



What You Should Know About...

# Retirement Planning

- ▶ EMPLOYER PLANS
- ▶ CALCULATING YOUR NEEDS
- ▶ INVESTMENTS DECISIONS



No matter who you are or how much money you have, you're probably hoping to enjoy a financially secure retirement. Your retirement might be a distant, long-term goal—or it might feel as if it's right around the corner. Either way, with a little planning, determination and some discipline, you can take the necessary steps to help you retire in comfort. You'll find there are plenty of tools you can use to make the most of your efforts.

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# Funding your retirement

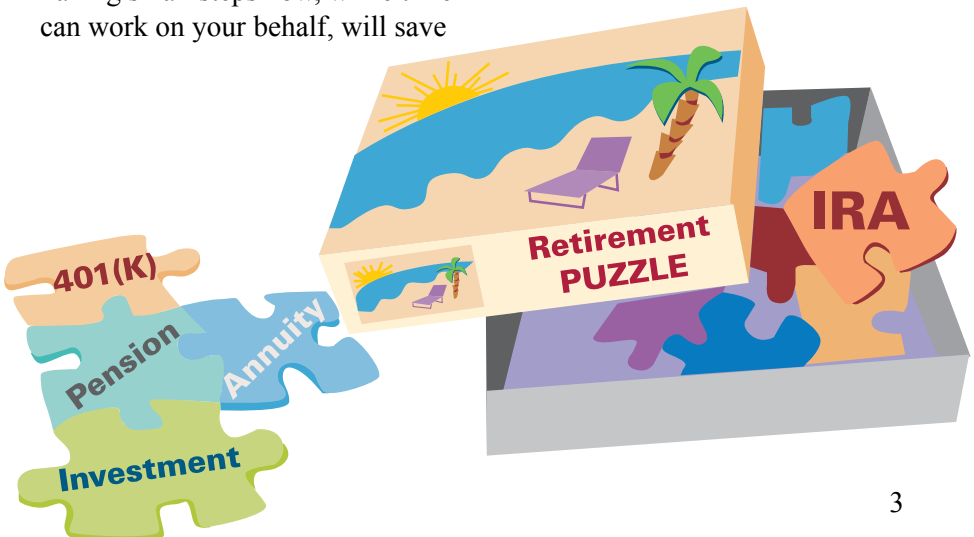
When you retire, you'll still need to support yourself. How will you manage when you're not receiving a paycheck? Social Security will likely cover some of your costs. You may have a pension from your employer. But those benefits alone will probably not be enough to let you live the way you'd like to in your retirement years. To help ensure a financially secure retirement, you'll need a plan for putting some of the money you're earning now into savings and investment accounts for the future.

Even if you're a long way from reaching retirement, and your primary goals are buying a home or paying for your children's education, you'll want to begin retirement planning as soon as you can. Taking small steps now, while time can work on your behalf, will save

you a lot of anxiety later, when you find yourself closer to retirement.

## Compound earnings

Time is a crucial element when it comes to building a retirement account—and the more time you have, the better. That's because of **compounding**, or the way earnings accumulate when you reinvest them. For example, if, one year, you earn an 8% return on \$10,000, your new total is \$10,800. If you earn another 8% the following year, the new base amount of \$10,800 earns \$864, and your balance grows to \$11,664. Because your earnings have the potential to generate more earnings, the longer the process continues, the bigger impact each dollar has. In fact, after 30 years earning 8% annually, your \$10,000 could be worth \$100,627 before taxes.



## The power of compounding

To take maximum advantage of the power of compounding, you'll want to start saving for the future early. The chart shows the results of two investors, one who begins saving at 25 and another who waits until 35.

Investor A sets aside \$3,000 a year from the time he's 25 to the time he's 35. Over those ten years, he puts a total of \$30,000 into that account, earning 5% interest that's compounded annually.

Investor B also sets aside \$3,000 a year from the time he's 35 to the time he's 50, and earns the same 5% annually compounded interest. Over those 15 years he puts away \$45,000, or 50% more than Investor A.

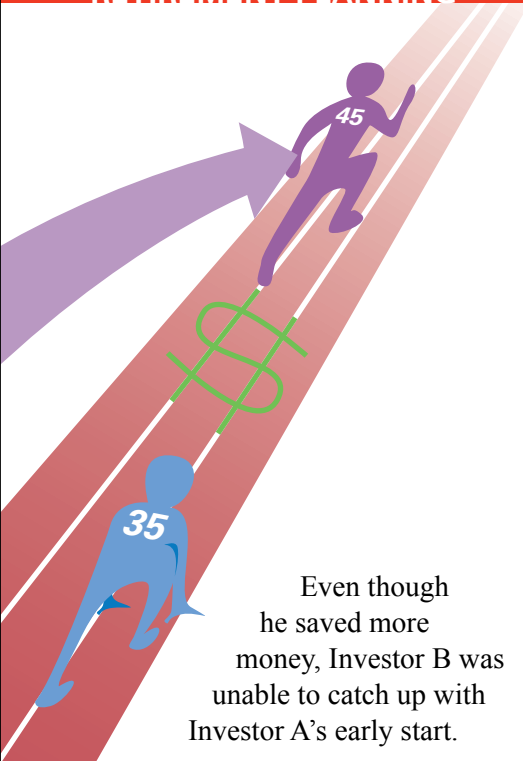
Compare what each has at the age of 50.

Age	Investor A	Investor B
25	\$3,000	
26	\$6,300	
27	\$9,765	
28	\$13,403	
29	\$17,223	
30	\$21,235	
31	\$25,446	
32	\$29,869	
33	\$34,512	
34	\$39,388	
35	\$41,357	\$3,000
36	\$43,425	\$6,300
37	\$45,596	\$9,765
38	\$47,876	\$13,403
39	\$50,270	\$17,223
40	\$52,783	\$21,235
41	\$55,423	\$25,446
42	\$58,194	\$29,869
43	\$61,103	\$34,512
44	\$64,159	\$39,388
45	\$67,367	\$44,507
46	\$70,735	\$49,882
47	\$74,271	\$55,527
48	\$77,986	\$61,453
49	\$81,885	\$67,675
50	\$85,979	\$74,209

### A word to the wise

Even the best plan can't guarantee you'll meet your goals. Things happen that you can't predict. But making no plan at all leaves everything to chance.





Even though he saved more money, Investor B was unable to catch up with Investor A's early start.

## Planning ahead

Part of planning for retirement is calculating how much you'll need to support yourself and the people who depend on you. As a rule of thumb, you can estimate that

you'll need about 80% of your pre-retirement income to maintain your standard of living. And the amount you need will increase over time due to inflation.

**80% of pre-retirement income**

If you're close to retirement, that amount should be fairly easy to calculate. But if you're many years from retiring, how can you tell what you'll need? One way is to use a retirement planning calculator that takes a number of factors, such as inflation and projected wage increases, into account.

### Questions to ask

You'll need to identify the different sources of income you know you'll have:

- Will you be receiving a **pension** from your employer? Do you know how it will be calculated?
- Do you save money in an employer sponsored **retirement savings plan**? How much have you accumulated? What will this be worth when you're ready to retire?
- How much can you expect from Social Security? Check the annual statement that the SSA provides. It should arrive about three months before your birthday each year.
- Do you contribute to a tax-deferred savings plan on your own? What's your current balance?
- How much, if anything, do you already have set aside specifically for retirement in taxable accounts?

Then, you'll want to add up the amount you expect to receive from each source. Sometimes—in the case of a pension, for example—you'll have a fairly clear picture. But it can be more difficult to estimate income from your tax-deferred and taxable savings plans. Because their returns are not guaranteed, what you'll have available will depend on how much was invested, where it was invested and how those investments performed.

### Taking the next steps

Once you know how much progress you've already made, you'll be able to start filling in potential gaps in your retirement plan. That may mean setting aside more of your income now, and making investment decisions that will help to increase the value of your savings. You can tackle this task in a number of different ways, including participating in a **401(k)** or other employer sponsored retirement plans, opening an **individual retirement account (IRA)**, buying annuities, and putting more savings into taxable investment accounts.

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## 401(k)s

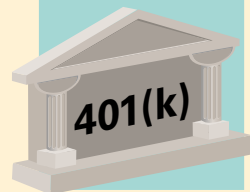
Saving for retirement might seem like an uphill battle, but there are many things you can do that both make the process easier and allow your assets to build more quickly. For example, you may have the option of saving for retirement through an employer sponsored retirement plan, such as a 401(k). These plans are also known as **salary reduction plans**, since you can defer a certain amount of your pretax salary into your retirement account. You take home a little less, but you postpone income tax on the amount you put into your account. So you have the double

advantage of saving money on taxes now and building your retirement account for the future.

Both the money you put into the account and any earnings it produces are tax deferred until you

### How a salary

The more money  
you put in a  
401(k) plan...



withdraw, usually in retirement. Tax deferral means your account has the potential to compound faster, since you don't have to take out any of your earnings to pay annual income taxes.

## Portable plans

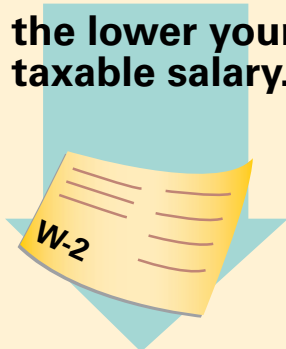
Another big advantage of a 401(k) and other salary reduction plans is their portability. That means that when you leave your job for any reason, you have the right to move the contributions you've made to your account plus any earnings to a new employer's plan—if the plan accepts transfers—or to an IRA. While you may have the option to leave your account with your former employer, at least for a while, being able to transfer the money to a new account has some potential advantages:

- You may have more control over how your savings are invested
- You don't risk losing track of your savings
- You have a bigger base of money to invest if you consolidate your accounts, which may entitle you to additional benefits from the new trustee of your transferred accounts

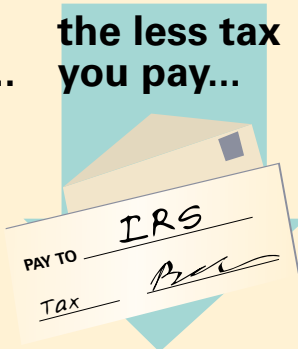
You do have the right to withdraw the money you've contributed to a 401(k) when you leave your job, but that's usually not the best choice. You'll owe income tax on the total amount you withdraw, plus a 10% federal tax penalty if you're younger than 59½. And you have to start all over again to accumulate retirement savings. The better plan is to keep the money invested in a tax-deferred account to help achieve your original goal—funding your retirement.

## reduction plan works

the lower your taxable salary...



the less tax you pay...



the greater your earnings potential



### A word to the wise

The details of 401(k) plans vary from employer to employer, but participating in a plan if it's offered is almost always something you'll want to consider seriously. It's easy to participate. You probably won't miss the money you're putting away. You'll reduce your current tax bill. And if your employer matches part of your contribution, why would you turn down free money?



- **Thrift savings plan** if you work for the federal government or one of the companies that offer them
- **SIMPLE** if you work for a company with fewer than 100 employees



Each of these plans works in much the same way that a 401(k) does, and each is just as beneficial to your retirement planning. You contribute part of your pretax salary, which reduces what you owe in taxes now, and you make investment choices for your assets, which accumulate tax-deferred earnings. Eventually when you withdraw the money, usually after you retire, you owe tax on your withdrawals at the same tax rate that you pay on other income.

## Other retirement accounts

Your employer might offer a plan that's similar to a 401(k) but has a different name. You might have access to a:



- **403(b) plan** if you work at a school, hospital, or other non-profit organization



- **457 plan** if you work for a state or local government

### Contribution limits

There's a government-imposed limit on how much you can contribute to your plan each year. For 2005, the maximum contribution is \$14,000 for a 401(k), 403(b) or 457 and \$10,000 for a SIMPLE. You can also make a catch-up contribution of up to \$4,000—\$2,000 in the case of a SIMPLE—if you're 50 or older and your plan allows them. Thrift plan contri-

**\$14,000**



Contribution limits vary depending on the specific plan, but are also capped at \$14,000.

In some cases, your employer may limit your contribution at a certain percentage of your salary. There may also be a limit imposed on the people who earn more than \$95,000. Employees in that category are defined by the government as being highly compensated (HCE, or highly compensated employee), and the percentage of salary they can contribute each year is determined by the percentage of salary that lower-paid employees of the same company contribute. You have to abide by the restriction that sets the lowest limit.

## Eligibility

Whatever retirement plan you're offered, you probably won't be able to participate your first day on the job. In most cases, you have to wait to become eligible, which usually happens after you've been with your employer for one year. Also, you must usually be at least 21. But be sure to check the first date you'll be eligible and be clear about what you have to do to participate.

## Matching contributions

Tax advantages aren't the only upside to participating in employer sponsored retirement plans. You may get some free money! In some cases, your employer may also contribute by matching some portion of your own contribution. If your employer contributes cash to your account, you can invest the added money as you like. Some employers match contributions with shares of the company's stock.

If you're part of a plan that offers matching contributions, you'll want to find out what percentage of your contribution that your employer will add. Even if you can't afford to save the maximum you're allowed to contribute, adding the most your employer will match lets you maximize the free money.

For example, some employers add 50% of what you put in, or 50 cents for every \$1, up to 6% of your salary. The more you add, up to the limit, the more matching you're eligible for.



**YOUR PLAN**

**Employer**



You contribute	Your employer contributes	Total
3% of \$25,000 salary, or \$750	50% of your contribution, or \$375	\$1,125
6% of \$25,000 salary, or \$1,500	50% of your contribution, or \$750	\$2,250
3% of \$50,000 salary, or \$1,500	50% of your contribution, or \$750	\$2,250
6% of \$50,000 salary, or \$3,000	50% of your contribution, or \$1,500	\$4,500

**Vesting**

All the money you put into a 401(k) plan is yours, and you can take it with you if you change jobs. In most cases, though, you'll have to stay at your job for a certain length of time, known as a **vesting period**, before any of your company's matching funds are yours permanently. That means if you leave your job before you become fully vested, you won't get to keep your employer's contribution.

Some companies use a graded vesting schedule, which means you're entitled to 20% of the matched funds after two years. Your vesting percentage increases 20% each year, until you're fully vested after six years. Alterna-

tively, if your employer uses a cliff vesting schedule, you might be fully vested after three years. The vesting period can be shorter, but it can't be longer than six years.

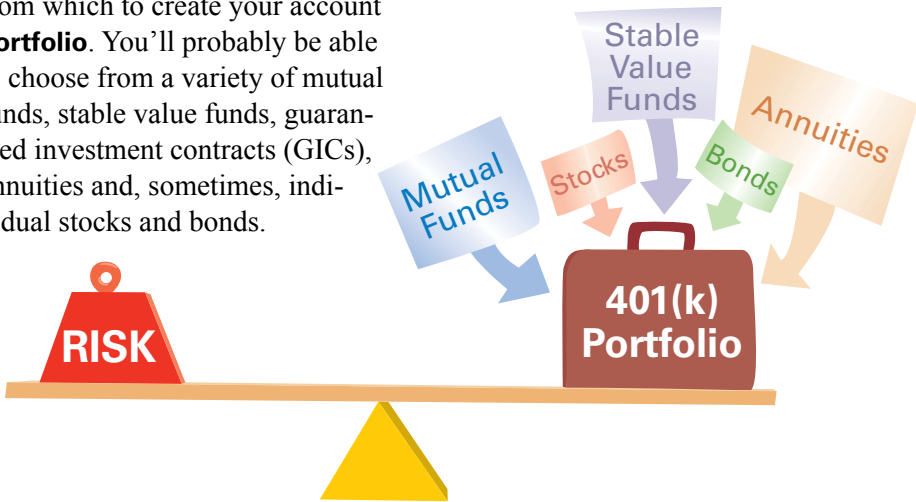
**Planning a move**

Talk to someone in your employer's benefits department if you're not sure what the vesting rules are. If you're considering taking a new job, it's worth investigating whether it might pay to stay with your current employer a little longer to be fully vested.

# Choosing 401(k) investments

While a 401(k) plan doesn't usually let you choose among all the investments available in the marketplace—which can be a good thing if you're uneasy about making investment decisions—you will have a range of selections from which to create your account **portfolio**. You'll probably be able to choose from a variety of mutual funds, stable value funds, guaranteed investment contracts (GICs), annuities and, sometimes, individual stocks and bonds.

On the other hand, being willing to take some risk with at least a portion of your account value increases the possibility of a stronger return and greater progress toward your financial goals. And, of course, the more time you have until you plan to retire, the more risk you can afford to take. You may want to talk with an investment adviser as you make these decisions.

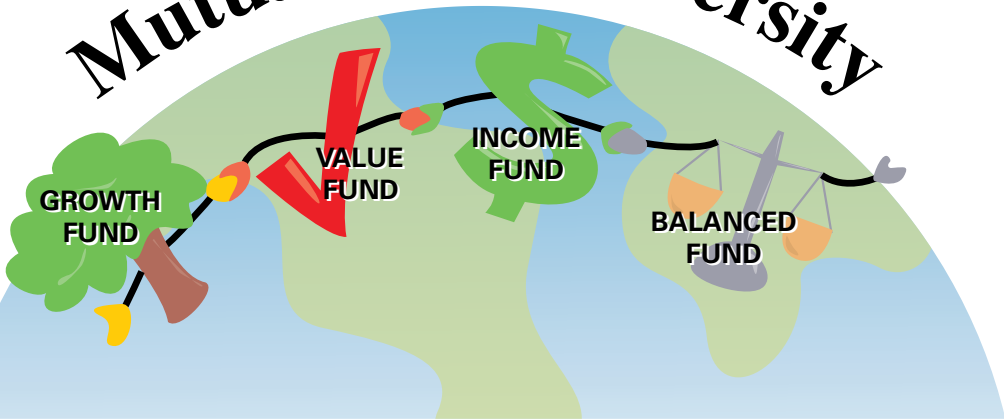


One of the things that will influence the investment selections you make is how much risk you're willing to take with your retirement plan account. Any investments that aren't guaranteed or insured expose you to the possibility of losing principal, especially in a market downturn when investments of all or many classes tend to lose value.

## Seeking diversification

One advantage of mutual funds is that they offer instant **diversification**. That's the case because most mutual funds make investments in dozens of companies. For example, instead of holding 1,000 shares of one stock, a stock mutual fund might own shares in 100 different stocks. Even if some of those 100 stocks lose value at some point

# Mutual Fund Diversity



while the fund owns them, others are likely to hold their own or increase in value.

Diversification is important because it may help you achieve a portion of the return that you would have had by owning only the strongest performing investments in any one period while reducing the risk of losing money. The risk is reduced because you'll never own only the weakest performing investments in that same period.

## Mutual fund choices

Each mutual fund has a specific investment goal and investment style, tailored to meet the needs of a particular type of investor. While a 401(k) plan usually offers a limited number of funds, you may be able to choose some

mutual funds that focus on growth, others that seek income, and some that do both by investing in both stocks and bonds. For most people, spreading assets among several funds with varying goals and styles is a good idea.

## What's what?

The mutual fund choices you face may seem very complex, but this short guide should help clarify some basic differences.

Most mutual funds concentrate their purchases on a certain investment type because they have a particular objective. Keep in mind, though, that the fund classifications are subjective, and the category a particular investment falls into depends on the guidelines the mutual fund manager is following and the judgments he or she makes.

## How the fund hopes to profit

- **Growth funds** usually look for companies that have the potential to increase significantly in value
- **Value funds** look for companies that are currently not performing up to their potential
- **Income funds** invest to earn regular dividend and interest payments
- **Balanced funds** invest in both stocks and bonds to reduce the risk of changing market conditions while providing a strong return

## What size companies the fund invests in

- **Small companies** that may be recent start-ups and offer more potential for growth, but also more risk of losing money
- **Large companies** are usually older, more stable companies that pose less risk of a major drop in price but offer slower potential growth
- **Mid-sized companies** have some of the growth potential of small companies but some of the stability of larger companies

## Where the fund invests

- **International funds** make investments around the world, though not in the US, to take advantages of various economic climates

- **Emerging market funds** invest in developing economies that offer high potential return but also carry significant risk
- **Domestic funds** invest in companies based in the US
- **Global funds** invest in both US and international companies
- **Sector funds** primarily invest in companies within a specific industry, such as energy, health-care or technology

## Company stock

You might be able to add shares of your employer's stock to your 401(k) or your employer may make matching contributions in stock. While the stock may be a solid investment, you should be wary of concentrating too much of your portfolio in one investment, since a drop in price could have a strong negative affect on your savings.

In fact, it's usually a good idea to keep no more than 10% of your 401(k) assets in your company's stock. And you're already dependent on the company for your salary, so if the worst happened and the company failed, you'd lose your retirement savings as well as your current income. You may also want to consider a similar guideline for shares of your employer's stock that you might hold in other accounts.

# IRAs

Whether or not you have a retirement savings account with your employer, you're always eligible for your own dedicated retirement account. An **individual retirement account (IRA)** is an account you set up and manage yourself. You'll have certain tax benefits, such as being able to defer taxes on any earnings in the account, in exchange for not withdrawing the money until you reach retirement age, but typically no earlier than 59½. You choose the way you invest your assets, so you can focus on meeting your specific investment goals.

## Following the rules

To contribute to an IRA, you must earn income. The only exception is that if your spouse doesn't earn an income and you do, you can contribute to an IRA you set up in his or her name as well as to an account in your own name. That's called a **spousal IRA**, and it's controlled by the person in whose name it's established.

There are three types of IRAs.

### Traditional non-deductible

- You contribute after-tax dollars
- Earnings in the account are tax deferred

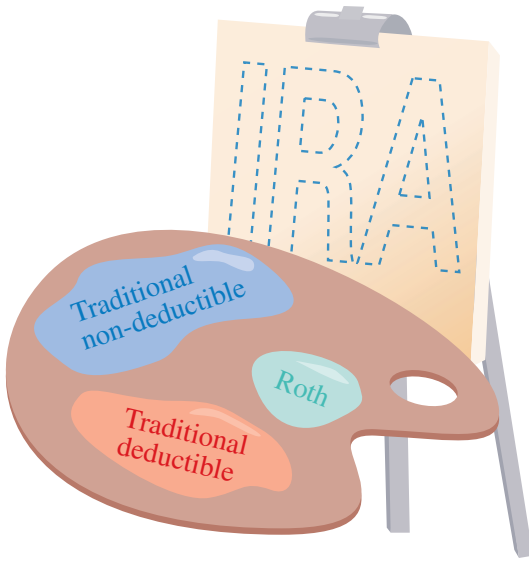
- You're required to begin taking withdrawals when you turn 70½ and owe income tax at your regular rate

### Traditional deductible

- You qualify if either you aren't eligible for a retirement plan at work, or your modified adjusted gross income (MAGI) is less than \$60,000 if you're single or \$80,000 if you're married and file a joint return
- You can deduct your contribution when you file your income tax return, which lowers your taxable salary
- Earnings in the account are tax deferred
- You're required to begin taking withdrawals when you turn 70½ and owe income tax at your regular rate

### Roth

- You qualify if your MAGI is less than \$110,000 if you're single and less than \$160,000 if you're married and file a joint return
- You contribute after-tax dollars
- You don't owe tax on any earnings in the account as they accumulate
- You can withdraw your contributions and earnings tax free if you're at least 59½ and your account has been open at least five years



An IRA is easy to open—you can get the forms from your bank, brokerage firm, mutual fund company or other financial services firm. Because you can invest your IRA assets almost any way you like, you’ll want to select an IRA provider that offers the choices you’re interested in. Your list might include **certificates of deposit (CDs)**, **mutual funds**, individual **stocks** and **bonds** or a range of other alternatives.

You can contribute up to \$4,000 of earned income in 2005 and another \$4,000 in 2006—though if you earn less than \$4,000 you can contribute only as much as you earned. If you’re 50 or older, you can also make catch-up contribu-

tions of \$500 in 2005 and \$1,000 in 2006. And you won’t have to pay taxes on your earnings until retirement—or never, in the case of a Roth IRA if you follow the rules for withdrawal. That lets your money accumulate more quickly than it would if you were paying taxes, and it makes a big difference to your account balance.

## Annuities

Annuities are another retirement savings option that you may want to consider. Annuities are insurance company products that let you accumulate tax-deferred earnings and then convert your account value to a source of income. You pay **premiums**, or cash payments, to the insurance company—either in one lump sum or in regular payments over time. You usually can’t withdraw without penalty before you turn 59½.

Annuities are available in many varieties. Some people use them to accumulate assets for their dependents, but most frequently they’re used to supplement other retirement savings plans. Other people buy an annuity as a source of immediate income.

## Deferred annuities:

- Can be a way to save for future needs
- There's an accumulation phase, when you put money into the contract
- When you're ready to retire, there's a payout phase when your account value is converted to a stream of income or you make some other withdrawal arrangement

## Immediate annuities:

- Appropriate if you'd like to receive income right away
- May be purchased with a pension payout, proceeds from

the sale of a business or an inheritance

- Provides income that begins as soon as you sign the contract and pay the premium

The annuity you choose will also depend on the return you'd like and the amount of risk you are willing to take. The choice here is between a variable and a fixed annuity.

- If you choose a **variable annuity**, the rate at which earnings accumulate in your account depends on the investment performance of the funds, called

subaccounts, you choose from among those the annuity offers. You'll earn more when they're doing well, and less when they're doing poorly.

- A **fixed annuity**, on the other hand, offers you the same rate of return each month for a specific term.

You can also choose an annuity as part of a qualified retirement plan or decide to buy a nonqualified annuity with other savings.

## Comparing Annuity Choices

### Retiring later

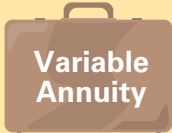


or

### Retiring now



### Chance for greater earnings



or

### Fixed return



### Employer sponsored



or

### On your own



- A **qualified annuity** is one that you purchase through your 401(k) or other employer plan. Your contributions are made with pretax dollars and are subject to contribution limits and withdrawal requirements.
- An **individual retirement annuity** resembles a traditional IRA in most ways, such as contribution limits and withdrawal requirements. The difference is that you purchase an annuity rather than CDs or

mutual funds. You may qualify to deduct your contribution when you file your tax return.

- A **nonqualified annuity** is one you purchase on your own, often when you've contributed as much as you can to an employer's plan or an IRA. Unlike 401(k)s or IRAs, there are no contribution limits and you're not required to begin withdrawals at 70½. In this case, you contribute after-tax income.

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## Taxable accounts

In addition to special retirement plans, you may also want to include regular taxable accounts, such as a savings account or investment account, in your retirement portfolio. The one drawback is that you will owe taxes each year on any account earnings and on any **capital gains**, or profit from selling an investment for more than you paid for it. But there are also potential advantages that may outweigh owing some tax now:



- There are no limits on the amount you can add to your taxable accounts each year
- There are no limits on the kinds of investments you can make
- There are no required withdrawals

### Taxed at a lower rate

What's more, taxes on most **stock dividends** and most **long-term capital gains** on investments you've owned more than a year are calculated at a lower tax rate than your regular tax rate, which applies to withdrawals from tax-deferred accounts. And you owe no tax on the increasing value of assets

you hold in your taxable accounts until you sell them.

Another point to consider is that you may pay less in fees and other charges to buy, sell and hold investments in a taxable account than you do in some tax-deferred accounts designed specifically for retirement savings. And if you need to use some of your taxable retirement savings to meet an immediate financial need, there is no 10% federal tax penalty.

## Asset allocation

All investments fall into different groups, called **asset classes**. Stocks are one asset class, bonds are another and cash or cash-equivalents, like CDs, are another. The asset allocation you choose, which is the way you divide your money among these classes, is key to building a retirement portfolio that can provide the long-term return you seek, with the level of risk you are comfortable assuming.

It might seem as if putting all of your money into investments that have the most growth potential or, alternatively, into insured investments that protect you against losing principal, is the smarter approach. In fact, it's a fairly risky approach. By making both types of

### The bottom line

A well-thought out retirement plan is usually one that includes several savings vehicles, including:

- An employer sponsored plan, if available, such as a 401(k), 457 or 403(b)
- Individual retirement accounts (IRAs)
- Taxable savings and investment accounts
- Employer pension programs
- Social Security benefits

investments, you're gaining protection, not only against a fluctuation in value that could wipe out your savings, but also from inflation that reduces your buying power.

When you invest in many different types of investment accounts—from IRAs to taxable accounts—you want to allocate your assets across the range of your accounts. So, for example, you might invest your taxable accounts for growth and your IRA for income. Or you might try to allocate each account across the available classes. It's up to you, and really depends on many factors, including:

- How many years you have before you retire

- How much money you have in each type of account
- Your personal tolerance for risk
- Your current and anticipated tax rates
- Inflation

## Doing the math

The exact asset allocation that's right for you depends on your goals and your risk tolerance as well as the time you have until retirement. In general, the closer you are to retirement age, the more conservatively you may want to invest.

Here's an example of some of the asset allocation models that you may see recommended for different stages in your investing life. What they show is a gradual movement from aggressive to conservative.

30 years to retirement:	80% stocks	10% bonds	10% cash
15 years to retirement:	60% stock	20% bonds	20% cash
5 years to retirement:	40% stock	40% bonds	20% cash

Remember, though, that models such as these aren't designed to predict a particular level of return. While allocating assets can help you moderate risk, it doesn't eliminate the possibility of accumulating less than you'd like.

Also remember that an asset allocation isn't fixed—as time passes and you near retirement, you may want to consider shifting some of your stock holdings into more conservative choices to avoid the impact of short-term drops in the market.

## Retirement resources

Your bank, brokerage firm or mutual fund company may offer retirement planning services or refer you to a professional.

You can learn about 401(k) plans on the NASD website ([www.nasd.com](http://www.nasd.com))

The Pension Benefit Guarantee Corporation website has a list of government agencies that provide retirement planning information ([www.pbgc.gov](http://www.pbgc.gov))

You can search the information available on the AARP website ([www.aarp.com](http://www.aarp.com))

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