

**PLANNING
FOR YOUR
RETIREMENT**

For

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ENG – 393 Technical Writing

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By

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EXECUTIVE SUMMARY

Planning for your retirement is the most important step to achieving financial success. The planning process begins with creating an emergency fund. This will allow you to successfully recover, should a tragedy strike. Obtaining adequate insurance to provide for your loved ones is very important. Paying off existing debt will provide more money in your pocket, by eliminating interest payments. You must establish long-term financial goals. Calculating your current cash flow will provide you with the information you need to formulate an investment strategy. This strategy will outline how you will reach your goals.

Common retirement accounts include, 401(K), Traditional IRA, and Roth IRA. The most common, and the one that provides the greatest return, is the 401(K) plan. Many employers match your contributions and the maximum contribution limit is significantly higher than other plans. The Roth IRA is a plan where your contributions will grow tax-free, adding up to a substantial nest egg, when you retire. The effects of compounding interest will provide you with substantial earnings. However, you need to start investing as soon as possible. The longer the money can be compounded equates to more money in your pocket. So, what are you waiting for?

INTRODUCTION

Planning for your retirement can be a daunting task. It is a subject that many people choose to avoid. Waiting until you retire is too late to start investing. If you are one of the few who has considered your retirement, where do you start and how do you know the information you are receiving is accurate? The following steps should help guide you through the planning process and eventually achieve your financial goals.

1. Take care of the Basics
2. Understanding your Investment Goals
3. Evaluate your cash flow and net worth
4. Create a strategy

This report will cover the importance of investing and describe various retirement accounts. Compounding interest will be stressed to emphasize the importance of investing early. A short tutorial in setting up an online IRA account will be provided.

This report will serve as an instructional tool for first-time investors. It will focus on individual investing through a tax-deferred retirement account. This report will not promote a specific investment account, but will explain their differences. This report will not cover Social Security.

THE PLANNING PROCESS

Take Care of the Basics

Before you begin investing, make sure you have created a financial safety net. Unexplained or unpredictable disasters can occur at a moments notice. The best defense against such a tragedy is to have an emergency fund and to be adequately insured.

Emergency Fund

Prior to setting up an emergency fund, you need to accurately assess your financial obligations. How much money do you need to survive, should you lose everything today? What will you do in the event of illness or unemployment? An adequate emergency fund will provide for at least three months' living expenses. A more conservative approach would be to set aside at least six months' living expenses. The size of the fund should correspond to the time you feel it would take to get back on your feet. In addition, your own tolerance for risk will dictate the size of this fund.

This fund should be established before any investments are made. This fund is not to be touched unless you experience an emergency. This fund should be liquid, meaning converted to cash as quickly as possible. Examples of liquid funds are savings accounts or money market funds (Schwab, 1998). Some financial professionals would include mutual funds in this list of liquid funds. However, you do not want your fund to suffer from fluctuations in the market. Ideally, you want your emergency fund to grow at a steady rate. Hopefully this account is never needed, but if an emergency happens, you will need immediate access to this money.

Insurance

Life insurance is the best protection against the ultimate family crisis, the death of the primary supporter. If you are single and not responsible for others, then life insurance in my opinion is a waste of money. Life insurance is a way to ensure your loved ones are taken care of, should something bad happen to you. This report will not cover insurance in detail, so you should seek out a professional to go through your options. However, inexpensive term life insurance will ensure your family is taken care of, should you suffer from premature death.

Pay off Existing Debt

Many people may argue with this category. However, consider the following example. You owe \$1,100 dollars on your credit card, which has an interest rate of 18.5 %. You pay only the minimum balance, which in this case is 1.7% (around 20 dollars per month) and do not add to the balance on the card. It will take you 12 ½ years to pay off this credit card and you will have paid approximately \$1,400 in interest (Schwab, 1998). By paying, even a small amount more than the minimum balance, you will significantly reduce your interest payments. This equates to more money in your pocket.

Prior to putting money into an investment account, consider your debt. Consider the annual percentage or interest rate on any credit card balances. Your best investment may be to pay off those balances first. If you are in considerable debt, I would advise consulting a debt management counselor, prior to making any investment decisions.

Understand Your Investment Goals

Before you decide on where to place your money, you need to determine your investment goals. There is a large difference between living and living comfortably. There are many retirement calculators on the Internet to help you determine what you will need to save now in order to reach your goals. You will need to determine how much money would like to have when you retire and when you would like to start utilizing these earnings. Based on this, most retirement calculators will determine how much you need to set aside today.

There are many financial calculators at the following websites:

<http://www.finance.cch.com/tools/calcs.asp#DZ06>

<http://www.fundadvice.com/tools/calculators/retirement-and-investment-calculators.html>

In addition, there are many financial planning tools available on the Internet, which can be downloaded free. Make sure you have a device to record your goals such as a computer program, financial planning guide, or even a well-organized notebook.

When determining your retirement goals, consider all areas of your life. Determine a dollar amount and how much you need to invest now to reach that amount. Set a target date, a date when you want to achieve your financial goals. Write down these goals and dollar figures. Place them in a highly visible place and work each day toward achieving these goals (AARP).

Many people say they don't earn enough to invest or their current obligations prevent them from being able to save. If you are in this group, I ask that you take a closer look at your life. Closely examine how you spend your money on a day-to-day basis. Consider that morning cup of coffee you purchase from your local coffee shop. You spend \$4.00 each day, which may not seem like much. However, \$4.00 everyday (Monday through Friday) adds up

to \$20 per week, which turns out to be \$1040 each year. Forgoing that morning cup of coffee gives you \$1040 to contribute toward your retirement. A closer look will show that investing for your future is all about choices. Choices you make today will dramatically affect your lifestyle in the future.

Evaluate Your Cash Flow and Net Worth

Evaluating your cash flow and expenses is one of the most important steps in financial planning. This step requires you to be honest regarding your incoming and outgoing money. Consider every source of income that you may have. In many cases, this may only involve one source. Calculating this amount may be very easy.

Calculate all your expenses. This may be difficult to think of all your daily expenses. You will undoubtedly forget to record many expenses. Take a week or a month and record your every expense. You will be surprised at the amount of your miscellaneous expenses, such as “dry cleaning, haircuts, and pet care (AARP).”

When determining your net worth, assemble a list of all assets and liabilities. Record the dollar figure of all your cash holdings (savings account or prior investments). Also, consider all your non-cash holdings (property or antiques). Next, make a list of all your liabilities. This list should include such items as car payment, credit cards, mortgage or rent payment, and any other financial obligations. Your net worth is the difference between your total assets and total liabilities (AARP).

Creating a Strategy

Up to this point, you have taken care of your basics, you have established where you want to be financially when you retire, and you have taken a close look at your income and expenditures. You have established your future goals, but all the planning in the world means nothing unless you decide how you will achieve these goals.

The first step in creating your financial strategy is to develop a budget (AARP). The budget is a way to mesh your long-term financial goals with your income and expenditures. Many people think of the word “budget” with a negative connotation. However, budgets are all about choices. Do not think of a budget in terms of what you can and cannot have. Think of it as a list of choices, made by you and your family. A budget gives you the power to be as flexible as you want. When you forgo an item today, it is because you CHOOSE something in the future. If you want to revise your budget to make a purchase today, be sure to think before you buy. You are choosing an item today, which may prevent you from having something in the future. If you are comfortable with this decision, then make your purchase. Always consider the consequences of a purchase and this may help you to stick to your budget. Placing a positive twist on budgeting can ensure that you and your family will stick to the plan and reach your financial goals.

Placing your money in a savings account is better than not saving at all, but there are better investment vehicles for your money. According to the Federal Reserve Bank of Minneapolis, the inflation rate for 2005 is 3.0%. Many regular savings accounts earn approximately 3.0% – 4.0%. This means that if inflation rises above the annual percentage rate of your regular savings account, you are losing money. No matter where you choose to

place your money, make regular contributions to yourself, first. Consider your retirement account as a monthly bill that you must pay.

COMPOUND INTEREST

This topic is so important that it must have a dedicated section. Compounding interest is the main reason why you should begin investing early. Making regular contributions, even small amounts, early in your life, will lead to substantial rewards.

A good way to help you stick to your budget, as discussed earlier, is to think of today's purchases in terms of potential future earnings. If you plan to purchase a car for \$20,000, first consider how much that money could have earned. "If you invest \$20,000 in an account with an annual rate of return of 10 % and never add another penny, in 20 years that money could easily grow to \$135,000 (Orman, 2001)." As you can see from this example, the car you plan on purchasing actually costs you \$135,000.

The following examples, with the help of an interest calculator from www.fundadvice.com, will show you the importance of compounding interest. You place \$200 each month into an account that earns an annual rate of return of 10% and continue this routine for 20 years. The amount of money you will have earned is \$151,873.77. However, if you continue this routine for 40 years, you will have earned \$1,264,815.92.

If you place \$10,000 into an account earning a 10% annual rate of return, and never add another penny, in 20 years you will have earned \$73,280.74. However, if you allow that same \$10,000 to grow in this account for 40 years, you will have earned \$537,006.63. These examples emphasize why you should start investing for your retirement now.

COMMON RETIREMENT PLANS

401 (K)

According to www.investopedia.com, a 401(k) plan is “a qualified plan established by employers to which eligible employees make salary-deferral (salary-reduction) contributions on a post- and/or pre-tax basis. Employers make matching contributions to the plan on behalf of eligible employees and may add a profit-sharing feature to the plan. Earnings accrue on a tax-deferred basis.” This plan is a voluntary plan offered to workers of a company. Employees can set aside a certain percentage of their earnings before or after taxes, up to a certain amount. These funds are invested within the established retirement account. The maximum percentage that you can contribute to this fund varies with each employer. In addition, the federal government establishes a maximum yearly contribution, which is tied to inflation and the consumer price index.

As of 2005, the maximum pre-tax annual contribution to a 401(k) plan is \$14,000. This amount is established by the Internal Revenue Service, but may be further restricted by an individual employer. In the past, the maximum annual contribution has increased by \$1,000 per year. This will continue until the year 2006, after which the maximum annual contribution is expected to increase only \$500 per year (Fidelity).

When you sign up for a 401(k) plan, you will have a choice of several types of investment vehicles. These investments will vary in risk and potential return. Typically, if the investment risk is low then the return on your investment will be low as well. Many companies allow you to allocate a percentage of your money into multiple investment vehicles. Even though you are required to choose at least one type of investment when signing up, you may reallocate your money later.

The money you place into a 401(k) plan will grow, tax deferred, until you withdraw the money at retirement. To prevent being penalized, you must wait until the age of 59 ½ to withdraw your money. At that time, you will need to pay regular income tax on your withdraws. Should you withdraw your money early, you will suffer a 10% penalty in addition to the regular income tax that you will pay (CCH Financial Planning Toolkit).

There are many benefits to contributing to a 401(k) plan. Most importantly, the contributions are easy and you benefit by paying yourself first. This money is removed from your pre-tax earnings and placed directly into your account. Essentially, you don't see it and therefore may never miss this money. You won't forget to write a check or be tempted to forgo a contribution. In addition, by making regular contributions to a fund, you benefit from what is referred to as dollar-cost-averaging. The amount you pay for an investment can be averaged over the course of a year. This amount will most likely be less than if you tried to time the market or made one lump sum contribution each year (Orman, 2001).

Traditional IRA

A traditional IRA is an individual retirement account that gives you the ability to set up your own tax-deferred investment account, without the intervention of an employer. As defined by www.investopedia.com, a Traditional IRA is defined as a retirement account where “individual taxpayers are allowed to contribute 100% of compensation (Self-employment income for Sole proprietors and partners) up to a specified maximum dollar amount to their Traditional IRA. Contributions to the Traditional IRA may be tax-deductible depending on the taxpayer's income, tax-filing status, and coverage by an employer-sponsored retirement plan.” The money contributed to a Traditional IRA account is from

your pre-tax income. For example, if you make \$30,000 during the year 2005 and make the maximum contribution to your Traditional IRA for that same year, you will only pay taxes on \$26,000. In addition, the current value of your Traditional IRA, along with any contributions, will grow tax-deferred until you make withdraws. At that time, the money will be taxed as regular income (Orman, 2001).

An individual can make regular contributions to this type of account up to the maximum yearly amount. As of 2005, the maximum annual contribution is \$4,000. This will remain the maximum until the year 2007. In 2008, the maximum contribution will increase to \$5,000. Then in 2009 and the following years, the maximum contribution amount will increase by \$500 each year (CCH Financial Planning Toolkit).

An advantage of Traditional IRA's, is the ability to take a tax deduction for your current year contribution, provided you qualify. The tax laws change from year to year, so you should check the current tax laws as set forth by the IRS.

Withdraws from a Traditional IRA cannot be made prior to the age of 59 ½. If done so, you are penalized 10% of the amount you withdraw, in addition to regular income taxes. Your money can remain in this account until April 15 of the year after you turn 70 ½. If you have not made your first withdraw by this date, you are penalized an annual amount of 50% of the amount you were supposed to withdraw (Orman, 2001).

There are exceptions to the early withdraw penalty, which are listed below (Orman, 2001). These exceptions are for both a Traditional IRA and a Roth IRA. Aspects of the Roth IRA will be covered later.

Exceptions

- 1. Disability:** You must prove that you cannot earn a living on your own due to a serious disability. This must be document by a medical doctor.
- 2. Death:** When you die, your beneficiaries can begin to withdraw the money at any age without paying a penalty.
- 3. Significant medical expenses:** If you have incurred significant medical bills, which are not covered by your insurance company, and those expenses exceed 7.5% of your adjusted gross income, you may be eligible for an exception.
- 4. First-time homebuyer:** You may not incur the 10% early withdraw penalty for building or purchasing a primary residence. The amount you withdraw can be up to a maximum of \$10,000. First-time homebuyer in this reference means that you have not owned a home in the previous two years.
- 5. Pay for college:** You or anyone in your family can use this money for college.
- 6. Health insurance:** If you need this money to pay insurance premiums for yourself or someone in your family and meet all of the following criteria:
 - a. You are unemployed because you lost your job.
 - b. You have received unemployment compensation for 12 consecutive weeks.
 - c. Your IRA withdraw is made in the same calendar year as the year you received unemployment.

Roth IRA

The Roth IRA was introduced by the Taxpayer Relief Act of 1997 (Appleby, 2004). This IRA is similar to a Traditional IRA with a few exceptions. Your contributions to a Roth

IRA grow tax-deferred as they would in a Traditional IRA, but you cannot deduct your contributions. The money you withdraw from a Roth IRA is not taxed.

According to www.investopedia.com, there are income limitations that dictate your eligibility for a Roth IRA. These limitations are listed below:

1. “No more than \$160,000 if you are married and file a joint tax return.”
2. “No more than \$100,000 if you are married and lived with your spouse for any period during the tax year, but filed a separate tax return.”
3. “No more than \$110,000 if you filed as ‘single’, ‘head of household’, or ‘married filing separately’ and did not live with your spouse at any time during the tax year.”

There are several advantages of a Roth IRA over a Traditional IRA. By forgoing a tax deduction now, you have the potential of gaining more money for when you retire. Also, when you make your withdraws, that money is non-taxable. This allows you to have considerably more spending money at a period in your life when you may need it. With a Traditional IRA, you are required to begin withdrawing the money at age 70 ½. If you do not need this money at that time, these withdraws will increase your income, thereby increasing your income tax. However, with a Roth IRA, you do not have to begin withdrawing the money at age 70 ½. The main reason to invest in a Roth IRA over a Traditional IRA is one of taxes. In a Roth IRA, your earnings are tax-free, with a Traditional IRA; they are merely tax-deferred (Appleby, 2004). During a period of your life, when your working income is nonexistent and your expenses, due to healthcare costs, are high, you do not want taxes eating away at your earnings.

For more information on setting up an IRA through a common online brokerage firm, consult appendix A.

CONCLUSION

Investing in general, let alone planning for retirement, can be very scary. You cannot expect your financial success of today to continue throughout your life. You must plan for retirement. By following the steps outlined in this report, creating an emergency fund, having adequate insurance, establishing your investment goals, evaluating your income and expenses, and finally creating a strategy to accomplish your goals, you will realize your financial dreams. Choose a retirement plan, such as a 401(k) or IRA that offers you the greatest benefit. Make regular contributions to this plan by paying yourself first. When deciding on today's purchases, consider them in terms of potential future earnings. Remind yourself that you are not giving up anything. You are choosing an alternative, which is financial freedom. Most important have fun and get the whole family involved.

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SETTING UP AN INDIVIDUAL RETIREMENT ACCOUNT

This section will describe some steps to establish an IRA through a common online brokerage firm. Ameritrade has been chosen for this example, however there are many online brokerage firms. Be sure to evaluate multiple firms prior to choosing one. This example cannot take you through the entire process because personal information is required. The steps are very easy and help is available along the way.

Step 1: Open your browser window and go to www.ameritrade.com

Step 2: Click on **Apply Online Now**. This button is located in the upper right-hand corner of your screen

Step 3: Select (IRA) Individual Retirement Account. Additional help is located in the Guidelines section, if you need it.

Step 4: Click **Next**.

Open Your Account - Mozilla Firefox

File Edit View Go Bookmarks Tools Help

https://wwwna.ameritrade.com/cgi-bin/apps/AccountApServlet?segment=ameritrade

Computer / Tech Email Games Navy School iTunes 4: Finding th... CNN.com - Breaking ...

AMERITRADE

New Account Application Ameritrade Chat with a New Accounts Representative Application Home

Welcome to Ameritrade

Setup Profile Agree Fund Review
Step 1

Congratulations! You've taken your first step toward opening an account and using Ameritrade to seek financial independence. Opening your account is faster and easier than ever. Simply follow the step-by-step instructions below. If you have questions during the process, check the **Guidelines** section on the right of each page or click **Chat with a New Accounts Representative** at the top of each page.

• required information

Please Select an Account Type *

Individual Joint (IRA) Individual Retirement Account

Next >

Guidelines

[I live in Canada](#)

[Where can I find additional account types?](#)

[How long will this take?](#)
The application process, on average, takes 12-15 minutes to complete.

[What information do I need?](#)

Step 5: Select how you will fund your new account. Click on the dropdown menu to see your funding options. If this is your first account, then you will most likely choose **Personal contribution**.

Open Your Account - Mozilla Firefox
File Edit View Go Bookmarks Tools Help
https://wwwna.ameritrade.com/cgi-bin/apps/AccountApServlet
Computer / Tech Email Games Navy School iTunes 4: Finding th... CNN.com - Breaking ...

AMERITRADE

IRA Account Application Ameritrade Chat with a New Accounts Representative Application Home

Create your Account Profile

Setup Profile Agree Fund Review
Step 1

Please select how your new account will be funded.*

Personal contribution
Select...
Personal contribution
Employer contribution
Roth conversion
Rollover (60-day or direct from another qualified plan)
Direct Transfer from another institution...

Cash Cash option (up to long options)

I have read the [Ameritrade Privacy Statement](#).

Next >

Guidelines

[I live in Canada](#)

[What are my funding options](#)

[What are the types of IRAs?](#)
Ameritrade offers 5 types of IRAs:

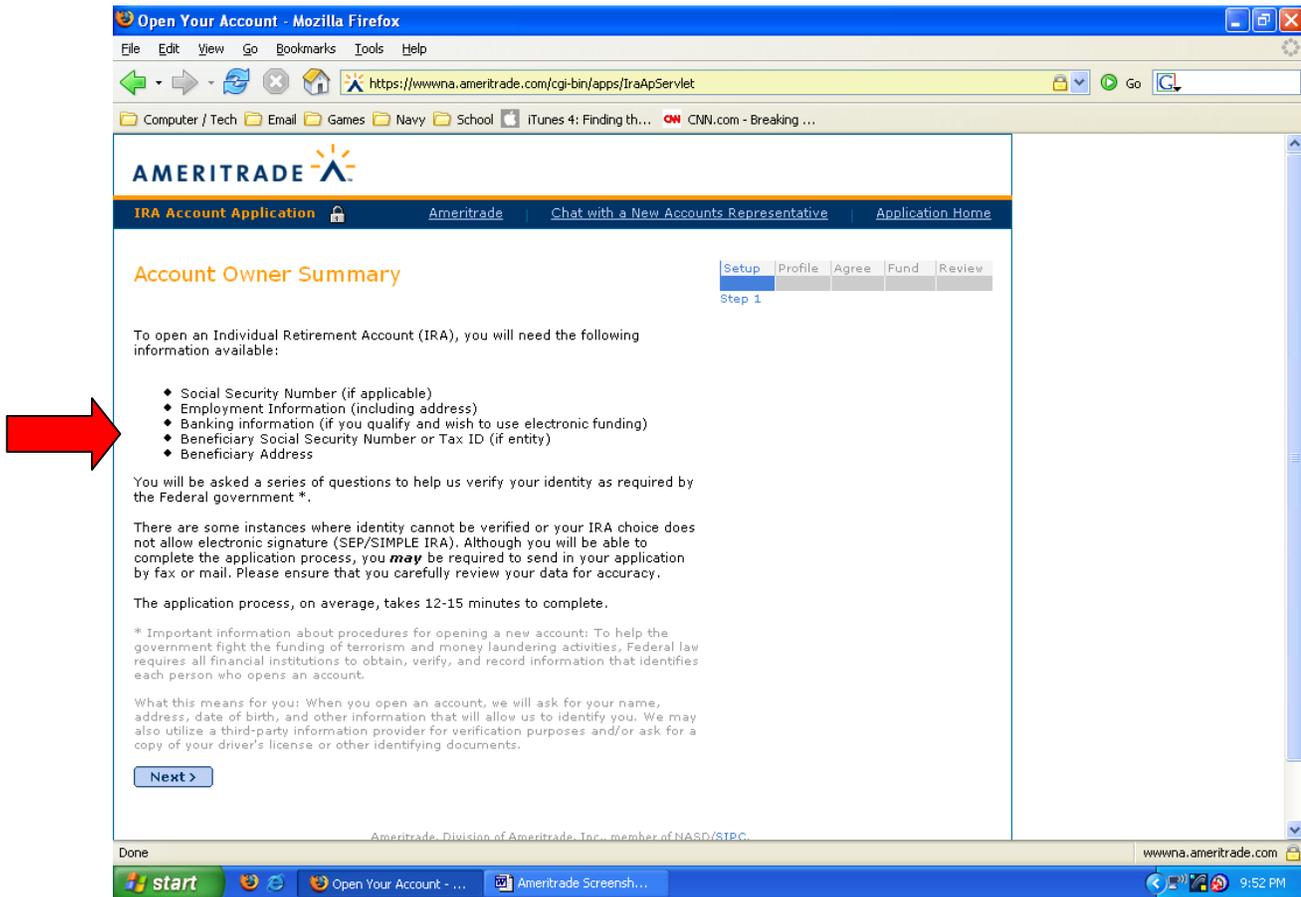
- **Traditional IRA:** A Traditional IRA (also called a Contributory IRA) can be established by an individual to save money for retirement. Contributions are tax deductible (with some exceptions) and withdrawals are taxed. The maximum annual contribution amount is set by the IRS.
- **Roth IRA:** A Roth IRA is similar to a Traditional IRA, except contributions are taxed and qualified withdrawals are federal tax free.
- **Rollover IRA:** A Rollover IRA is designed as a holding account for funds distributed from an employer's qualified retirement plan such as a 401(k) or 403(b). Moving funds into a Rollover IRA

Done
wwwna.ameritrade.com
start Open Your Account - ... Ameritrade Screensh... 9:51 PM

Step 6: Select an account profile. This means how you will make your personal contribution. If this is your first account, you will select **Cash**.

Step 7: Check the “I have read the Ameritrade Privacy Statement” and then click **Next**.

The screenshot shows the Ameritrade website's 'Create your Account Profile' page. The browser window is titled 'Open Your Account - Mozilla Firefox' and the address bar shows 'https://wwwna.ameritrade.com/cgi-bin/apps/AccountAp5ervlet'. The page has a navigation bar with 'IRA Account Application', 'Ameritrade', 'Chat with a New Accounts Representative', and 'Application Home'. The main heading is 'Create your Account Profile' with a progress indicator showing 'Step 1' of 'Setup', 'Profile', 'Agree', 'Fund', and 'Review'. Below the heading, there are two main sections: 'Please select how your new account will be funded.' with a dropdown menu set to 'Personal contribution', and 'Please Select an Account Profile' with two radio buttons: 'Cash' (selected) and 'Cash & Option (up to long options)'. A red arrow points to the 'Cash' radio button. Below the radio buttons is a checked checkbox 'I have read the Ameritrade Privacy Statement.' and a 'Next >' button. To the right, there is a 'Guidelines' section with links for 'I live in Canada', 'What are my funding options', and 'What are the types of IRAs?'. The 'What are the types of IRAs?' section lists three types: Traditional IRA, Roth IRA, and Rollover IRA, each with a brief description. The footer of the browser window shows the Windows taskbar with the Start button and several open applications, including 'Open Your Account - ...' and 'Ameritrade Screensh...'. The system clock shows 9:52 PM.

Step 8: Gather the following information, if you have not already done so.

The screenshot shows the Ameritrade website's 'IRA Account Application' page. The browser window title is 'Open Your Account - Mozilla Firefox'. The address bar shows the URL: <https://wwwna.ameritrade.com/cgi-bin/apps/IraApServlet>. The page header includes the Ameritrade logo and navigation links: 'IRA Account Application', 'Ameritrade', 'Chat with a New Accounts Representative', and 'Application Home'. The main heading is 'Account Owner Summary', with a progress indicator showing 'Step 1' of five steps: Setup, Profile, Agree, Fund, and Review. A red arrow points to the following text:

To open an Individual Retirement Account (IRA), you will need the following information available:

- ◆ Social Security Number (if applicable)
- ◆ Employment Information (including address)
- ◆ Banking information (if you qualify and wish to use electronic funding)
- ◆ Beneficiary Social Security Number or Tax ID (if entity)
- ◆ Beneficiary Address

You will be asked a series of questions to help us verify your identity as required by the Federal government *.

There are some instances where identity cannot be verified or your IRA choice does not allow electronic signature (SEP/SIMPLE IRA). Although you will be able to complete the application process, you *may* be required to send in your application by fax or mail. Please ensure that you carefully review your data for accuracy.

The application process, on average, takes 12-15 minutes to complete.

* Important information about procedures for opening a new account: To help the government fight the funding of terrorism and money laundering activities, Federal law requires all financial institutions to obtain, verify, and record information that identifies each person who opens an account.

What this means for you: When you open an account, we will ask for your name, address, date of birth, and other information that will allow us to identify you. We may also utilize a third-party information provider for verification purposes and/or ask for a copy of your driver's license or other identifying documents.

Next >

The browser's taskbar at the bottom shows the Windows start button, the current browser window, and the system clock at 9:52 PM.

Step 9: Enter your personal information. Additional help is provided on the right-hand section of your screen, labeled **Guidelines**.

The screenshot displays the 'Create your account profile' page on the Ameritrade website. The page is titled 'Create your account profile' and is part of a multi-step process (Step 2). The 'Personal Information' section includes the following fields:

- First ***: Text input field
- Middle**: Text input field
- Last ***: Text input field
- Suffix**: Dropdown menu
- Street Address *** (No P.O. Boxes): Two stacked text input fields
- City ***: Text input field
- State ***: Dropdown menu (Select...)
- Zip/Postal Code ***: Text input field
- Country ***: Dropdown menu (UNITED STATES OF AMERICA)
- Province**: Text input field

There is a checkbox labeled 'My mailing address is different from the street address.' Below the personal information section is the 'Contact Information' section, which includes fields for 'Home Phone Number *' and 'Work Phone Number'.

On the right side of the page, there is a 'Guidelines' section with several links for help:

- [Why does Ameritrade need my personal information?](#)
- [Citizenship status](#)
- [What is an ITIN?](#)
- [What is the difference between a street address and a mailing address?](#)
- [What is a Statement?](#)
- [What is a Trade Confirmation?](#)
- [What is Shareholder Information?](#)
- [Why isn't the country I live in included in the list?](#)

The browser's address bar shows the URL: <https://wwwna.ameritrade.com/cgi-bin/apps/IraApServlet>. The browser's title bar reads 'Open Your Account - Mozilla Firefox'.

This tutorial unfortunately cannot go any further. The next screen cannot be viewed until your personal information has been entered. The above steps will get you started and if you need additional assistance along the way, look to the **Guidelines** box located on the right-hand section of your screen. At any point, you can contact a representative for the brokerage firm you choose. They will be able to answer all of your account setup questions.