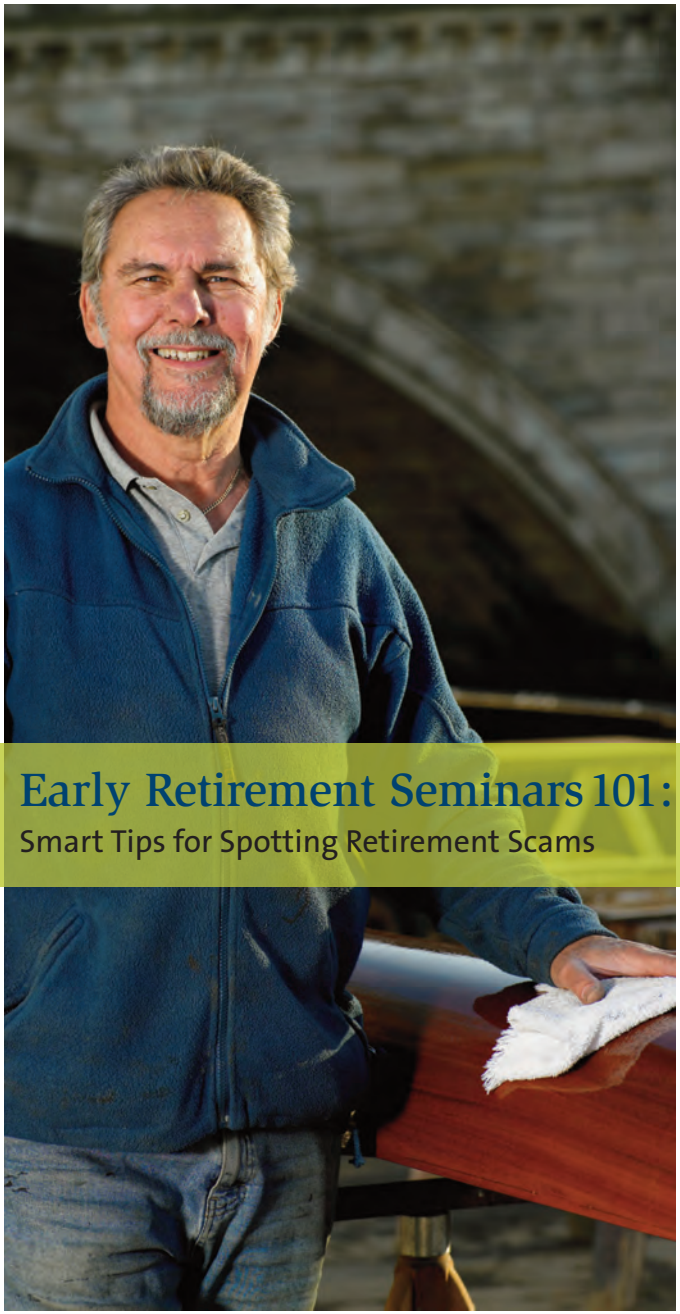
Financial Industry Regulatory Authority



Early Retirement Seminars 101:

Smart Tips for Spotting Retirement Scams

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SMART TIPS FOR SPOTTING RETIREMENT SCAMS

For many Americans, retirement can be an alluring stage of life—a time when many hope to finally have the time to try new hobbies or travel. But retiring comfortably and being able to do the things you dream about requires a steady stream of income that lasts as long as you do. The earlier you retire, the more important it is to manage your retirement assets wisely.

Unfortunately, some financial "experts" tout early retirement schemes that promise more than they can deliver. This brochure will help you avoid being misled by flawed or even fraudulent retirement pitches, particularly those that dangle the prospect of early retirement with little or no reduction in income compared to your working years. It describes real-life examples of fraudulent early retirement pitches, provides tips on how to recognize and avoid these sorts of pitches and tells you where to turn for help.

What This Brochure Does Not Cover

Understand that this brochure does not cover early retirement packages that may be offered by your company. For employer-sponsored early retirement programs, the best source of information will be your company's human resources or benefits department.

REAL-LIFE EXAMPLE

Employees of a major corporation attended free seminars near their place of employment where a broker pitched a strategy which recommended that they:

- Retire earlier than they might otherwise have done;
- Cash out of their 401(k) plan or take a lump-sum payment for the cash value of their pension; and
- Open a traditional Individual Retirement Account at the broker's firm and invest in securities that carried substantial risk and high fees.

During the seminars, the broker represented that these investments would generate aggressive annual returns of as high as 18 percent. Little mention was made of the risks associated with such an aggressive growth scenario—the most obvious risk being that the value of the investments go up and down with changes in market conditions. The pitch also failed to adequately explain that the overall return on the investments would be reduced by various fees and expenses associated with the purchase and ongoing administration of the investments.

Furthermore, the strategy recommended annual withdrawal amounts generally starting at 7.5 to 9 percent of the initial investment. While materials given to individual employees in one-on-one meetings portrayed these rates as being sustainable for more than 30 years, they assumed returns of 11 to 14 percent.

The reality is that these rates proved unrealistic and were not achievable. Employees who followed the broker's program could not maintain the recommended withdrawal amounts without depleting their retirement accounts to levels that threatened their retirement security. By the time many of the employees realized this, they had lost a significant portion of their retirement nest egg.

Be Skeptical of Early Retirement Investment Claims

Because the allure of a leisurely retirement can be very tempting, and those who promote early retirement schemes can be extremely persuasive, it's critical to think carefully before you act.

Signing on to an early retirement investment strategy presents risks. It only makes sense if you have saved enough to begin with, make smart investment choices during your retirement years and withdraw money at a rate that does not deplete your savings too early.

How much is enough? This depends on many factors, including other sources of income, such as a company pension, rate of return on your investments and how long you live. You likely will need a savings nest egg that is many times your current yearly earnings to provide enough income to live comfortably in retirement[1]. For an approximate estimate of how much savings you will need to accumulate, use the **Employee Benefits Research Institute's Ballpark E$timate calculator** ***(www.choosetosave.org/ballpark)***

1 *The Employee Benefit Research Institute (EBRI) suggests you will need target multiples of at least 12 times your current household earnings, and in some cases much more, to obtain a 90 percent chance of having adequate retirement income to cover basic expenses plus non-covered health care costs throughout retirement. EBRI Issue Brief, June 2006, "Measuring Retirement Income Adequacy: Calculating Realistic Income Replacement Rates." Jack VanDerhei, Temple University and EBRI Fellow.*

BE SKEPTICAL IF YOU HEAR:

- **Everyone can retire early!** The reality is that many employees simply do not have the resources to do so. Early retirement is not feasible for many people, and is particularly risky for workers who haven't saved enough for an extended retirement and who have limited opportunities for other employment.
- **You can make as much in retirement as you can by continuing to work!** Promises like this usually hinge on unrealistically high returns on investments and unsustainably large yearly withdrawals.
- **You can expect returns of 12 percent or more!** First of all, no one can predict what an investment will do from one year to the next—and even if an investment performed well in the past, this is no guarantee it will do so in the future. Second, any return over 10.4 percent exceeds the historical long-term returns for the stock market (assuming all dividends were reinvested rather than spent), and greatly exceeds long-term returns for less risky investments such as bonds, for which the average annual return over the long term is less than 6 percent. Finally, the stock market is inherently volatile it goes up, and it goes down. Over the last 80 years, there have been many short-term periods that produced returns well below the historical average of 10.4 percent.
- **You can withdraw 7 percent or more and never run out of money!** While there is no perfect consensus on what this withdrawal rate should be, the uncertainty of return, market fluctuations and increased life expectancies among other factors argue for being conservative with your withdrawals, especially during the first years of retirement. Many experts recommend withdrawal rates between 3 and 5 percent per year, especially in the first years of retirement.

What the IRS Says About Early Withdrawals from Your Retirement Plan

In addition to the income tax you pay on most retirement plan withdrawals, Section 72(t) of the Internal Revenue Code imposes an additional tax of 10 percent on distributions from qualified retirement plans—including traditional IRAs—made before age 59 ½. The IRS does, however, allow you to avoid this 10 percent penalty if the distributions from your retirement plan "are part of a series of substantially equal periodic payments."

These payments must last for five years or until you reach age 59 ½, whichever is longer, and IRS rules govern how you calculate the amount of the payments. For more information on Section 72(t) and methods for calculating payments, see the IRS's FAQ regarding Revenue Ruling 2002-62. *(www.irs.gov/retirement/article/0,,id=103045,00.html.)*

TIPS TO AVOID BEING TAKEN

Don't let the promise of easy money lure you into an early retirement you weren't otherwise considering. Before you quit your day job (or night job) and invest your retirement savings, follow these tips:

1. **Be skeptical of "free lunch" seminars.** Even if those events take place at or near the workplace, don't assume that your employer is behind the event.

2. **Be wary of early retirement pitches based on little-known loopholes.** While IRS Section 72(t) is a "little-known loophole" that allows you to access your retirement funds early, there's a lot more to a successful early retirement than avoiding a 10 percent tax penalty.

3. **Determine your willingness to live with an unpredictable amount of retirement funds.** Think hard before trading the relative certainty of a company pension—which may offer steady and predictable payments for as long as you live—for the uncertainty of investments whose value fluctuates.

4. **Know your current plan.** Many employers allow former employees to leave their 401(k) assets in the company's plan. Before moving your assets, take time to understand your current plan. You may find that staying put is a sound and less costly option.

5. **Understand the tax bite.** Before quitting and cashing in a 401(k), do a little math. Remember that even if you avoid the 10 percent early withdrawal tax penalty, you won't be able to spend every penny. Instead, you will have to pay ordinary income taxes on your withdrawals. Be sure to ask a tax professional about any other potential tax consequences of your decision.

6. **Figure out the unintended consequences of early retirement.** You may also wish to consult an attorney about any other unintended consequences, especially if you are in debt or owe child support or alimony. Depending on the laws in your state, cashing out of your retirement plan may mean that your creditors can collect against that payment you receive—even if you're rolling the assets to a traditional IRA.

7. **Understand the difference between classes of mutual fund shares.** Keep in mind that Class A mutual fund shares may be the best choice if the investment amount is large enough to qualify for a discount on front-end sales loads that may be offered for larger mutual fund investments. Such discounts usually start with investments of $50,000, but sometimes can begin at $25,000. Use FINRA's Mutual Fund Expense Analyzer *(http://apps.finra.org/Investor_Information/EA/1/mfetf.aspx)* to compare and calculate mutual fund expenses.

8. **Consider the costs associated with variable annuities.** Be aware that most variable annuities have sales charges, including asset-based sales charges or surrender charges. In addition, variable annuities may impose a variety of fees and expenses when you invest in them, including mortality and expense fees, administrative costs and investment advisory fees.

9. **Check the speaker's credentials.** Find out whether the person offering you investments is registered with FINRA, which regulates brokers. Use FINRA BrokerCheck *(www.finra.org/InvestorInformation/InvestorProtection/ChecktheBackgroundofYourInvestmentProfessional/index.htm)* or call the FINRA Hotline at (800) 289-9999. If he or she is registered, be sure to check out any red flags raised by employment or disciplinary history. To check out an investment advisor, contact your state securities regulator *(www.nasaa.org/QuickLinks/ContactYourRegulator.cfm)* or call (202) 737-0900.

10. **Get a second opinion.** Before committing to an early retirement strategy, consult with a financial professional of your choosing before taking the advice of someone who "found you."

Keep in mind that your retired life may be as long as, or longer than, your working life. Take the time to research your retirement options carefully—before you leave the working world behind.

If a Problem Occurs

If you have questions or wish to file a complaint about an early retirement pitch that involves investments, be sure to file a complaint with FINRA:

ONLINE: *www.finra.org/complaint*

MAIL OR FAX: FINRA Complaints and Tips
9509 Key West Avenue
Rockville, MD 20850-3329

Fax: (866) 397-3290

Who We Are

FINRA, the Financial Industry Regulatory Authority, is the largest non-governmental regulator for all securities firms doing business with the U.S. public. All told, FINRA oversees over 5,000 brokerage firms, about 173,000 branch offices and more than 677,000 registered securities representatives. Created in July 2007 through the consolidation of NASD and the member regulation, enforcement and arbitration functions of the New York Stock Exchange, FINRA is dedicated to investor protection and market integrity through effective and efficient regulation and complementary compliance and technology-based services. For Investor Alerts and other investor information, go to *www.finra.org*.

Investor protection. Market integrity.

1735 K Street, NW
Washington, DC 20006-1506
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