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FN 281: Individual Assignment #4
Due Date: Sat. 14 May 2016 (16:00)

1. What types of expenses can be lowered or eliminated during retirement?

One of the simplest things you can do to make sure you stay financially viable during retirement is pay attention to your spending. It is important to understand exactly where your money is going and what you are getting for it. There are a lot of ways to cut spending on things you just don't need.

Whether you are in the midst of retirement or you are just planning ahead, consider cutting back in the following areas to prevent unnecessary expenditures and financial worries down the road:

Credit cards: As you move into retirement, you will likely have to adjust to living on a lower income. To avoid getting into trouble later, make sure you are only buying what you can afford. This is not to say you can no longer use credit cards. You just have to approach the situation differently, and be willing to look at new offers if the fee structures and payment agreements do not match your financial abilities.

Technology: Don't sign up and pay for anything you aren't going to use. "How many people watch 50 percent, or even 30 percent, of the things they pay for with cable?" Paying for cable can become a major financial drain over time. Consider slimming down on elaborate packages or turning to cheaper alternatives. Today, you can get the content from other outlets like Netflix, RedBox or Hulu, for little to no cost.

Additionally, be realistic about your needs and wants. If you need a cellphone just for making an occasional phone call, don't purchase the latest smartphone with an unlimited data package. You don't need to be paying for fancy phones with features or minutes you don't use.

Insurance: The older you get, the less important it becomes to focus your attention and money on life insurance plans. In the event of your death, [life insurance pays] your dependents or those closest to you. But when you are retired, typically the folks who were dependent on you before aren't anymore. Also, theoretically, you've had time to build up other assets so the need isn't there. You shouldn't always cancel your life insurance policy because many of them have viable cash return options and could help a surviving spouse or have estate planning benefits.

Travel: Travel tends to increase during the early years of retirement and taper off later on. If you know you are going to travel more during retirement, try to factor those costs into your retirement saving ahead of time. However, regardless of prior planning, keep costs low by adjusting your travel itinerary. Shop around for the cheapest airline seats and discounted hotel rooms.

Cars: If possible, avoid buying new vehicles. Avoid overspending on maintenance, gas and oil, too. There is no need to spend money on premium fuel if the manufacturer recommends regular unleaded. You can't be afraid to look around for the best deals, and haggle a bit for what you need. Individual lifestyle needs may come into play, but it is important to evaluate your transportation needs to keep costs low. Take a step back and maybe say, 'Do we really need two cars? Some people may need two vehicles, while others may not. It's important to examine your lifestyle needs.

Gambling: Avoid recreational activities that involve spending a lot of money and not getting much, if anything, in return. A large percentage of lottery tickets are purchased by seniors, and it's throwing away money for everyone. Senior citizens are also disproportionately represented at casinos.

Instead, choose activities that will improve your quality of life. Focus on activities that help you collect memories and experiences – not things or money. The idea is to spend what little discretionary income you have on what is most important to you. But your income may not be on the upswing, so that means you have to be more careful.

Food: Food is a necessity that you can't eliminate, but there are steps you can take to help maintain a solid budget throughout retirement. Go for the generic or store-brand items instead of brand names. It's the little things that add up over time but can be easily avoided. Indulging in marked-up movie theater snacks and dining at restaurants are two other things that can be cut back to save money in the long run. Save these things for special occasions.

Home repairs: This may be another unavoidable area for spending, but it comes down to doing your research and understanding what you need, especially if you are not able to do the repairs yourself. Home repair can be really expensive. You've got to be willing to shop around and find the best deal.

In sum, Work-related expenses, clothing expenses, transportation costs, and housing expenses will probably be lower during retirement. You'll probably pay taxes at a lower rate because your taxable income may be lower.

2. What types of expenses might increase during retirement?

Many retirees do find that their expenses go down, sometimes even below that estimate. But others are surprised to see them heading in the opposite direction. Travel is one big reason. Uncovered medical expenses are another. Still another cause: Retirees simply have more free time to spend, spend, spend.

Travel: To start on a happy note, your travel expenses could easily shoot up in retirement, particularly in the early. Suddenly you'll have the leisure to go places you've always wanted to see but never had time for when you were working 9 to 5 and perhaps raising kids. Of course, your job-related commuting expenses will no longer be a factor, so whatever you were spending there each month can be applied to your new fun-travel budget.

Healthcare: As mentioned earlier, Medicare, insurances usually won't cover you if you get sick and need treatment overseas. It also doesn't fund a number of other expenses that your previous, employer-paid health insurance probably took care of. These include most dental care, eye exams, hearing aids and routine foot care, among others. So you probably should build some extra money for these services into your retirement budget. If your former employer provides any retiree health benefits, those will figure into the equation too.

Taxes: Your income may decline during retirement, resulting in a lower marginal tax bracket and a smaller income tax bill. But if you have a lot of money in retirement plans, such as traditional IRAs, that are subject to required minimum distributions every year after age 70.5, you could actually find your income and income taxes going up. That’s a nice problem to have, but it can be a shocker nonetheless.

Shopping: Retirement often means spending more time at home, particularly in the daylight hours. You might want to treat yourself to an up-to-date kitchen, a more luxurious bath or a separate home office where you can manage your investments or write your spy novel.

Finally, we can say that medical expenses and expenses for leisure activities tend to increase with age.

3. Explain the difference between a defined-contribution and defined benefit plan.

Retirement plans may be categorized as either defined benefit plans or defined contribution plans.

Defined Contribution Plans

A defined contribution plan specifies how much money will go into a retirement plan today. The amount typically is either a percentage of an employee's salary or a specific dollar amount. Then, those funds often are invested in mutual funds available inside the retirement plan. The amount you have at retirement depends on how much your employer contributes to the plan, how much you as the employee save in the plan, how long you leave those funds invested, and how well your investments perform inside the plan.

More and more employers are replacing defined benefit plans with defined contribution plans, primarily due to the expense and long-term obligations associated with running a defined benefit plan. If you have a defined benefit plan through your employer, be sure to regularly let your employer know that you really appreciate your retirement plan; it’s a benefit well worth keeping.

Defined Benefit Plans

A defined benefit plan identifies the specific benefit that will be payable to you at retirement. Your basic retirement benefit is usually based on a formula that takes into account factors like the number of years a participant works for the employer (years of service) and the participant's salary. Your retirement benefit is generally provided in the form of regular payments over your lifetime beginning at what the plan calls "normal retirement age," which is typically age 65. This stream of periodic payments is generally known as a pension or sometimes called an annuity.

Employers guarantee a specific retirement benefit amount for each participant of a defined benefit plan, which can be based on the employee's salary, years of service or a number of other factors. Employees have little control over the funds until they are received in retirement. The employer bears the investment risk of ensuring the defined benefit amount is able to be paid to the retired employee. Due to this risk, defined benefit plans require complex actuarial projections and insurance for guarantees, making the costs of administration very high. This has made defined benefit plans all but obsolete.