Glossary of Italicized Terms

Defined Benefit Pension: Often thought of as "old-fashioned" pension plans, a defined benefit system means that the employer bears the risk for your retirement plan. Subject to certain rules, such as length of service to the company, a worker is promised a set monthly benefit when she retires.

Defined Contribution Pension: These pension plans gained popularity in the 1990s and now cover more American workers than their defined benefit ancestors. You may know them by various names, such as 401(k), 403(b), 457, SEP-IRA, SIMPLE IRA, profit-sharing or other plans. The rules vary by plan type and by employer, but all defined contribution plans make the employee bear all the risk for the investments. Defined contribution plans also offer tax advantages, such as having your monthly contributions deducted before taxes, automatically reducing your annual income taxes.

Individual Retirement Account (IRA): An IRA is a type of retirement savings plan where the federal government, in exchange for limited access to your cash, offers you various types of tax advantages. Most IRAs require you to wait until age 59 to begin withdrawing your money without penalty,[7] but there are tax benefits to encourage you to save. There are several types, including traditional, Roth, SEP, SIMPLE, and education IRAs.

Compound interest: The principle that your money can work for you, as even small investments become larger given time. For example, money you put into a savings account earns interest. Then you earn interest on the money you originally put in, plus on the interest you've accumulated. The real power of compounding comes with time, so the earlier you start saving, the more your money can work for you.[8]

Annuities: As you approach retirement, an annuity is one way you can manage your income from defined contribution pensions or IRAs. According to the Women's Institute for Secure Retirement (WISER), an "annuity lets you convert all or part of your retirement savings to a guaranteed stream of lifetime income; the insurance company takes on the risk of figuring out how to make the money last as long as you will live,"[9] and determines your monthly benefit accordingly.

Lump Sum Distributions: When you leave a job or retire, you may have the option of cashing out your defined benefit or defined contribution retirement assets; this is considered a lump sum distribution. Be sure to convert this money into another official retirement plan to preserve your retirement savings. If you spend it, you'll incur a hefty tax.

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[1] U.S. Administration on Aging, *Older Women: A Diverse and Growing Population*, 2000.
[2] AARP, *Midlife and Older Persons with Disabilities: Who Gets Help?*, 1998.
[3] OWL, *State of Older Women in America*, 2001.
[4] Women's Institute for a Secure Retirement, *What Every Woman Needs to Know about Money and Retirement*, 1998.
[5] Social Security Administration, *Fact Sheet: Women and Social Security*, May 2001.
[6] MetLife Mature Market Institute, *The MetLife Juggling Act Study: Balancing Caregiving with Work and the Costs Involved*, 1999.
[7] Women's Institute for a Secure Retirement, *What Every Woman Needs to Know about Money and Retirement*, 1998.
[8] U.S. Department of Labor, Pension and Welfare Benefits Administration, *Savings Fitness: A Guide to Your Money and Your Financial Future*.
[9] Women's Institute for a Secure Retirement, *Making Your Money Last For A Lifetime: Why You Need to Know About Annuities*, 2001.

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More in *The Color of Money* primer series . . .

- For an overview of women and Social Security, see Primer I: Women's Realities and Retirement Consequences.
- For more information on the retirement security of African American, Latina, and Asian American women, see Primer II: Retirement Security and Women of Diverse Communities.
- To read about reforms to Social Security, see Primer III: Women's Stake in the Social Security Debate.

Primer IV

Strategies for a Secure Retirement

The Color of Money primer series has presented a sobering account of women's prospects for economic security in retirement. Despite dramatic increases in female labor force participation, a host of factors continue to leave many women, including those who have worked for long periods of time, economically vulnerable late in life.

Women need to start planning for their retirement when they first enter the labor market. Although young women are not usually encouraged to make long-term financial plans, these primers show that the choices women make about work and family early in their lives often have serious consequences when they enter retirement.

Here are a number of actions that individual women can take to enhance their retirement security . . .

1. Become financially literate

It is crucial for women to learn how Social Security works and understand its primary and unique role in their retirement future. Knowledge of various investment instruments such as annuities, 401(k)s, and Individual Retirement Accounts (IRA) is critical. If married, a woman needs to make her marriage a true financial partnership by becoming a full participant in all savings and retirement decisions.

Educate Yourself Sometimes it's hard to know where to start, but putting off getting your finances in order only makes things much harder in the end. You'll likely be surprised by how easy it is to find the answers to your questions: local libraries have a wealth of information on financial planning (look under the topics of personal finance, household budgeting, retirement planning, and investing), and the Internet offers many helpful articles and calculators. In many communities, it's not difficult to find free or low-cost seminars in financial planning for women, or a nonprofit credit counseling service, or other self-help resources published by nonprofit groups. For-profit financial services companies of all kinds (banks, mutual fund companies, insurance agents, stock brokers, and financial advisors) also offer helpful booklets on investing basics—just remember to use your consumer savvy to distinguish a commercial pitch from general knowledge sharing.

Set Goals. Once you take control of one aspect of your finances (for example, learning how to reduce credit card debt), you'll realize you can tackle the next hurdle, such as opening an IRA. Every woman is in a different situation, so you'll need to spend a little time figuring out what your goals are.

Aisha is a 22-year-old woman in her first job who wants save more in her company's 401(k) plan. It is a challenge to find "extra" money when she's just starting out and retirement feels so far away, but investing early will allow her nest egg to grow much larger than if she waited even just a few years to start. Her goal may be to research the benefits of *compound interest* (see glossary) to understand more fully the tax advantages of a 401(k), and then to cut back on new DVD or clothes expenditures in order to increase her monthly contribution to her retirement plan.

THE COLOR OF MONEY: RETIREMENT FOR WOMEN OF DIVERSE COMMUNITIES is a public education and media campaign designed to build greater understanding of America's retirement system and women's stake in the discussion to reform it.

The campaign specifically encourages dialogues with African American women and Latinas about their significant vulnerability to retirement insecurity. Funded by the Retirement Research Foundation, this project will work with OWL chapters to hold community conversations across the country to address retirement security issues facing African American women and Latinas, with a special emphasis on younger women.

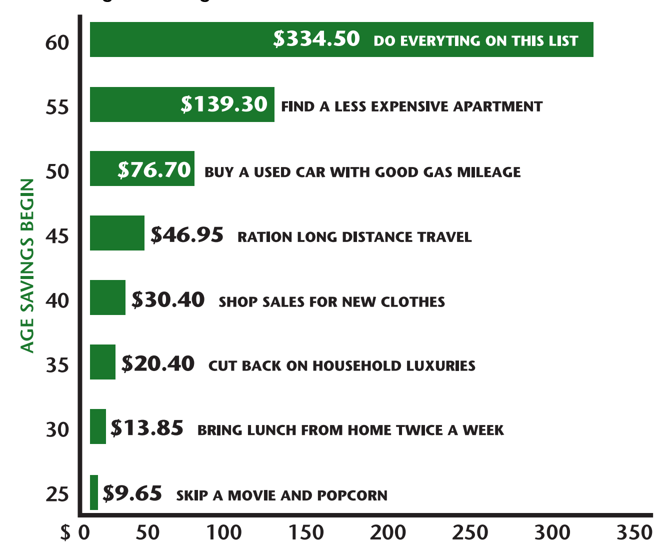
Maria is a 45-year-old, newly divorced woman who can't imagine being ready for her retirement, as she is struggling every month with overwhelming credit card bills. She wants to reduce her debt (nonprofit credit counseling services may help with this), save money to protect her family in an emergency (often called short-term savings), then look closely at her retirement savings needs and set out a plan to get there in the next 20 years.

These women, like so many others, have unique financial needs given their life, family, and work circumstances. The common denominator is that every woman—including you—can take charge of her finances by educating herself on the basics and then setting goals.

Pay Yourself First. It's amazing how few women do this. Historical patterns and social customs often encourage women to put others first, but then women are left alone to take care of themselves in old age. Eighty percent of seniors living alone are women,[1] and women make up two-thirds of nursing home residents.[2]

Break this mentality and be sure to pay yourself first. Before your paycheck gets eaten up by the usual expenses, make your own financial security a top priority and put aside a set amount in a savings account, money market account, IRA, or other savings or investment vehicle. Many banks and other financial institutions will let you have the money automatically withdrawn from your paycheck or checking account every month, making it a bit easier to stay disciplined.

Getting from here to there: Savings for a $100,000 retirement fund at age 65, 7% growth



Source: Projections from 1999 Medicare Benefits Stimulation Model, Gibson and Foley, 2000.

2. Start early

Saving and investing as early as possible is the best approach. Presuming a 7 percent return on her investments, a woman would need to save $9.65 a week at age 25—the equivalent of a movie and popcorn—but $334.50 a week at age 60 in order to achieve the same $100,000 retirement fund by age 65 (see chart).[3]

3. Learn about your employer's pension plans

Ask whether your employer offers a pension plan, and what the eligibility requirements are. If your employer has a *defined benefit* plan (see glossary), find out how and when you can sign up, at what age you can retire, and what the reductions for early retirement might be. If the employer offers a *defined contribution* plan (see glossary), it is important for you to sign up and contribute as much as you can afford. In plans where the employer contributes a set amount or makes a matching contribution, it's vital that you know the rules that allow you to maximize this employer contribution—if you don't, it's almost like turning down a raise. If the defined contribution plan offers a choice of investments, think carefully about the potential risks and rewards of different investment options. Do a little research about investing, get your questions answered by your plan's administrator, and make choices that make sense for you.

4. Contribute to an Individual Retirement Account

Whether in the paid labor force or not, you can—and should, if possible—contribute up to $3,000 annually to an *Individual Retirement Account (IRA)* (see glossary) in your own name.

An IRA is a type of retirement savings plan where the federal government, in exchange for limited access to your cash, offers you various types of tax advantages. Most IRAs require you to wait until age 59 to begin withdrawing your money without penalty,[4] but there are tax benefits to encourage you to save.

In 2002 through 2004, the maximum contribution to all types of IRAs (combined) is $3,000 a year; this will rise to $4,000 in 2005. If you're over 50 years of age, there are new "catch-up" provisions that allow you to add more to your IRA. If at all possible, maximize your IRA contribution—but even if you only have $500 to put away this year, go ahead and get started. Most financial institutions offering IRAs have very low minimum contributions to open an account.

All types of financial institutions offer IRAs—your local bank, a mutual fund company, an online brokerage—so it's up to you to decide what type of investment you want first, then find someone who offers it. For example, young Aisha has a longer time horizon, so she may choose a more aggressive IRA vehicle, like a mutual fund made up of stocks. Maria may be more cautious and want a company that can offer a combination of investments for her IRA. As with all financial decisions, your individual needs and goals must be considered in deciding what investments will work best for you.

5. Investigate the exact amount of future Social Security benefits

The Social Security Administration (SSA) sends everyone over 25 years of age an annual statement, typically mailed three months before your birthday. This tool can help confirm that SSA has an accurate wage history for you, as well as show you what your expected benefits would be at different potential retirement ages. (See SSA's web site at *www.ssa.gov/women/* for more information.) This information will be extremely helpful as you chart a course toward retirement security.

6. Carefully consider the impact of labor market decisions on retirement income

In general, the longer you remain on the job, the more your defined benefit and defined contribution plans accumulate in value—presuming you have a pension plan at your job. When considering a job change, it is important to find out whether a prospective employer offers a pension plan, and how that pension plan stacks up next to that of your present employer. It is also important to consider how such a move could impact current pension benefits. If you are three months away from vesting in a pension plan, you should consider what resigning and losing that benefit could mean for your retirement.

Don't forget that your workforce decisions affect Social Security, too. Your Social Security retirement benefits are based on your highest 35 years of earnings, but women's median participation in the workforce is 29 years, as compared with 38 years for men.[5] This time out for caregiving dramatically impacts a woman's future Social Security benefits: It translates into $2,100 less in annual retirement benefits.[6]

7. Preserve lump sum distributions for retirement

If at all possible, you need to retain, not spend, any *lump sum distributions* (see glossary) received upon terminating with an employer. The penalties are severe for spending lump sum distributions (up to 20 percent penalties in addition to regular income taxes), and most women will need this money in retirement. When you leave an employer, investigate options for preserving lump sum distributions—which may include keeping the accumulation in a former employer's plan, rolling over the lump sum payment into the pension plan of a new employer, or rolling it over into another tax-advantaged savings vehicle such as an IRA.

Find the answers to your questions.