Vanguard®

How to turn retirement savings into retirement income

You've saved for retirement for years. Now that retirement is approaching, how can you create a regular stream of income from your savings to help pay your bills?

You can combine your retirement plan savings with other sources of retirement income, such as Social Security or a pension, to create a long-lasting stream of income. It's like drawing water from a well—you don't want to take so much at once that it runs dry.

Keep in mind that there is no single "right" approach. It's important to stay flexible by adjusting your approach over time as your investment performance and life circumstances change.

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How much will you need?

Through your career, retirement may have seemed a distant dream. Now, as it approaches, you'll want to make a dollars-and-cents calculation of retirement costs.

You can start with a back-of-the-envelope approach: Take what you spend today and multiply it by 75% or 85%. Think of that as your first-year retirement budget. Why might you live on less in retirement? Here are three common reasons:

- You no longer have to save for retirement.
- Work clothes and commuting costs are a thing of the past.
- You may have paid off your mortgage before retiring.

Of course, if you have considerable continuing expenses or health issues, or if you plan to travel extensively, your retirement can cost as much as—or more than—your current life. And don't forget that you will still owe income taxes, including on your retirement plan withdrawals (unless they qualify for the Roth exemption).

Some people draw up detailed budgets to plan with more certainty how much money they will need in retirement. You can record today's expenses by reviewing your bank and credit card statements. Then estimate which expenses might rise or fall in retirement.

Next, compare your expenses with your anticipated retirement income from all sources: Social Security, pension, part-time work after retirement, and withdrawals from savings.

CASE STUDY:

Dennis and Roberta estimate their retirement expenses

Today, Dennis and Roberta live comfortably on an income of $100,000. Their children are grown, they're saving 15% of their income for retirement, and their mortgage payment (principal and interest) amounts to $1,200 per month. If they succeed in paying off their mortgage before they retire—which is their plan—Dennis and Roberta should be able to live on 71% of their current income in retirement without changing their lifestyle.

Current annual income	$100,000
Minus current annual mortgage expense	–$14,400
Minus current annual retirement savings	–$15,000
Rough estimate of the income they'll need in retirement	$70,600

Two types of retirement income

You're likely to have two main types of retirement income: regular and variable.

Regular sources of income can include Social Security, a pension, or an annuity. With these, an outside entity such as the federal government, your employer, or an insurance company promises a specified amount of retirement income, typically for as long as you live. The outside entity bears the risk and responsibility of providing a steady stream of promised income.

Variable sources of retirement income are essentially your savings, including employer retirement plan accounts, IRAs, lump-sum pension distributions, and taxable savings accounts.

You, as the owner of these accounts, are responsible for managing your money and deciding how much spending money to withdraw each year. No outside entity is guaranteeing that your accounts will provide lifelong income in any specific amount.

In addition, most retirees wish to preserve a pool of personal savings for emergencies, special expenses (such as college, travel, or weddings), or to pass down to heirs.

Seek to blend the two

Each type of retirement income has its benefits and risks, as you can see on the next page. That's why it is best to derive your retirement income from both regular and variable sources.

Regular income

Examples
- Social Security.
- Employer's pension when taken as an annuity, rather than as a lump sum.
- Income annuity.

Benefits
- Your payments are promised for life.
- Your income is regular and predictable, not subject to market swings.
- Social Security payments increase with inflation, so your spending power doesn't diminish.

Costs or risks
- Loss of control over money invested in an annuity.
- Extra fees for annuity insurance guarantees.
- No pool of savings to tap for emergencies or leave to heirs.
- No opportunity to capture market growth, as your invested assets could.
- Payments depend on the claims-paying ability of an outside entity.

Variable income

Examples
- Employer's defined contribution retirement plan: 401(k), 403(b), 457 accounts.
- Traditional and Roth IRAs.
- Other savings and investments.
- An employer's pension benefit taken as a lump sum, rather than as an annuity.

Benefits
- Spending flexibility, especially in emergencies.
- Growth potential depending on how your assets are invested and the performance of the capital markets.
- The ability to transfer your assets by gift or inheritance.

Costs or risks
- Withdrawing income from your savings requires spending discipline so you don't run out of money.
- If your savings are invested in the stock and bond markets, they're subject to market swings. Prolonged market declines may dictate belt-tightening to avoid running out of money.
- If your savings are invested in cash-like instruments, such as money market funds, bank savings accounts, and CDs, you may lose purchasing power over time.

One way to increase your Social Security benefits is to postpone filing for benefits.

Making the most of Social Security

Social Security is the most common source of income among Americans age 65 and older. Benefits are guaranteed by the government, so market fluctuations will not change payment amounts. What's more, benefits increase with inflation, so your Social Security payments will maintain their purchasing power.

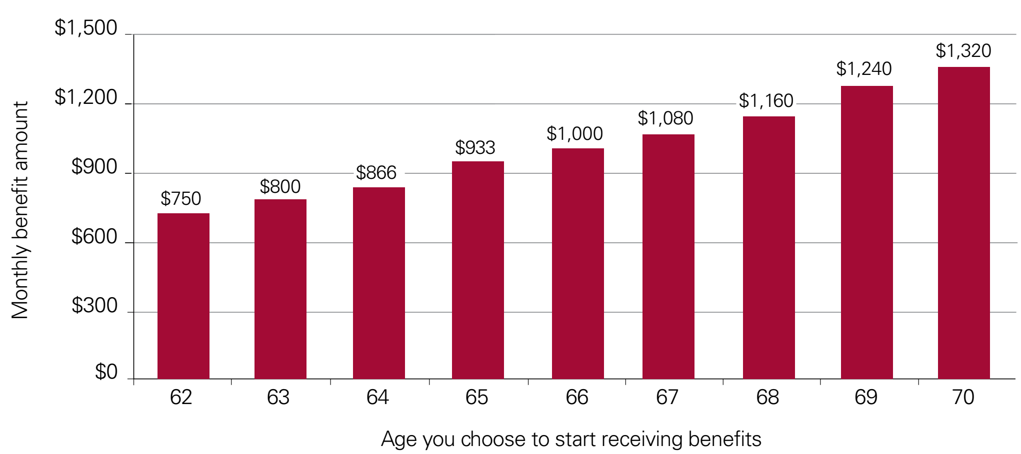
One way to increase your Social Security benefits is to postpone filing for benefits. Workers can file for Social Security retirement benefits as early as age 62. But if you wait until your full retirement age (from age 65 to 67, depending on what year you were born), your Social Security benefits will be 20% to 30% higher for life.

Similarly, if you continue to postpone benefits after your full retirement age, your benefits will rise by 8% for each year you delay up until age 70. If your full retirement age is 66 and you wait until age 70 to begin receiving benefits, your monthly payments will be 32% higher for life. Payments are not increased if you delay taking benefits past age 70.

You can obtain different benefit estimates based on your records by calling a Social Security representative at **800-772-1213**. Or you can estimate your Social Security retirement benefits at various ages using the Social Security Estimator at **ssa.gov**.

Monthly benefit amounts differ based on the age you start receiving benefits

This example assumes a benefit of $1,000 at a full retirement age of 66.



Source: Social Security Administration.

Making the most of your retirement savings

A retiree's largest source of variable income is typically his or her accumulated retirement savings. If you've worked for multiple employers, you may have retirement savings scattered across multiple plan accounts. You may also have an IRA, which has grown, like your employer's plan, tax-deferred. Finally, you may have additional retirement savings or assets in taxable accounts—meaning that you've paid taxes every year on their earnings without any deferral from the IRS.

Whether your retirement savings are in one account or a dozen, as a pool they represent a single source of income. They also represent a challenge—to withdraw from them in a disciplined way that ensures that your income will last as long as you do. Unlike with Social Security, you decide how to invest this money and how much to spend each year.

Numerous studies suggest that if you follow a disciplined withdrawal plan, your savings have a good chance of providing income for 30 years or longer. A rule of thumb is to start by withdrawing no more than 4% of your retirement savings in the first year of retirement.

After the first year of retirement, you may choose to increase your annual withdrawal amount by the rate of inflation to maintain your spending power. But be flexible, too. If a sharp market drop reduces the value of your portfolio by 10% or more, consider tightening your belt. You could omit inflation adjustments for a year or two or even reduce your withdrawal amount so you don't deplete your retirement savings too rapidly.

Retirees who follow this systematic withdrawal plan should consider owning a broadly diversified mix of investments, roughly balanced between bond and stock holdings. It's true that stocks can have sharp price swings, but they have also shown greater potential for growth over the long term than bonds or short-term reserves—a factor that may help to sustain your savings over a lengthy retirement. Please keep in mind that diversification does not ensure a profit or protect against a loss.

With a systematic withdrawal plan, keep these three practical considerations in mind:

1. If you are withdrawing money from tax-deferred retirement accounts, you will owe income taxes on the withdrawal. Set a percentage of the withdrawal aside to meet your income tax obligation later on.

2. If your employer's retirement plan does not allow systematic withdrawals or if it has a fixed distribution period (for example 10 or 20 years), you may need to move your retirement savings. Consider rolling your plan savings to an IRA from which you can extend your withdrawals over a longer period. For information about rolling over to a Vanguard IRA®, visit **vanguard.com/rollover**.

3. After age 70½, you must take required minimum distributions (RMDs) from tax-deferred retirement savings, including 401(k)s, 403(b)s, and IRAs. There is more about how to calculate and take your RMDs on page 31, but for now just remember that unless your systematic withdrawals meet this minimum withdrawal requirement, you could owe a substantial penalty tax.

There are important factors to consider when rolling over assets to an IRA or leaving assets in an employer retirement plan account. These factors include, but are not limited to, investment options in each type of account, fees and expenses, available services, potential withdrawal penalties, protection from creditors and legal judgments, required minimum distributions, and tax consequences of rolling over employer stock to an IRA.

Taking a pension

Not everyone has a pension, but if you do, the amount it pays is typically based on two factors: how long you have worked for your employer, and how much you've earned over that time.

Pensions are generally paid in two ways: as an annuity or a lump-sum. We'll discuss annuity payments first.

A pension taken in annuity payments

Many pension plans offer an annuity payout only. An annuity provides periodic (generally monthly) payments for life.

If you are offered an annuity, you will be asked whether you want a "single life" or a "joint-and-survivor" payout. A single-life annuity would pay benefits over your lifetime only. A joint-and-survivor annuity would continue payments to your designated beneficiary (typically your spouse) should he or she outlive you.

Federal law encourages married workers to choose joint-and-survivor pension benefits. It requires that spouses consent in writing to the selection of a single-life annuity payout. Joint-and-survivor annuity benefits are typically lower than single-life benefits because the payments must be made over two lifetimes rather than one.

In the unlikely event that a pension plan is terminated because it doesn't have enough money to pay promised benefits, the federal Pension Benefit Guaranty Corporation (PBGC) steps in. The PBGC will pay retired workers' basic pension benefits up to certain limits set by federal law.

A pension taken in a lump-sum payment

Some employers allow workers to take their pension in a one-time payout of everything they're entitled to receive. If you take a lump-sum payout, you have three main alternatives:

1. **Take it in cash.** If you are issued a lump-sum payment, you can simply cash the check. This is usually the least desirable solution, however, because the money would be subject to ordinary income taxes. If the lump-sum payment is large, it can also push you into a higher tax bracket. You could quickly deplete your savings just as you enter retirement.

2. **Roll it into a defined contribution plan.** Some employers permit you to transfer a lump-sum payment to their 401(k) or 403(b) defined contribution account. If you make a direct rollover, you will not owe taxes on the lump sum until you withdraw money from the plan later on.

This option may make sense if you like your plan's investment options, or if you retire between ages 55 and 59½. Between these years, you can take penalty-free withdrawals from your plan savings but would owe a 10% penalty tax on withdrawals from an IRA. Your plan withdrawals would still be subject to ordinary income taxes.

Check with your plan administrator about its distribution options. Some plans limit the frequency of withdrawals or have other restrictions.

3. **Roll it over to an IRA.** This choice can also preserve the tax-deferred advantage of a lump-sum distribution while offering an array of investment options.

Alternatively, you could invest some or all of the lump-sum rollover in an annuity. That could provide you with a guaranteed stream of income over your retirement.

Just keep in mind that annuities purchased from private insurers are not guaranteed by the Pension Benefit Guaranty Corporation. These annuity guarantees are based on the claims–paying abilities of the underlying insurance companies.

CASE STUDY:

Jim and Barbara adopt a systematic withdrawal plan

Jim, an engineer, is retiring at age 66; his wife, Barbara, a teacher, is 65. Jim has looked forward to retiring and started saving in his company's 401(k) plan in the first year it was offered.

Barbara has worked for 30 years in the same suburban school district and qualifies for a pension. Jim plans to retire at the end of the year, and Barbara wants to continue working to earn income, but plans to shift to a part-time teaching schedule.

Jim and Barbara start by writing down their regular and variable sources of retirement income:

- Jim has $200,000 in a 401(k) invested equally between stocks and bonds.
- Barbara has a pension that will pay $950 a month.
- Jim will receive $1,900 a month in Social Security retirement benefits.
- Barbara will receive $700 a month in Social Security retirement benefits.
- Barbara will earn $450 a month as a part-time teacher, a job she hopes to continue for a few years.

Because Jim and Barbara will have lifetime income from their Social Security benefits and her pension, they decide to keep Jim's savings in his 401(k) plan. This will provide them with income, plus the flexibility to meet emergencies.

The day he retires, Jim withdraws 4% of his 401(k) balance, or $8,000, and deposits it into a taxable money market fund outside his 401(k) plan. From there, he arranges automatic monthly transfers of $667 to his checking account. When this money is combined with Social Security and Barbara's pension and teaching income, Jim and Barbara will have $4,667 a month the first year of retirement.

As the years go by, Jim increases his initial withdrawal amount by the rate of inflation. Inflation ranged between 2% and 4% in the first four years of Jim and Barbara's retirement. The chart on the next page shows how he adjusts his withdrawals to keep up with the rising cost of living.

Jim adjusts his yearly withdrawals for inflation

	Calculation	Withdrawal amount	Inflation rate
Year one	$200,000 x 4% =	$8,000	3%
Year two	$8,000 x 1.03 =	$8,240	2%
Year three	$8,240 x 1.02 =	$8,405	4%
Year four	$8,405 x 1.04 =	$8,741	2%

Staying flexible

Jim plans to increase his withdrawals by the rate of inflation unless his account balance falls in a sharp market downturn. If the market were to drop, say, 10%, Jim might omit his inflation adjustments until it recovered. If the market fell 20%, he might reduce his withdrawals to help preserve his savings.

CASE STUDY:

Jim and Barbara adopt a systematic withdrawal plan, continued

Every year when he makes his withdrawal, Jim also rebalances his 401(k) account to maintain its 50% stocks and 50% bonds asset allocation. He does this by taking his withdrawal from the higher-performing investment category. For example, if his stock funds were up 10% and his bond funds down 5%, Jim would withdraw money from his stock funds until he restored the 50-50 asset allocation.

When Jim turns 70½, he makes sure that his annual withdrawals satisfy his required minimum distributions. Using a calculator on **vanguard.com**, Jim determines that his required minimum distribution is $7,299. His current withdrawal rate exceeds his required minimum distribution, so Jim doesn't change his withdrawal amount.

If Jim adheres to this disciplined withdrawal plan, his 401(k) could provide a steady stream of retirement income for more than 30 years. (Of course, this hypothetical example does not represent the return on any particular investment.) Barbara's continuing income from her part-time teaching position would also provide important support in the early years of their retirement.

Create a cash reserve

You might think of your retirement savings as divided into two broad categories:

- Long-term money, which remains invested in the capital markets (for example, in stock and bond mutual funds) to capture earnings and growth opportunities.
- A cash reserve—your spending money for the next year or two—which belongs in a low-risk money market fund or other account you can easily withdraw from. Your goal should be to protect the money you need for short-term expenses from the possibility of market declines.

Deriving income from your retirement savings is a process of gradually transferring money from your long-term investments to a short-term spending account.

You can move the amount you expect to need for 12 months into your money market fund at one time. That way you won't have to worry about market swings affecting your immediate spending needs.

For convenience, you can link your cash reserve money market fund electronically to your bank account, so you can easily move money to your checking or debit accounts. You could set up automatic monthly transfers to your checking account to recreate the cash flow of a regular monthly paycheck.

Please note that all investing is subject to risk, including the possible loss of the money you invest. Bond funds are subject to the risk that an issuer will fail to make payments on time, and that bond prices will decline because of rising interest rates or negative perceptions of an issuer's ability to make payments.

Investing in retirement

Those who use a systematic withdrawal plan like Jim and Barbara's should consider owning a broadly diversified portfolio that maintains an investment in stocks. It may seem that stocks and their risks have no place in a retirement portfolio. Why take the chance that a stock market downturn will shrink the savings you're relying on? Because stocks can help you avoid another danger in retirement—inflation risk. Remember that retirement can stretch to three decades or longer. Over a 30-year retirement, a moderate inflation rate of 2.5% would cut the buying power of your savings in half.

Vanguard Target Retirement Funds

One way to create your retirement portfolio is to invest in a single Vanguard Target Retirement Fund. These funds are designed so that a single one can serve as a complete portfolio throughout your career and retirement. Vanguard Target Retirement Income Fund is designed specifically for retirees withdrawing income from their savings.

Investments in Target Retirement Funds are subject to the risks of their underlying funds. The year in the fund name refers to the approximate year (the target date) when an investor in the fund would retire and leave the workforce. The fund will gradually shift its emphasis from more aggressive investments to more conservative ones based on its target date. An investment in a Target Retirement Fund is not guaranteed at any time, including on or after the target date.

Vanguard Managed Payout Fund

Vanguard Managed Payout Fund offers another approach. This balanced fund is designed to provide automatic monthly income payments to retirees. It invests in a complete portfolio, diversified across asset classes, maintained by professional managers, and intended to achieve some modest growth. The fund's monthly payment amount is based on a total annual payment of 4% of your balance.

The Managed Payout Fund is not guaranteed to achieve its investment objectives, is subject to loss, and some distributions may be treated in part as a return of capital. The dollar amount of the fund's monthly cash distributions could go up or down substantially from one year to the next and over time. It is also possible for the fund to suffer substantial investment losses and simultaneously experience additional asset reductions as a result of its distributions to shareholders under its managed distribution policy. An investment in the fund could lose money over short, intermediate, or even long periods of time because the fund allocates its assets worldwide across different asset classes and investments with specific risk and return characteristics. The fund is proportionately subject to the risks associated with its underlying funds, which may invest in stocks (including stocks issued by REITs), bonds, cash, inflation-linked investments, commodity-linked investments, long/short market neutral investments, and leveraged absolute return investments.

The Managed Payout Fund may not be appropriate for all investors. For example, depending on the time horizon, retirement income needs, and tax bracket, an investment in the fund might not be appropriate for younger investors not currently in retirement, for investors under age 59½ who may hold the fund in an IRA or other tax-advantaged account, or for participants in employer-sponsored plans. Investors who hold the fund within a tax-advantaged retirement account should consult their tax advisors to discuss tax consequences that could result if payments are distributed from their account prior to age 59½ or if they plan to use the fund, in whole or in part, to meet their required minimum distribution (RMD) obligations. Distributions from the fund are unlikely to precisely match an investor's IRA RMD obligations. In addition, use of the fund may be restricted in employer-sponsored plans by the terms of the governing plan documents and/or at the discretion of the plan administrator. Review the information carefully with your financial advisor before deciding whether the fund is right for you.

You can learn more about generating income in retirement at **vanguard.com/retirementpaycheck**.

Working in retirement

Some of the most effective ways to increase retirement income is to work a year or two longer, or to take a part-time job to supplement your income in the early years of retirement.

Working a year or two longer has three important benefits:

- You can save more for retirement.
- It reduces the number of years that your retirement savings must last.
- Your Social Security benefit increases with every month you delay filing for benefits up until age 70.

If you don't want to work full time, consider taking a part-time job. Many retirees supplement their income by turning a hobby into a part-time job.

Earned income can reduce Social Security payments until you pass your full retirement age (which is 65 to 67, depending on your year of birth). The rules are complicated, but you can learn more from the publication "How work affects your benefits," at **ssa.gov**.

CASE STUDY:

Marsha consolidates her retirement accounts

Marsha—a graphic designer, age 65—is single with two grown children. Over a 30-year career she's accumulated savings in multiple retirement accounts, including an IRA that she inherited from her husband. She expects a small pension in addition to her Social Security benefits. Marsha also expects to supplement her retirement income with some freelance work for a few years.

Marsha has never had much interest in managing her investments—and expects to have even less interest in retirement. Above all she wants to simplify her finances.

Marsha retires at age 65 with:

- $250,000 in her 401(k) account.
- $60,000 in a university 403(b).
- $200,000 in her late husband's IRA.
- A house in the suburbs that's almost paid off—and where she wants to continue living.
- $975 in expected monthly income from Social Security.
- Her university pension—which she could take as a choice of either:
  - > A lump sum of $75,000, or
  - > An annuity of $445 per month for the rest of her life (with no adjustments for inflation).

Marsha's first decision is to take her university pension as an annuity rather than as a lump sum. That gives her a guaranteed floor of $1,420 per month consisting of her $975 Social Security payment and her $445 pension payment.

Unlike her Social Security benefit, Marsha's pension payment won't increase with inflation. It will remain $445 per month decades from now. Marsha understands that its purchasing power will erode over time.

Marsha's next decision is to consolidate all of her scattered retirement plan accounts into one. She rolls over both her 401(k) and 403(b) savings into her IRA, which is now worth $510,000.

Marsha still needs to withdraw some money from her IRA to supplement the guaranteed income she'll be getting from Social Security and her pension. Though she can't afford a personal investment manager, she does a little research and finds out about the next best thing: a managed-payout mutual fund.

Marsha invests her entire IRA balance of $510,000 in Vanguard Managed Payout Fund. In her first year of retirement, this fund will pay Marsha $1,700 per month. Marsha's first year retirement income will include:

- Monthly Social Security payment: $975.
- Monthly pension payment: $445.
- Monthly distributions from her IRA/Managed Payout Fund: $1,700.
- Marsha's combined income from these sources will be $3,120 a month. This does not count any freelance work she might do to supplement her income.

Marsha's monthly Social Security and pension payments will be automatically deposited to her checking account. Marsha contacts her fund company to arrange that the distributions from her IRA are also automatically transferred to her checking account. From these three sources, Marsha will get monthly retirement income from which she will pay her living expenses.

Note: This hypothetical example does not represent the return on any particular investment.

CASE STUDY:

Marsha consolidates her retirement accounts, continued

Marsha is now set for her first year of retirement: She has enough income to support her lifestyle, and she still has substantial savings in her IRA. Moreover, she's achieved her primary goal of simplifying her finances. But Marsha has a few other things she needs to think about:

Variability. The monthly distributions that Marsha will receive from the Managed Payout Fund could vary unpredictably in subsequent years. If the markets are favorable, the income that the fund generates should also grow. But markets aren't always favorable, so the fund could be flat or even lose money in future years—which would reduce the income it generates. In that case, Marsha may have to reduce her spending.

Discipline. Marsha has a half-million dollars saved in her IRA, so at some point she may be tempted to cash in some of that to take a vacation, buy a luxury car, or generally increase her spending beyond her $3,120-per-month income. And, at some point, she may need some of that money for an emergency.

Spending flexibility is indeed one of the advantages of preserving a pool of savings in retirement. But Marsha understands that the more she taps her IRA, the less income the Managed Payout Fund will generate for her. This is a powerful incentive for her to keep her spending matched to her income.

Required minimum distributions. After age 70½, Marsha must take required minimum distributions from her IRA. If she withdraws too little, she could owe a 50% tax penalty on the shortfall.

Take your withdrawals in a tax-efficient order

If you have different types of retirement accounts, you may be able to prolong your savings by withdrawing money in the most tax-efficient order:

1. Spend from your taxable accounts first before taking withdrawals from tax-advantaged accounts.

2. Next, consider withdrawing money from tax-deferred accounts, such as an employer's plan or a traditional IRA.*

3. Finally, withdraw money from tax-free accounts, such as qualifying Roth contributions made to an IRA or your employer's plan.

*You are required to take taxable distributions from tax-deferred accounts (such as an employer's plan or traditional IRA) after age 70½ or face a potential 50% federal penalty tax on the amount that should have been withdrawn.

CASE STUDY:

Rick and Doris organize their withdrawals

Rick and Doris are in their second year of retirement and have combined retirement savings of $750,000:

- Rick has $200,000 in his 401(k).
- Doris has $380,000 in her 401(k).
- Rick has an IRA worth $50,000.
- They jointly own mutual funds worth $120,000 in a taxable account.
- All the distributions from their taxable investments are directed to a money market fund, which is their cash reserve.

Their plan at the beginning of every year is to make sure that they have a year's worth of spending money on hand: 4% of their savings, or $30,000. And they've set up their money market account to send $2,500 each month, electronically, to their bank checking account, from which they pay their bills.

Because it's January, Doris is preparing to move enough money from their investment accounts to their cash reserve account to total $30,000. She notices that, though she and Rick spent all $30,000 last year, their cash account still has a $3,600 balance. This is because all through the previous year, the dividends and capital gains distributions from their taxable investments were automatically deposited to their cash account. To bring the cash balance up to $30,000, Doris sells shares worth $26,400 from their taxable investments and directs the proceeds to their cash account.

Because Rick and Doris are in their mid-60s, they aren't subject to the IRS's required minimum distribution (RMD) rules yet. This means that their 401(k) and IRA investments can continue to grow untouched and tax-deferred for a few more years.

How to obtain additional regular income

A systematic withdrawal plan like the one described on page 8 gives you plenty of flexibility. You maintain control over your investment strategy and have complete access to your money.

It's important to realize there are risks as well. If the market drops sharply early in your retirement, you may have to reduce your withdrawals to make your savings last. If the downturn is severe and sustained, your money could run out even if you reduce your withdrawals.

For many, Social Security provides a steady floor of support, and withdrawals from savings add flexibility. But if you're concerned about running out of money, consider using a portion of your retirement savings to purchase an annuity.

An annuity is an insurance contract. In return for a single up-front payment, you receive regular payments that are guaranteed by the insurance company that sells you the annuity. The income can last for as long as you are living, as long as you or your spouse is living, or for a specific number of years.*

Here are some of the most common annuity options, and what the terms mean:

- **Single premium** annuities are purchased with a single payment, typically at retirement.
- **Immediate-income** annuities begin to pay regular cash benefits right away.
- **Single life** could provide benefits for as long as you live.
- **Joint-and-survivor** means that payments continue over the lifetimes of you and another person, such as your spouse.
- **Fixed period** means guaranteed payments for a certain number of years. If you die during the guarantee period, remaining payments go to your beneficiaries.

*Product guarantees are subject to the claims-paying ability of the issuing insurance company.

Important considerations about annuities

When shopping for an immediate annuity, you should seek a highly rated insurance company, which means that it is considered financially strong enough to honor its obligations. You may also want to purchase a policy with an inflation rider to preserve your spending power over a lengthy retirement.

Insurance companies calculate annuity payments based on average life expectancies. The longer you expect to live, the more economic sense an annuity purchase may make.

However, an annuity purchase is typically irrevocable, so you do give up flexibility in return for guaranteed payments. What you're buying is a stream of regular income, but it's not generally an asset you can pass along to heirs or cash in for emergencies.

Finally, an annuity may not be a feature of your employer's retirement savings plan. In that case, you would have to roll over your money to purchase it outside your plan.

If you're thinking of purchasing an income annuity, consider Vanguard Annuity Access™, powered by the Income Solutions® platform. In just a few minutes, you'll get customized online quotes from several highly rated insurance companies. You can access this service at **vanguard.com/income**.

C A S E S T U D Y :

Fred purchases an annuity

Fred is single—a widower. He's done well, and all along he's been planning to retire at age 70, sell his house in the suburbs, and move into the city. He's healthy and he intends to enjoy life—but he's not rich, so he can't be extravagant.

Fred is a good planner: he knows where his income will be coming from in retirement, and he's calculated how much he can afford to spend.

Fred retires at age 70 with:

- $450,000 in his 401(k).
- $250,000 in an IRA.
- A house in the suburbs worth about $500,000; his mortgage is paid off.
- $1,600 in monthly income from Social Security.

Fred sells his house for $500,000 and rents an apartment for $1,500 a month. He now has $1.2 million in total savings, including the cash from selling his house, which he deposits into a money market fund.

Fred's retirement savings	
401(k)	$450,000
IRA	$250,000
Proceeds from the sale of his house	$500,000
Total	**$1,200,000**

CASE STUDY:

Fred purchases an annuity, continued

Fred uses $400,000 of his cash—one-third of his total savings—to buy an income annuity, which will pay him guaranteed income of about $1,400 per month for the rest of his life, adjusted for inflation. Fred chooses two options for his annuity:

- An inflation adjustment; without this option, Fred's $1,400 monthly payment would never increase with the cost of living.
- A 20-year "period certain" option—meaning that if he dies before age 90, his son, Xavier, Fred's sole beneficiary, will collect his remaining payments.

At this point, Fred can count on $3,000 per month in regular, inflation-adjusted, lifetime income (from Social Security and his annuity), and he has $800,000 left. And for convenience, Fred consolidates his retirement accounts by rolling over his 401(k) balance into his IRA.

Fred's remaining savings	
IRA	$700,000
Cash left over in his money market fund after buying the annuity	$100,000
Fred's total savings	**$800,000**

Fred still needs to withdraw money from his savings to supplement the regular income he'll be getting from Social Security and the annuity. He decides to spend 5% of his total savings—or $40,000—in his first year of retirement, adding $3,333 per month to his spending money ($40,000 ÷ 12 months = $3,333).

Fred's monthly income	
Monthly Social Security payment	$1,600
Monthly annuity payment	$1,400
Monthly withdrawals from savings	$3,333
Fred's total monthly income in year one	**$6,333**

Fred's monthly Social Security and annuity payments will be automatically deposited to his bank checking account. Similarly, Fred contacts his fund company to arrange that $3,333 be automatically transferred each month from his money market account to his checking account. From these three sources, Fred receives monthly retirement income of $6,333.

Fred is now set for his first year of retirement. He has enough income to support his lifestyle, and he still has substantial savings. But Fred has a few other things he needs to think about:

Inflation. In subsequent years, Fred will want to adjust his withdrawals from his savings for inflation, just as his Social Security and annuity payments will be adjusted. This is easy enough to do. In his second year of retirement, he'll check the U.S. Bureau of Labor Statistics' website to determine the annual inflation rate—as indicated by the Consumer Price Index—and increase his withdrawal from his savings accordingly.

So, if the inflation rate between year one and two of his retirement is 2%, Fred may want to spend $40,800 from his savings in year two: $40,000 increased by 2%. The same process could apply in future years.

Inflation-adjusted withdrawals	
Year one withdrawal	$40,000
Year two withdrawal (2% inflation)	$40,000 x 1.02 = $40,800
Year three withdrawal (3% inflation)	$40,800 x 1.03 = $42,024

Staying flexible. Fred shouldn't take these annual increases for granted, however. He should keep his eye on the markets and on his account balances. If the markets decline and the value of his savings drops significantly, Fred should reduce his spending in those years rather than increase it by the inflation rate.

Required minimum distributions (RMDs). In his first year of retirement, Fred has more than enough cash left over from the sale of his house to cover his $3,333 monthly withdrawals. This means that, for at least one more year, he doesn't have to touch his IRA, permitting it—if the markets are favorable—to continue to grow on a tax-deferred basis.

CASE STUDY:

Fred purchases an annuity, continued

But starting in the year after a retiree turns 70½—an age which Fred will reach soon after retiring—the IRS requires investors to begin taking minimum distributions from their qualified retirement plans, such as IRAs and 401(k)s, and to pay taxes on those distributions.

Fred signs up for the automatic RMD service offered by his IRA provider: each year the provider will calculate (and distribute to Fred) the minimum amount he needs to withdraw from his IRA to comply with the law. Fred knows, however, not to confuse his RMDs with his spending plan. Regardless of the amount that the IRS requires Fred to withdraw from his IRA, Fred intends to follow his disciplined withdrawal schedule.

In some years Fred's RMD will exceed his spending plan, so he'll save the excess for the future; in other years Fred's spending plan may dictate that he withdraw more than the required minimum from his IRA.

Smart investing. Fred realizes that the rate at which he'll be spending from his savings (5% of his savings in year one with annual increases for inflation) is somewhat aggressive. He understands that there's some risk that he'll run out of money in 20 or 30 years, unless his savings grow at a rate that keeps pace, roughly, with his withdrawals.

That's why he has decided to keep his **long-term money**, such as his IRA, invested and diversified across the stock and bond markets, a strategy that has a good chance of increasing his portfolio over time even as he spends from it. Fred isn't interested in making any radical changes to the way he has been investing over the past decade, which has been about 60% in stock funds and 40% in bond funds. As he ages, he expects to gradually reverse those allocations and get somewhat more conservative—perhaps to 40% stocks and 60% bonds—still keeping enough of a stake in the stock market to capture some of its potential for growth.

Fred will keep his **cash reserve**—his spending money for the next year or so—in his money market fund, which is low-risk and highly liquid. Each year, in accordance with his spending plan, he'll shift some of his long-term savings to his money market fund. At the same time he'll check the allocation of his long-term savings and rebalance them if necessary.

Remember your RMDs

Because Fred is turning 70½ this year, he must begin taking required minimum distributions (RMDs) from his tax-deferred retirement savings no later than April 1 of next year. RMDs are intended to ensure that taxpayers withdraw and pay taxes on their tax-deferred retirement money over their lifetimes.

Fred checks an online calculator and finds that his planned first year withdrawal of $40,000 will satisfy the IRS's annual RMD rules for someone with his amount of assets.

But rather than take his distribution from his taxable money market account—as he did in year one of retirement— in year two Fred must withdraw the money from his tax-deferred IRA and pay taxes on the distribution. That way Fred will meet his RMD obligation.

It's important to pay careful attention to RMDs because failing to meet them can result in a tax penalty of 50% of the amount that should have been withdrawn. In addition, the retiree must withdraw—and pay taxes on—the amount that should have been withdrawn in the first place.

Free Vanguard RMD service

If you have tax-deferred accounts at Vanguard that are subject to required minimum distributions, we'll calculate your RMDs for those accounts free after you turn age 70½. If your money is in an IRA, Vanguard will arrange to send your RMD payments to you automatically if you call us at **800-205-6189**. For money in your employer's retirement account, call us at **800-523-1188**.

Five ways to increase retirement income

What should you do if you don't have enough money to retire? Here are five ways to make up a shortfall:

1. **Postpone retirement.** Working another year or two may allow your savings to grow and reduces the number of years you'll be making withdrawals. You may get a larger Social Security check as well.

2. **Work part-time during retirement.** Nearly 20% of the income reported by Americans age 65 and older comes from wages.

3. **Save more in your plan.** Step up your retirement savings while you're still working. If you're already saving the maximum allowed, open or add to an IRA or contribute money to a taxable account.

4. **Tap into your home's equity.** If you own your home, could you downsize like Fred and add to your retirement savings? Or if you want to stay put, you could examine a reverse mortgage (although the fees and other costs should be carefully evaluated).

5. **Reduce your expenses.** Maybe you could make it a priority to pay off your mortgage before retirement. Or perhaps you could become a one-car family when you retire. Examine your budget carefully for opportunities to cut costs.

Stay flexible and adjust

While you've learned several ways to create a steady stream of retirement income, it's important to realize that no one method is perfect and that most retirees change their approach as their circumstances change.

If the market drops sharply, many retirees will instinctively tighten their belts and take less from savings that year. Or a series of good returns on their investments might permit them to splurge a bit.

Because there are so many factors that you can't control (such as market performance, the rate of inflation, and life expectancy), the more flexible you are, the more likely it is that you can maintain a lifelong stream of retirement income.

Vanguard can help

The decisions you make about your retirement savings are important. Take your time as you make up your mind about what course to follow.

Vanguard can answer your questions about retirement income, and also offers a wide array of investment and planning services that can help you as you transition from work to retirement.

Retirement can be a wise time to engage the services of a financial planning professional to make the most of your choices.

Visit **vanguard.com/retirementpaycheck** to learn more about generating income during retirement. Or you can speak with a Vanguard Participant Services associate at **800-523-1188** Monday through Friday from 8:30 a.m. to 9 p.m., Eastern time.

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For more information about any fund, including investment objectives, risks, charges, and expenses, call Vanguard at 800-523-1188 to obtain a prospectus or, if available, a summary prospectus. The prospectus contains this and other important information about the fund. Read and consider the prospectus information carefully before you invest. You can also download Vanguard fund prospectuses at vanguard.com.

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