek Expert Advice.** When developing a strategy to diversify your concentrated holding in your employer's stock, it's important to seek expert advice in evaluating the strategies available. Implementing a strategy without considering the consequences could leave you facing taxes or high fees for a plan that fails to help you meet your overall objectives. Some questions to answer when weighing your choices include:

- What percentage of your total net worth does the single stock represent?
- What degree of concentrated risk are you willing to accept?
- What is your outlook on the market in general and your stock holding in particular?
- How long do you expect to remain invested in a diversified portfolio?
- Do you qualify as an "insider" or affiliate? Is your stock restricted?
- Do you have a vested personal interest in the single stock position?
- What is your cost basis in the stock and the resultant capital gains exposure?
- What estate tax issues do you anticipate?

Answering these questions honestly will help you and your advisors create a plan that will help meet your needs.

### *Diversifying as an "Insider"*

If you are considered an insider or affiliate, you face several limitations on transactions of your company's stock. Generally, you must disclose your transactions via certain regulatory filings. You also are prohibited from making transactions during certain periods prescribed by the company.

Fortunately, strategies do exist that allow insiders to diversify a large holding of company stock. One such strategy – the variable delivery forward – is a preferred hedging tool among executives because the SEC has given sellers regulatory relief for certain restrictions under the Securities Act of 1933 specifically to facilitate executing a forward sale.

### Translating Your Target Into a Plan

Now that you’ve calculated your retirement cash flow target and worked with your advisors to create an allocation strategy for your portfolio to best achieve it, you’re ready to begin planning your retirement account distribution strategy.

### How Northern Trust Can Help

If you are holding a large concentration of a single stock, Northern Trust’s Alternative Solutions Group can help. Working with solutions ranging from exchange funds to variable delivery forwards, they can work with you to develop a strategy for managing your concentrated risk.

## SNAPSHOT OF AVAILABLE EQUITY RISK MANAGEMENT STRATEGIES

### SALE AND REINVESTMENT

<b>Advantages</b>	Creates liquidity Reduces exposure
<b>Disadvantages</b>	Capital gains tax Potential market impact

### EXTENDED-TERM SOLUTIONS

#### EXCHANGE FUNDS

<b>Advantages</b>	Achieves diversification No market impact Capital gains deferred
<b>Disadvantages</b>	Limited liquidity Selectivity of fund

#### CHARITABLE REMAINDER TRUSTS

<b>Advantages</b>	Fulfills charitable intentions Generates an income stream Creates charitable income tax deduction at the time of the grant
<b>Disadvantages</b>	Transfer of assets is irrevocable Investor does not participate in asset price appreciation

### HEDGING

#### COVERED CALL WRITING

<b>Advantages</b>	Generates income Downside risk reduced by the amount of premium
<b>Disadvantages</b>	Upside participation limited Potential liability at maturity

#### PROTECTIVE PUT BUYING

<b>Advantages</b>	Limits downside risk with some upside participation Retains dividends and voting rights
<b>Disadvantages</b>	Upfront premium payment

#### ZERO-PREMIUM COLLAR

<b>Advantages</b>	Limits downside risk with some upside participation No initial cash outlay required
<b>Disadvantages</b>	Upside participation limited Tax straddle rules apply

#### VARIABLE DELIVERY FORWARD

<b>Advantages</b>	Generates up-front proceeds Retains dividends and voting rights
<b>Disadvantages</b>	Upside participation limited Implicit borrowing costs and early termination costs

**Retirement Alert! Be aware of your plans' distribution rules.**

Many defined contribution plans, such as 401(k)s, pay you a lump sum when you retire, based on your contributions, any employer contributions, and the earnings on these amounts. It then becomes your responsibility to invest that money to ensure it will meet your needs throughout your retirement.

**ASK YOUR ADVISOR**

**Is a joint and survivor annuity a good choice for me?**

While the idea of leaving your spouse a guaranteed income after you die may sound appealing, you should consider this option in conjunction with your overall estate plan. For many affluent individuals, a joint and survivor annuity may not be the best option.

## CREATING A DISTRIBUTION STRATEGY

You've determined how much you're going to need in retirement to support your desired lifestyle and worked with your advisors to position your portfolio to best help you achieve your income goals. Your next step is to create your distribution strategy.

Determining what to withdraw from which of your accounts, and when it makes the most sense to make those withdrawals is just as important as any of the steps you've taken so far. Your withdrawal strategy can affect your tax situation, estate planning and, potentially, the growth of your portfolio.

### Withdrawal Rules Form the Framework

The money you have invested in any IRAs and qualified retirement plans through your employer is subject to very specific regulations governing distributions. These will provide the basic framework of your distribution plan.

**IRA Withdrawals.** You can begin taking withdrawals from both traditional and Roth IRAs when you reach age 59½. Any withdrawals you take before age 59½ are subject to a 10% early withdrawal penalty. Money withdrawn from a Roth IRA can be tax-free.

Withdrawals from a traditional IRA are taxed as ordinary income. After age 70½, you must begin taking required minimum distributions from a traditional IRA (see page 30), which are also taxed as ordinary income.

There is an exception to the 10% penalty for early withdrawals: taking a series of substantially equal payments. These payments are calculated by your life expectancy (or the joint expectancy of you and your beneficiary) using one of three methods: minimum distribution, amortization or annuitization.

These payments must be made to you at least once a year and must continue for at least five years or until you reach age 59½, whichever comes later. Failing to take all of the required payments will subject you to a 10% penalty retroactively on all payments received before you turned 59½.

**Employer-sponsored plans.** You can begin taking penalty-free distributions from your qualified retirement plans, such as 401(k), 403(b) or 457 plans, when you reach age 59½. If you retired from the company running the plan on or after you turned 55, you can start taking penalty-free distributions when you retire. Money withdrawn from employer-sponsored plans (other than any after-tax contributions you may have made to the plans) is taxed as ordinary income.

While every plan offers a variety of choices, you generally must decide whether to receive an outright lump-sum distribution or annuity payments, or to place the assets in a rollover account.

- **Lump-sum distribution.** With a lump-sum distribution, you will pay income taxes on the entire balance of your retirement account at once. Typically, your employer will withhold 20% of the account balance to cover taxes, and you will pay (or be credited) the difference when you file your income tax return for the year. You can then take this amount and invest it in your taxable investment account. The downside of a lump-sum distribution is the immediate taxation leaves you with less to invest initially, and you lose the benefit of tax-free compounding.
- **Lifetime annuity.** Some plans give you the option of taking your plan assets as a lifetime annuity. An annuity pays you a monthly benefit for your lifetime or for the lifetimes of you and your surviving spouse. This option guarantees a lifetime benefit; however, if it pays a fixed amount, inflation may reduce its purchasing power. Under most plans, the original monthly payment is determined actuarially based on your age (or your and your spouse's ages if you've chosen a joint annuity). Annuities lack the flexibility to deal with special cash flow needs and emergencies. Also, this option leaves nothing to future beneficiaries.
- **Rollover.** Rolling over your lump-sum distribution provides you with direct access to and control over your money, with the added benefit of deferring taxes. Funds can be transferred to a rollover IRA or another qualified plan. (We talk more about rollover IRAs on page 30.)

**Retirement Alert! Be cautious about consolidating IRA accounts if bankruptcy is a concern.**

Legislation passed in early 2005 provides unlimited bankruptcy protection to IRAs that contain rolled over retirement plan assets. IRAs you've made contributions to, however, are limited to only \$1 million in bankruptcy protection. Because of this, if you are concerned about bankruptcy, you may want to reconsider plans to consolidate your rollover and contributory IRA accounts.

## PLANNING TIP

### Understanding Your Required Minimum Distributions Helps in Cash Flow Planning

You must begin taking required minimum distributions from most retirement plans and IRA accounts after you turn 70½. The required minimum distributions are based on your current age and the account balance from the prior year-end, divided by the number found in the table below. So, if you are 79 today, and the balance in your retirement account at the end of 2005 was \$1.5 million, you would be required to take distributions totaling at least \$76,923 in 2006.

#### Uniform Distribution Table

Age	Divisor	Age	Divisor
70	27.4	93	9.6
71	26.5	94	9.1
72	25.6	95	8.6
73	24.7	96	8.1
74	23.8	97	7.6
75	22.9	98	7.1
76	22.0	99	6.7
77	21.2	100	6.3
78	20.3	101	5.9
79	19.5	102	5.5
80	18.7	103	5.2
81	17.9	104	4.9
82	17.1	105	4.5
83	16.3	106	4.2
84	15.5	107	3.9
85	14.8	108	3.7
86	14.1	109	3.4
87	13.4	110	3.1
88	12.7	111	2.9
89	12.0	112	2.6
90	11.4	113	2.4
91	10.8	114	2.1
92	10.2	115+	1.9

## Required Minimum Distributions

IRS regulations generally require that you begin taking “required minimum distributions” from traditional IRAs and many employer-sponsored plans when you reach age 70½. This is an important consideration when developing your distribution plan – especially if you would not otherwise need the income from those plans. Failing to take the required minimum distribution from each account will result in penalties of 50% of the amount you should have withdrawn and didn’t.

If your only beneficiary is your spouse who is 10 or more years younger than you, you can calculate your required minimum distribution based on the joint-life table, which will result in a smaller required minimum distribution. Distributions made after your death would be based on your designated beneficiary’s life expectancy.

If you turn 70½ in 2006, you can defer your first required minimum distribution until April of 2007. Doing this, however, means you will be required to take two distributions in 2007 – a distribution in April of your 2006 amount and again before December 31 for your 2007 distribution. Your advisors can help you determine if it makes sense for you based on your tax situation and personal circumstances.

## Consider Consolidation

Today, it’s typical for someone who is approaching retirement age to have worked for several employers, often accumulating a number of employer-sponsored retirement plans in the process. You also may have one or more IRAs. As you near retirement, you must make many important decisions and elections for each of these accounts – decisions that have lasting implications. You may want to consider consolidating these accounts into a single rollover IRA or IRA rollover trust to simplify the decision-making process and your investment strategy. It is no longer necessary to have several IRAs to hold different types of contributions.

## Simplify Your Retirement Finances

Keeping your funds in a single IRA can help simplify your distribution planning. Some of the advantages include:

- **Simplified tracking.** It’s easier to monitor your retirement savings and account earnings when your money is all in one

place. With all of your retirement savings in one account, you'll receive a single statement, rather than having to track statements from multiple sources.

- **Lower costs.** You may be able to reduce the costs of maintaining multiple accounts by consolidating them.
- **Easier distribution calculations.** When you reach age 70½ and have to begin taking required minimum distributions from your retirement accounts and IRAs, it's often easier to calculate this amount from a single account.
- **Continued tax deferral.** Rolling over money from your employer-sponsored plan rather than taking a lump-sum distribution and investing it in a taxable account allows you to continue to benefit from tax-deferred growth on those assets.

Both a consolidated IRA and an IRA rollover trust will allow you to combine assets from a variety of plans, including 401(k), 403(b), governmental 457, 401(a) and Simplified Employee Pension plans, into a single account. In most cases, you can include existing IRAs as well.

### *Rollover Trusts Offer Additional Benefits*

Choosing an IRA rollover trust gives you some additional benefits compared to simply consolidating your accounts into a single IRA – including the peace of mind from working with a professional trustee who has fiduciary duties to you and your heirs.

In an IRA rollover trust, the trustee will work with you to establish an investment strategy for your retirement assets that reflects your investment objectives, risk tolerance and cash flow needs. The trustee also can manage the complex process of determining your required minimum distributions, and can monitor withdrawals to ensure you are in compliance with those requirements.

An IRA rollover trust also offers protection should you become disabled or unable to manage your financial affairs. In these circumstances, the trustee has the authority to apply your retirement assets for your benefit, and can continue to manage the funds in the trust to help meet your needs and objectives.

And finally, with an IRA rollover trust, you can more easily integrate retirement plan assets into your overall estate plan by designating beneficiaries and the manner and rate of distributions to them.

### **PLANNING TIP**

#### **Direct Rollovers Minimize Tax Consequences**

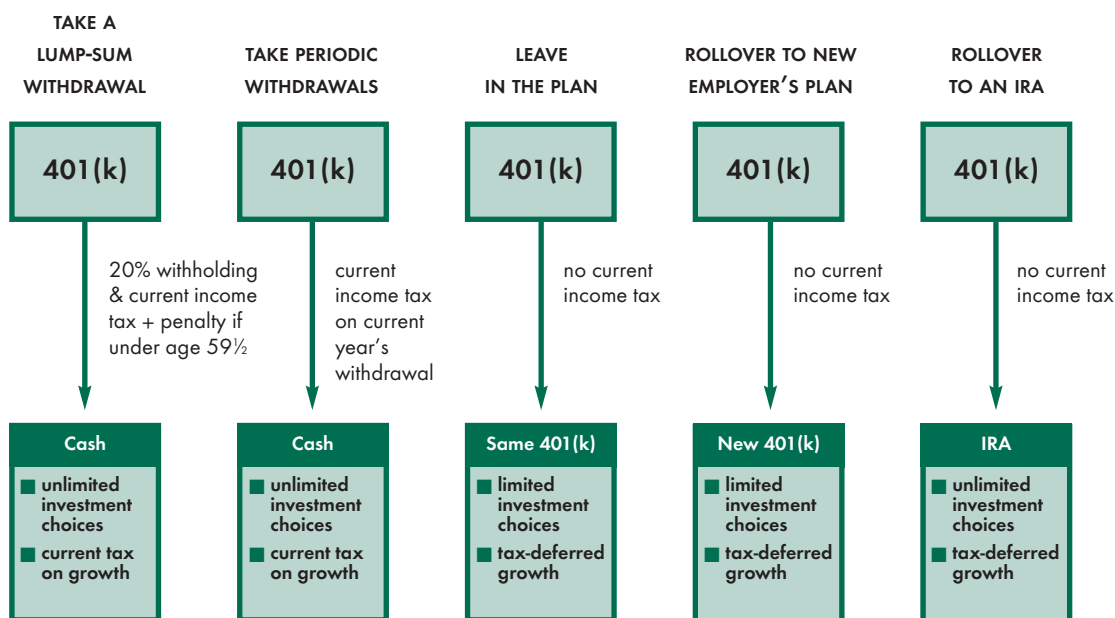
If you decide to consolidate your retirement plans into one account, you will need to decide whether to make a direct or indirect rollover from each account.

Many people prefer to make a direct rollover. Because the check is made payable to the new IRA custodian or trustee, no tax consequences apply. With an indirect rollover, the check is made payable to you, generally with taxes withheld. You are then responsible for forwarding the funds to the new custodian or trustee within 60 days. In addition to having the taxes withheld, if you are younger than 59½, you may also pay a penalty on any amount you don't transfer into the new IRA.

## Pension Plans May Be Eligible for Rollover Too

Even though a pension plan is set up to provide a specific annual benefit throughout retirement, you may be able to take a lump-sum distribution equal to your entire vested balance if the plan permits. As with a 401(k) lump-sum distribution, if you directly roll over the lump sum to a traditional IRA (or another qualified plan), you won't owe current taxes and can enjoy tax-deferred growth on the balance.

### COMPARING OPTIONS WHEN CONSIDERING RETIREMENT PLAN CONSOLIDATION



Source: Northern Trust. For illustrative purposes only.

## Determining Which Accounts to Use for Withdrawals

As we mentioned earlier, the decision as to whether to take withdrawals from your taxable or tax-deferred accounts (or both) should be based on several considerations including your age, tax situation and the size of your portfolio. Each of these plays a role in developing a withdrawal strategy that will not only meet your retirement cash flow needs, but will also allow you to fulfill your estate planning and charitable giving goals.

## Your Current Age Will Be a Factor

While your withdrawal strategy during retirement should be developed specifically to meet your cash flow needs, several components will vary based on your age.

**Before Age 59½.** If you retire before age 59½ and the overwhelming majority of your assets are in qualified plans, you may want to consider a direct withdrawal of cash or qualified employer securities to bridge any gap between your retirement date and the date you reach age 59½. As long as you take a direct distribution from the plan, are over age 55 and are no longer working, you will not be subject to the 10% early withdrawal penalty. You also can take penalty-free withdrawals from your IRAs prior to age 59½ as long as they are in the form of “substantially equal” payments (see page 28 for more information).

With all of these options, it is best to work with your advisors to determine whether the advantages of being able to make early withdrawals outweighs the disadvantages of foregoing the continued tax-deferred growth these accounts offer.

You can begin taking withdrawals from any deferred compensation you have when you retire, regardless of age. This makes a deferred compensation plan a good source of early retirement income. If you don't have a deferred compensation plan or need more income than it will provide, it may be better to take withdrawals primarily from your taxable accounts during this period.

**Between Ages 59½ and 70½.** Your withdrawal options during this period are the most flexible. You are eligible to begin taking distributions from your retirement plans without penalty, but generally are not required to do so. Your withdrawal strategy should be based on tax considerations, your estate planning goals and the size of your overall portfolio. Typically, however, it makes sense to take withdrawals from your taxable portfolio as much as possible during this period to allow the assets in your retirement accounts to continue to grow tax-deferred as long as possible.

### PLANNING TIP

#### Consider your options before rolling employer stock into an IRA.

If you have a large amount of highly appreciated employer stock that will be distributed to you from a qualified retirement plan, you may want to consider receiving the stock itself instead of rolling it into an IRA because:

- You will owe income taxes only on the shares' value when they were added to your retirement plan (that is, the stock's cost basis).
- If you were born before 1936, you may be able to use forward averaging techniques to minimize the income taxes due on the shares' cost basis. (Forward averaging is not available, however, if you roll over any part of your lump-sum distribution.)
- If you withdraw the stock before age 59½ (or age 55 if you are terminating employment), the 10% penalty applies only to the stock's cost basis.
- You can continue to defer taxes on all the appreciation that accrues from the time the stock was initially purchased until you sell the shares. When you sell them, you will pay long-term capital gains tax instead of the possibly higher ordinary income tax rate that would apply if the stock were distributed out of an IRA.
- When you die, your heirs will receive a step-up in cost basis on any appreciation that occurred after you left the retirement plan.
- You do not have to start taking withdrawals at age 70½ and you can deduct losses.

### PLANNING TIP

#### **If your income-tax bracket drops, consider taking IRA withdrawals.**

In some circumstances, taking a withdrawal from your IRA may make more sense than leaving the money untouched to grow. If after retirement your income-tax bracket drops and you expect that it will go up again, you may pay less in taxes by taking the withdrawal now than by deferring the taxes.

Your tax advisor can help you determine whether taking a withdrawal makes sense.

**After Age 70½.** Your withdrawal strategy at this stage will be built around the required minimum distribution rules. You should start by looking at how much you must take out from any traditional IRAs and qualified retirement plans you have. (Roth IRAs do not have required minimum distributions.) If you need additional income beyond this amount, consider your estate planning and charitable giving goals, as well as your tax situation.

### *Taxable vs. Tax-Deferred Considerations*

If you have investments in both taxable and tax-deferred accounts, how do you determine where to withdraw from first? This will depend in part on your tax situation, and your estate planning and charitable giving goals.

Taxes are only one aspect to consider when developing your withdrawal strategy, but understanding the rates can be helpful in your planning.

- Qualified distributions from a Roth IRA are tax-free because you already paid income taxes on your contributions.
- Typically, investments in your brokerage accounts will be taxed at the 15% capital gains rate, as long as you've held them for at least a year.
- Withdrawals from a traditional IRA will be taxed at your ordinary federal income-tax rate, which currently could be as high as 35%. Any applicable state taxes would also apply.

From a strict tax perspective, if you have a rollover IRA, a Roth IRA and a taxable portfolio it typically makes sense to withdraw money from your taxable accounts first. Why? Because the longer you are able to leave assets in your IRAs, the more time your money has to grow tax-deferred (or tax-free in the case of a Roth IRA).

After your taxable accounts, you probably will want to begin taking withdrawals from your traditional IRA, leaving your Roth IRA untouched for as long as possible – especially if you are planning to leave assets in your retirement plan to your heirs.

Unlike the traditional IRA, which requires that you begin taking distributions when you turn 70½, a Roth IRA has no required distributions. This means, if you don't need the money in that account to

meet your cash-flow needs, it can continue to grow indefinitely. If you leave your Roth IRA to your spouse when you die, he or she also will not be required to take distributions, which can further extend the period during which the account can grow before your children ultimately inherit and must begin taking distributions.

However, other concerns, such as your basis in the stocks held in your brokerage accounts, health considerations, estate planning goals, and your charitable giving intentions, may outweigh these general tax considerations. For this reason, it's important to work with your advisors to make sure your distribution strategy takes into account your specific circumstances.

### Coordinating With Your Estate Planning Goals

Some estate planning strategies are more effective when you consider them in the context of your retirement income planning strategy. Considering the two in conjunction is particularly useful if you have significant savings in your qualified retirement plans or IRA that you are planning to leave to your heirs or charity. The rules governing retirement plan distributions could have unintended consequences if you don't consider them in your planning.

### Beneficiary Choices Affect Estate Planning Outcomes

For instance, you may be considering establishing a trust for your heirs as part of your estate plan. While trusts offer many estate-planning benefits, exercise caution when naming a trust as beneficiary of a retirement plan. Why? Because after your death – assuming you die after you are required to begin taking distributions – required minimum distributions will be taken out at a rate based on the oldest trust beneficiary's life expectancy.

If you named your parent, for instance, to receive even a small portion of the trust, distributions from the plan will be taken over the parent's life expectancy. This means distributions will be made more rapidly, reducing the opportunity for tax-deferred growth for any of the younger beneficiaries.

Likewise, if you are planning to use a portion of the assets in your retirement plan for charitable gifts, a trust may not be the best beneficiary. Because a charity is a nonindividual beneficiary, the IRS will deem the retirement plan as having no designated beneficiary. As a result, the balance of the plan will be distributed over a shorter

#### PLANNING TIP

##### Consider leaving IRA assets in deceased spouse's name.

If you are the beneficiary of your spouse's IRA and are younger than 59½, you can withdraw assets from your spouse's IRA without paying the 10% early distribution penalty. To do this, however, you must leave the IRA in your deceased spouse's name.

When you reach age 59½, you may also want to consider rolling the IRA over into your own IRA to continue the tax-deferred treatment.

##### Retirement Alert! Your will doesn't affect your IRA beneficiary designation.

Regardless of what your will says, who inherits your IRA will be dictated by the beneficiary designation you made when you opened the account. If you haven't done so recently, you may want to review your beneficiary designations for your IRAs to make sure they are in keeping with your current estate plan.

period. Again, this may have the unintended consequence of depriving your heirs of tax-deferred growth and distributing assets to them more quickly than you intended.

Allowing the plan's assets to be used to pay estate tax, debts and expenses could also allow the IRS to argue that the estate – a nonindividual – is a beneficiary of the trust. Again, this would trigger a shorter distribution period for the trust.

### *Planning Options for Bequeathing Retirement Savings*

When considering how to integrate your estate planning and retirement planning goals, you may want to consider the advantages of a Roth IRA. If you plan to leave the money in your retirement accounts untouched for a number of years, bequeath retirement account assets to your heirs or continue working beyond “normal” retirement age, a Roth IRA conversion may be worth considering.

If you plan to continue working beyond the typical retirement age, a Roth IRA can allow you to continue to make contributions after age 70½ (the cut-off point for contributions to traditional IRAs). Roth IRAs also are not subject to the required minimum distribution rules, meaning you can leave the account balance untouched during your lifetime, leaving a larger nest egg for your heirs.

To qualify for the conversion, your adjusted gross income, not including the conversion amount or required minimum distributions (together with your spouse's adjusted gross income if you are married), must be less than \$100,000. You would pay income taxes on the amount converted, but because the contribution to the Roth IRA is made after taxes, the growth of assets in the account is not taxed. If you plan to leave the assets in the account for a number of years, this could be significant. If you're still working and your income is too high now to qualify for a conversion, keep in mind that you may be able to qualify after you retire.

### **Charitable Giving and Your Retirement Plans**

One of the greatest advantages of wealth is that it enables you to support causes and programs that are of particular importance to you and your family. Formulating your charitable intentions is a

#### **Retirement Alert! Avoid Roth IRA conversion confusion.**

You cannot roll assets directly from an employer-sponsored plan to a Roth IRA. You would first need to roll the plan assets to a traditional IRA, then convert the IRA to a Roth IRA. Converting a traditional IRA to a Roth does have tax implications, which you should discuss with your tax advisor before making a decision.

If you plan to leave your IRA to your children and want them to have the benefits of a Roth IRA, you must do the conversion before your death. Your children will not be able to convert an IRA after they've inherited it.

personal and rewarding experience. And tax laws also provide financial incentives for making charitable gifts.

Regardless of whether your motives for giving are personal or financial, it makes sense to carefully consider how you plan to donate during your retirement and as part of your estate plan.

### *Charitable Donations*

If you are inclined toward charitable giving, doing so with an IRA can offer you additional benefits. Although you currently must take distributions and pay the applicable taxes before making a lifetime gift to charity, this strategy may make sense from a tax perspective – at least until the estate tax is fully repealed in 2010. And, because your IRA is subject to estate tax and withdrawals are taxed as income, donating IRAs to charity may reduce both income and estate taxes.

Taxes can take more than half of a traditional IRA's assets when left to someone other than your spouse. Donating an IRA to charity instead can be a potent planning option because you can receive significant tax leverage in exchange for the gift. Two gifting possibilities exist:

- 1. Lifetime charitable gifts.** This involves taking a taxable distribution from your IRA before donating to charity. The gift, however, is deductible up to 50% of adjusted gross income for gifts to public charities and operating private foundations, or up to 30% for nonoperating private foundations. This helps to offset income taxes the IRA distribution triggers. And, once you make the gift, the assets are no longer part of your estate, which will help minimize your estate tax burden when you die.
- 2. Testamentary gifts.** These gifts allow you access to IRA funds during your lifetime; at death, the remainder will pass to charity, and 100% of the gift will escape income taxation and also qualify for the estate tax charitable deduction. As a result, in a large estate where more than 65% of the IRA value could be lost to double taxation, the real cost of giving away one IRA dollar to charity is effectively 35 cents.

#### **PLANNING TIP**

**If you are age 70½ or older, qualifying for a Roth IRA conversion is now easier.**

If you are 70½ or older, your required minimum distribution from your traditional IRA will not be counted as income in calculating whether you are eligible for a Roth IRA conversion.

## RETIRING WITH PEACE OF MIND

Creating a strategic plan for your retirement years – whether retirement is just around the corner or off on the horizon – is vital to achieve your goals. It also will help you face retirement with peace of mind.

This guide has highlighted many of the issues and concerns retirees often face, and also has provided potential solutions. Working through these issues with your advisors can help you create a strategy for generating a stable cash flow that will allow you to have the retirement lifestyle you want.

If you have any questions about your retirement savings, or would like help developing your own retirement strategy, please call us. The experts at Northern Trust would be happy to work with you and your advisors to develop a plan for your retirement years.

2005 - 2006 IRS COST-OF-LIVING ADJUSTMENTS  
FOR PENSION PLANS & IRAS

<b>IRS LIMITS</b>	<b>2005</b>	<b>2006</b>
<b>DEFINED CONTRIBUTION PLANS ANNUAL ADDITION LIMITS</b> (Profit Sharing, Money Purchase and Keogh plans)	\$42,000	\$44,000
The combined maximum employer/participant contribution is up to 100% of a participant's compensation for an incorporated employer and 100% of earned income if the employer is unincorporated (e.g., self-employed), not to exceed \$42,000 in 2005, and \$44,000 in 2006. Note: While a self-employed person technically could contribute up to 100% of his or her earned income (up to \$42,000 in 2005 and \$44,000 in 2006), he or she only could deduct up to 20%.		
In 2005, individual participants in 401(k) and 403(b) plans are limited to \$14,000 in pretax deferrals (plus an additional \$4,000 catch-up contribution if they are age 50 or older). In 2006, individual participants are limited to \$15,000 in pretax deferrals (plus an additional \$5,000 catch-up contribution if they are age 50 or older).		
<b>401(k) &amp; 403(b) INDIVIDUAL PARTICIPANT PRETAX DEFERRAL</b> Plus: Catch-up for individuals age 50 or older	\$14,000 Plus \$4,000	\$15,000 Plus \$5,000
<b>INDIVIDUAL 401(k) CONTRIBUTION</b>	\$42,000	\$44,000
<b>LIMITATION ON ANNUAL BENEFIT PAYABLE FROM DEFINED BENEFIT PENSION PLANS</b>	\$170,000	\$175,000
<b>SIMPLE IRA CONTRIBUTION</b> Plus: Catch-up for individuals age 50 or older	\$10,000 Plus \$2,000	\$10,000 Plus \$2,500
<b>SEP IRA CONTRIBUTION</b>	\$42,000	\$44,000
Maximum employer contribution, if the employer is incorporated, is up to 25% of compensation not to exceed the annual limit. If the employer is unincorporated (e.g., self-employed) the maximum employer contribution is up to 20% of earned income, not to exceed the annual limit.		
<b>TRADITIONAL IRA CONTRIBUTION</b> Plus: Catch-up for individuals age 50 or older	\$4,000 Plus \$500	\$4,000 Plus \$1,000
<b>ROTH IRA CONTRIBUTION</b> Plus: Catch-up for individuals age 50 or older	\$4,000 Plus \$500	\$4,000 Plus \$1,000
Starting in 2005, if you are 70 ½ or older, the required minimum distribution from your traditional IRA, although taxable, will not be counted as income when calculating whether or not you are eligible for a Roth IRA conversion. To qualify for the conversion, your adjusted gross income, not including the conversion amount, must be less than \$100,000. Thanks to a section of the Federal Restructuring and Reform Act of 1998, Roth IRAs will be more attractive to affluent retirees who want to pass assets to their heirs. You should consult with your financial and estate advisors to see if a conversion from a traditional IRA to a Roth IRA makes sense.		
<b>OTHER LIMITS</b>		
<b>HIGHLY COMPENSATED EMPLOYEE COMPENSATION</b>	\$95,000	\$100,000
<b>SOCIAL SECURITY TAXABLE WAGE BASE</b>	\$90,000	\$94,200

## GLOSSARY

**401(k) Plan** An employer-sponsored qualified deferred compensation retirement plan that allows employees to have a portion of their compensation paid to a tax-deferred account. The maximum employee contribution for 2006 is \$15,000 with a combined employer and employee contribution limit – including matching contributions – of \$44,000.

**Alternative Investment** An investment other than real or personal property that has a low correlation with traditional investments (stocks, bonds, cash and cash equivalents). This means they perform differently under the same market conditions. Two of the most common types are hedge funds and private equity.

**Bond** A debt instrument that is a “promise to pay” issued by corporations, federal and state governments and municipalities to raise capital. The bond issuer promises to pay the holder of the bond the principal amount of the loan when the bond matures and a fixed rate of interest periodically during the term of the bond.

**Bull Market/Bear Market** Terms frequently used to describe the outlook for short- and long-term market performance: bull refers to the belief that stock prices are likely to rise; bear refers to the expectation that prices will decline.

**Cash** Money kept in bank accounts, money market funds and certificates of deposit that are generally free from the risk of losing principal. As a result, the return typically is low. If it’s below the inflation rate, over time spending power is lost.

**Certificate of Deposit (CD)** A long-term, FDIC-insured savings vehicle that typically offers a higher interest rate than a savings account in exchange for holding the money for a set period of time – the longer the period, the higher the interest rate.

**Defined Benefit Plan** An employer-sponsored qualified deferred compensation retirement plan that promises a specific benefit the employee will receive at retirement, commonly referred to as a “pension.” The company’s contributions are calculated actuarially based on the amount necessary to provide that benefit. For 2006, the maximum benefit a pension can provide is the lesser of \$175,000 or 100% of the average amount of the employee’s three highest consecutive years of compensation. Generally, only the company contributes, not the employee.

**Defined Contribution Plan** An employer-sponsored qualified deferred compensation retirement plan that allows a certain amount or percentage of funds to annually be paid to a tax-deferred account. Common defined contribution plans include 401(k) plans, profit sharing plans, money purchase plans and Keogh plans.

**Equity** A share of ownership in a company, also referred to as stock. Equities are divided among various categories, such as by size (large capitalization vs. mid-cap vs. small-cap), type of return (growth vs. income), and origin (domestic vs. international).

**Keogh Plan** A qualified deferred compensation retirement plan set up by someone self-employed. The plan can be a defined contribution plan (in the form of a profit sharing or money purchase plan) or a defined benefit plan. The 2006 contribution limit for a defined contribution Keogh is the lesser of \$44,000 or 100% of compensation. The limit for a defined benefit Keogh is a future benefit of the lesser of \$175,000 or 100% of earned income.

**Money Purchase Plan** An employer-sponsored qualified deferred compensation retirement plan that requires annual employer contributions to a tax-deferred account in accordance with the plan’s formula. The contributions are pretax and the maximum contribution is 25% of compensation. Generally, only the company contributes, not the employee.

## GLOSSARY

**Mutual Fund** An investment company that enables investors to pool their funds in order to invest in a managed portfolio of securities.

**Pension Plan** An employer-sponsored qualified deferred compensation retirement plan that promises a specific benefit the employee will receive at retirement, technically called a defined benefit plan. The company's contributions are calculated actuarially based on the amount necessary to provide that benefit. For 2006, the maximum benefit a pension can provide is the lesser of \$175,000 or 100% of the average amount of the employee's three highest consecutive years of compensation. Generally, only the company contributes, not the employee.

**Profit Sharing Plan** An employer-sponsored qualified deferred compensation retirement plan where an employer's annual contributions to a tax-deferred account for the benefit of the employee are discretionary, based on the employer's annual financial results. The contributions are pretax and the maximum contribution is 25% of compensation. In addition, the plan may have a 401(k) component to allow for employee contributions.

**Restricted Stock** Stock typically given to a key employee in which he or she becomes vested over a set period. If the employee leaves the company before vesting, he or she forfeits the stock. Because of this risk of forfeiture, income recognition is deferred until the restricted stock no longer is subject to that risk or the stock is sold.

**Rollover IRA** A special IRA that is established specifically for funds distributing from a tax-qualified retirement plan. As in the case of a traditional IRA, funds are not subject to tax until they are withdrawn from the account.

**Roth IRA** A retirement account an individual can set up to save money for retirement tax-free – no tax will be due on qualified distributions. The maximum contribution for 2006 is \$4,000, less any traditional IRA contributions, though income limits also apply. Roth IRA holders age 50 or older can contribute an additional \$1,000. The contributions are not tax-deductible.

**Simplified Employee Pension (SEP)** A qualified deferred compensation retirement plan set up by an employer, including someone who is self-employed, similar to a defined contribution Keogh plan but with simpler documentation and filing requirements. The 2006 contribution limit is the lesser of \$44,000 or 25% of compensation (special rules apply for self-employed limits).

**Social Security** A federal benefits program for retirees, as well as surviving spouses and minor children, and the disabled. The amount of payment a retiree receives depends on such factors as the credits earned from paying FICA taxes and retirement age.

**Stock** A share of ownership in a company, also referred to as an equity. Stocks are divided among various categories, such as by size (large capitalization vs. mid-cap vs. small-cap), type of return (growth vs. income), and origin (domestic vs. international). Return may come from dividends or from selling the stock at a gain.

## GLOSSARY

**Stock Option** The opportunity to buy a set number of shares of stock in the future at the market price of the stock at the time the option is granted. Options come in two forms: incentive stock options (ISOs) and nonqualified stock options (NQSOs). The main difference between the two is how they are taxed. ISOs create no tax liability when they are exercised (except a preference if the owner is subject to the alternative minimum tax). Tax is owed only when the stock purchased via the exercise is sold at a gain. NQSOs do create tax liability when they are exercised, on the difference between the exercise price and the fair market value.

**Traditional IRA** A retirement account an individual can set up to save money for retirement tax deferred. The maximum contribution for 2006 is \$4,000 and IRA holders age 50 or older can contribute an additional \$1,000. These amounts are deductible if the individual's income doesn't exceed specified limits or he or she doesn't also participate in an employer-sponsored qualified deferred compensation retirement plan.



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