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FN281 homework Assignment4

Retirement Planning

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

Answer:

-Take required minimum distributions: Those ages 70½ or older must take required minimum distributions from retirement accounts each year. The withdrawal amount is calculated by dividing your individual retirement account and 401(k) balances by your life expectancy, as determined by the Internal Revenue Service. The penalty for failing to take out the correct amount from your retirement accounts is steep: a 50 percent tax penalty, plus income tax on the amount that should have been withdrawn.

-Mortgage : Paying off your mortgage eliminates one of your biggest monthly bills. While you will still have to pay for insurance and property taxes and continue to maintain your home, these costs are likely to be a fraction of what you were paying for your mortgage. There's also a big emotional payoff when you own your home mortgage-free.

-Downsize your home: Once your kids move out of the house, you no longer need a multiple-bedroom home near a good school district. "It's not just the mortgage but all the maintenance," says Jane Young, a certified financial planner for Pinnacle Financial Concepts in Colorado Springs, Colo. "A lot of people like to move into a townhouse where they no longer have to take care of a huge yard." Consider downsizing to a smaller home or condo and padding your nest egg with the extra income.

-Ditch a vehicle: Eliminating a daily commute is one of the biggest perks of retirement. Couples may no longer need two vehicles when they don't travel to separate offices. Ditching a car also will cut your insurance and car maintenance bills. Some retirees who can't or don't want to drive can even go carless.

-**Commuting costs**: Gas for your car or train fare is a big expense for employees with long daily commutes to work. In retirement, all your driving is for personal errands or pleasure, and some retirees are able to completely avoid traffic by skipping outings during peak travel times.

-Professional clothing: Some jobs require expensive professional attire, stylish haircuts and makeup and formal clothing for special events. Dry cleaning and professional tailoring cost even more. Retirees get to trade in their suits for jeans and don't have to keep up with the latest fashion trends unless they want to.

-**Office costs**: Being involved in office social life comes with some costs. You might pay for lunch out with coworkers, chip in for gifts for colleagues or get drawn into the office pool. These costs are often a necessary part of team building with coworkers, but retirees don't have to pay them.

2.What types of expenses might increase during retirement?

Answer:

-**Health insurance premiums**: Those with employer-subsidized health insurance premiums could see higher costs in retirement. Medicare Part B premiums for new enrollees in 2010 range from $110.50 monthly for individuals earning less than $85,000 annually ($170,000 for couples), up to $353.60 per month for couples with income over $428,000.

-Prescription drugs: Retirees should shop around annually for the best Medicare Part D prescription drug plan that meets their medication needs. Many plans have deductibles as high as $310, charge a co-payment or a percentage of the bill for each prescription, and have a coverage gap.

-**Household help**: As you age, you may need to hire help with yard work you previously did yourself, such as raking leaves and shoveling snow. Many seniors also need assistance with physically demanding home maintenance and household chores.

- Co-pays and deductables: Seniors with original Medicare Part A without supplemental insurance will pay a $1,100 deductable for each hospital stay up to 60 days and face additional charges for longer stays. Medicare Part B has a $155 deductable in 2010, after which you must pay 20 percent of the Medicare-approved amount for most doctor services.

-Socializing: Employees get plenty of opportunities for social interaction at the office. But socializing in retirement often means eating meals out or entertaining others in your home. Try to find low-cost ways to enjoy time with friends and family.

-Entertainment: Retirees have eight or more extra hours to fill each day, which makes it easy to spend more on entertainment. Before you retire, make plans for volunteer work, dig out your library card, and search for free or low-cost activities to avoid developing expensive hobbies.

-**Travel:** Many retirees are eager to do all the traveling they never had enough vacation time for while working. Try to travel on off-peak times, take advantage of last-minute deals, and don't forget to ask for senior and AARP discounts.

-**Dental work will likely increase**: Crowns, bridges and root canals are incredibly expensive. So make sure you’re brushing, flossing, and using a mouthwash so you can keep this expense as minimal as possible.

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

Answer:

A defined contribution plan is a type of retirement plan in which the employer, employee or both make contributions on a regular basis. Individual accounts are set up for participants and benefits are based on the amounts credited to these accounts plus any investment earnings on the money in the account. Only employer contributions to the account are guaranteed, not the future benefits. In defined contribution plans, future benefits fluctuate on the basis of investment earnings. The most common type of defined contribution plan is a savings and thrift plan. Under this type of plan, the employee contributes a predetermined portion of his or her earnings, which is usually pretax, to an individual account, all or part of which is matched by the employer. So, this kind of plan is usually led by the employee since they will have a choice on how much should they invest. Then, employer will match the amount and let they employee choose which market they want to invest. The example of those markets would be money market, bond market, and equity market. And right after the fund has been deposited, the employer will no longer have any obligation with the plan. So, the plans require a little and low risk to employer. Therefore, most risk will be put on employee as they had to set contribution and investment in order to meet the retirement plan.

A defined-benefit plan is an employer-sponsored retirement plan where employee benefits are sorted out based on a formula using factors such as salary history and duration of employment. Investment risk and portfolio management are entirely under the control of the company. There are also restrictions on when and how you can withdraw these funds without penalties. However, this plan, the employer will guarantee the amount of retirement individual will get after they retire. Moreover, the payment will be paid throughout the individual’s life. The plan will be managed by the professional under the guild line. So, the cost of administration is very high, and the risk falls on the employer.

In conclusion, the offer from Defined benefits plan tends to benefit employee more than what Defined-contribution has provided.