Back to the Basics Financial Tool Kit

Prepared for:
Back to the Basics

Prepared by:
Tim Hudson, CFP®, CLU, ChFC, CRPS®
President
SilverStar Wealth Managment, Inc.
(Located within Cy-Fair FCU)
13525 Skinner Road
Cypress, TX 77429
Phone: 281-477-3847
Email: tim@silverstarwealth.com
Website: SilverStarWealth.com
April 2, 2020

Table of Contents

Disclosure Notice....................1
Covid-19 Meeting Immediate Financial Needs....................2
The Personal Budget....................4
The Personal Budget Worksheet....................6
Credit Cards....................8
Debt Repayment Strategies....................12
Managing Your Debt....................15
Repaying Student Debt....................18
Planning for Kids Going to College....................22
Planning for the Recent College Graduate....................24
Planning for the Adult Child at Home....................26
Coping With Market Volatility....................28
Basic Investment Tools....................30
Asset Allocation....................34
General Purposes of Life Insurance....................36
Considerations in the Purchase of Life Insurance....................38
How Much Life Insurance? - Worksheet....................40
Using Cash Value Life Insurance....................44
Individual Disability Income Insurance....................48
COBRA Coverage Continuation....................50
Long-Term Care....................52
Average Life Expectancy at Age 65....................55
Do You Desire Retirement Peace of Mind?....................56
Evaluating Early Retirement Offers....................60
The Need for Retirement Planning....................63
Deferred Income Annuities....................66
Deferred Annuities....................70
Annuities in Retirement Income Planning....................76
An Overview of Social Security Benefits....................79
Medicaid....................82
Medicare Parts A and B....................88
Medicare Part C - Medicare Advantage....................91
Medicare Part D - Prescription Drug Coverage....................94
Medigap Policies....................98
Medigap Policies Compared....................101
How Often Should Legal Documents Be Reviewed?....................104

Disclosure Notice

The information that follows is intended to serve as a basis for further discussion with your financial, legal, tax and/or accounting advisors. It is not a substitute for competent advice from these advisors. The actual application of some of these concepts may be the practice of law and is the proper responsibility of your attorney. The application of other concepts may require the guidance of a tax or accounting advisor. The company or companies listed below are not authorized to practice law or to provide legal, tax, or accounting advice.

Although great effort has been taken to provide accurate data and explanations, and while the sources are deemed reliable, the information that follows should not be relied upon for preparing tax returns or making investment decisions. This information has neither been audited by nor verified by the company, or companies, listed below and is therefore not guaranteed by them as to its accuracy.

If a numerical analysis is shown, the results are neither guarantees nor projections, and actual results may differ significantly. Any assumptions as to interest rates, rates of return, inflation, or other values are hypothetical and for illustrative purposes only. Rates of return shown are not indicative of any particular investment, and will vary over time. Any reference to past performance is not indicative of future results and should not be taken as a guaranteed projection of actual returns from any recommended investment.

Securities offered through Kestra Investment Services, LLC (Kestra IS), member FINRA/SIPC. Investment advisory services offered through Kestra Advisory Services, LLC (Kestra AS), an affiliate of Kestra IS. Kestra IS and Kestra AS are independently owned and are not affiliated with SilverStar Wealth Management or any other entity referenced. Securities products are not insured by NCUA, are not guaranteed by Cy-Fair Federal Credit Union and are subject to investment risks including the potential loss. Kestra IS and Kestra AS are not affiliated with any other entity listed herein.

Covid-19: Meeting Immediate Financial Needs

The Covid-19 pandemic currently sweeping the world has left many Americans struggling to make ends meet. While the federal government works to create, and then implement, a longer-term relief package, many immediate financial needs can be met from two primary sources: (1) personal financial resources, and (2) existing government relief programs.

Personal Financial Resources

Potentially, there are a number of personal financial resources that might be used[1]:

- Personal savings: Some individuals will have personal savings (an emergency fund) that will allow them to survive financially for a period of time.
- Credit cards and existing personal lines of credit: Those with credit cards and other existing lines of credit (a home-equity loan, for example), may be able access these resources to pay bills. Un-employed borrowers will likely find it difficult or impossible to establish new borrowing arrangements.
- Cash value life insurance: Certain types of life insurance policies develop "cash values" which the policy owner can access through withdrawals (a partial or complete policy surrender) or policy loans.[2]
- Deferred annuities: Many deferred annuities allow an owner, prior to annuitization, to withdraw all of the funds in the annuity (complete surrender), although a surrender charge may apply. Partial withdrawals may also be allowed, sometimes without a surrender charge.[3]
- Withdrawals from retirement plans: Some individuals may be able to withdraw funds from retirement plans such as IRAs or 401(k)s. With the recent, significant market declines, this may not be the best time to sell retirement assets. For those under age 59½, there may also be an additional 10% federal penalty tax, unless an exception applies.

---

[1] Some of the options discussed here have federal income tax implications. State or local income tax law may vary.

[2] Policy withdrawals will reduce the death benefit available under a policy. If an insured dies with a policy loan outstanding, the policy's death benefit is reduced by the amount of the loan balance. Excess use of withdrawals and policy loans can result in a policy lapsing; such a lapse can result in unexpected, negative income tax consequences.

[3] Funds withdrawn from an annuity prior to annuitization are considered to be made from interest or other growth, taxable as ordinary income. If the annuity owner is under age 59½ at the time of the withdrawal, a 10% federal tax penalty may apply to the earnings, unless an exception applies. Withdrawals from the owner's initial investment are received tax-free.

Covid-19 Meeting Immediate Financial Needs

Personal Financial Resources (continued)

- Existing disability insurance: For those unable to work because of Covid-19, an existing disability insurance policy, either a group or an individual policy, can provide at least a partial replacement for lost income.
- Ask for forbearance: Recognizing the nature of the current crisis, a landlord or other creditor may be willing to temporarily forgo or suspend rent or other debt repayments. It doesn't hurt to ask.

Existing Government Relief Programs

There are a number of existing government relief programs, usually administered by state or local governments, which may come into play. Note that the benefits available, the requirements needed to qualify, and the benefit amounts payable will vary from locality to locality.

- Unemployment insurance: Individuals who have lost a job or had hours reduced because of COVID-19 may be entitled to file a claim for unemployment insurance. This could also include a parent forced to stay home to care for dependent children because of a school closure.
- Disability Insurance: A worker who is unable to work because of being ill or due to a COVID-19 quarantine may be entitled to file a disability insurance claim.
- Paid family leave: An individual who is unable to work because he or she must provide care for a medically ill or quarantined family member because of COVID-19 may be able to claim paid family leave.

Seek Professional Guidance

A panicked response to the current crisis may create unforeseen problems which will last long into the future. The advice and guidance of appropriate financial, legal, and tax advisors is strongly recommended.

The Personal Budget

The basic purpose of a personal budget is to plan how an individual's money will be spent. Given limited financial resources, a budget is a method of managing personal cash flow, to meet current needs and save for the future.

Reasons to Prepare a Personal Budget

- **A planning tool:** Correctly used, a personal budget can ensure that income and expenditures match, both in amount and timing. It can both spotlight potential cash-flow problems, and identify opportunities to make better use of current income.

- **A yardstick to measure progress:** By comparing the planned budget against actual results, an individual can see if progress is being made toward meeting specific goals. This measuring process will often highlight areas where changes should be made.

Preparing a Personal Budget

- **Past income and expenditures:** This initial step entails recording information on past cash flow, both income and spending. Ideally, a year's worth of data should be gathered, to even out the effect of seasonal variations. Paycheck stubs, check registers, cancelled checks, copies of paid bills and recent income tax returns are excellent sources of this information. An individual may also want to keep a daily spending diary for a short period of time.

- **Set goals:** Clear goals should be set, with both specific dollar amounts and a realistic time frame for accomplishing each goal. A goal can be as simple and immediate as making ends meet each month, or as complex and long term as planning for retirement.

- **Maintain records:** Perhaps the most difficult part of the budgeting process is consistently keeping adequate monthly records of income and expenditures.

- **Periodic review:** A periodic review, comparing the planned budget with actual results, provides a means of measuring progress toward an individual's goals. The review will usually indicate if changes should be made, either in income, expenditures or both.

The Personal Budget

National Spending Patterns

How does your spending compare with these broad national budget averages?[1]

	National Spending
Food	12.9%
Clothing and Services	3.0%
Housing	32.8%
Personal[2]	23.8%
Medical	8.1%
Transportation	15.9%
Other	3.3%
Totals	100%

[1] Source: Bureau of Labor Statistics, Consumer Expenditures 2018, September 10, 2019.

[2] Personal includes personal insurance, pensions, personal care, education, entertainment, and cash contributions.

The Personal Budget Worksheet

Name: ____

Period covered - From: ______________________ To: ____________________

Item	Historical	Current Budget	Current Actual	Difference
Debt, savings and investment				
Credit and charge cards	$__________	$__________	$__________	$__________
Other installment loans	$__________	$__________	$__________	$__________
Education fund	$__________	$__________	$__________	$__________
Retirement	$__________	$__________	$__________	$__________
Other savings goals	$__________	$__________	$__________	$__________
Other	$__________	$__________	$__________	$__________
Total debt, savings, etc.:	**$__________**	**$__________**	**$__________**	**$__________**
Food				
Home consumption	$__________	$__________	$__________	$__________
Outside the home	$__________	$__________	$__________	$__________
Total food:	**$__________**	**$__________**	**$__________**	**$__________**
Clothing				
Clothing and shoes	$__________	$__________	$__________	$__________
Cleaning, laundry	$__________	$__________	$__________	$__________
Jewelry, watches, etc.	$__________	$__________	$__________	$__________
Total clothing:	**$__________**	**$__________**	**$__________**	**$__________**
Housing				
Rent or mortgage	$__________	$__________	$__________	$__________
Real estate taxes	$__________	$__________	$__________	$__________
Insurance	$__________	$__________	$__________	$__________
Furniture and furnishings	$__________	$__________	$__________	$__________
Appliances	$__________	$__________	$__________	$__________
Cleaning, repairs and maint.	$__________	$__________	$__________	$__________
Electricity, gas and heating	$__________	$__________	$__________	$__________
Water and sewer	$__________	$__________	$__________	$__________
Telephone, cable	$__________	$__________	$__________	$__________
Other housing	$__________	$__________	$__________	$__________
Total housing:	**$__________**	**$__________**	**$__________**	**$__________**
Totals for this page:	**$__________**	**$__________**	**$__________**	**$__________**

The Personal Budget Worksheet

Name: ____

Period covered - From: ________________________ To: ______________________

Item	Historical	Current Budget	Current Actual	Difference
Personal and Legal				
Personal care and toiletries	$___________	$___________	$___________	$___________
Child care	$___________	$___________	$___________	$___________
Legal and accounting	$___________	$___________	$___________	$___________
Life and disability insurance	$___________	$___________	$___________	$___________
Other personal and legal	$___________	$___________	$___________	$___________
Total personal and legal:	**$_________**	**$_________**	**$_________**	**$_________**
Medical				
Medicines	$___________	$___________	$___________	$___________
Doctors, dentists and hospitals	$___________	$___________	$___________	$___________
Health insurance	$___________	$___________	$___________	$___________
Other medical	$___________	$___________	$___________	$___________
Total medical:	**$_________**	**$_________**	**$_________**	**$_________**
Transportation				
Auto payments	$___________	$___________	$___________	$___________
Repairs and maintenance	$___________	$___________	$___________	$___________
Insurance	$___________	$___________	$___________	$___________
Gas, oil and tires	$___________	$___________	$___________	$___________
Public transportation	$___________	$___________	$___________	$___________
Other transportation	$___________	$___________	$___________	$___________
Total transportation:	**$_________**	**$_________**	**$_________**	**$_________**
Miscellaneous				
Books, magazines and newspapers	$___________	$___________	$___________	$___________
Vacations	$___________	$___________	$___________	$___________
Entertainment and clubs	$___________	$___________	$___________	$___________
Charitable	$___________	$___________	$___________	$___________
Education	$___________	$___________	$___________	$___________
Other miscellaneous	$___________	$___________	$___________	$___________
Total miscellaneous:	**$_________**	**$_________**	**$_________**	**$_________**
Totals for this page:	**$_________**	**$_________**	**$_________**	**$_________**
Totals from previous page:	**$_________**	**$_________**	**$_________**	**$_________**
Grand totals:	**$_________**	**$_________**	**$_________**	**$_________**

Credit Cards

The use of credit cards has become a widespread and accepted part of modern life. From modest beginnings in the early 1900s, credit card usage has grown to the point where 70.2% of American families have at least one general-purpose credit card, with a median credit balance outstanding of $3,000.[1]

Reasons to Use a Credit Card

There are many reasons individual consumers use a credit card.

- **Safety:** The use of credit cards allows a consumer to purchase goods and services without the need to carry large amounts of cash.
- **Opportunity:** A credit card allows a consumer to deal with short-term situations, such as Christmas or emergency auto repairs, when paying cash might not be possible.
- **Facilitate transactions:** Credit cards allow for payment of goods and services purchased via telephone or the Internet. Some transactions, such as renting a car, purchasing airline tickets, or guaranteeing payment for late arrival at a hotel, would be impossible without the use of a credit card.
- **Leverage:** Paying with a credit card can provide a consumer with additional leverage, in case of disputes with merchants over defective or poor quality merchandise.
- **Identity:** In certain types of transactions, such as cashing a check, credit cards have become a means of personal identification.

Types of Credit Cards

Not all credit cards are alike. They will vary widely in terms of issuer, scope of use and contract terms.

- **Bankcards:** Are issued not only by banks, but also by other financial institutions such as savings and loans or credit unions. These general-purpose credit cards can usually be used to purchase a wide range of goods and services. Credit is usually provided on a revolving basis, under which a borrower is granted a specific amount of credit. Typically, minimum monthly payments are required and any unpaid balance is subject to an interest charge. As borrowed amounts are repaid, the amount of available credit increases, up to the credit limit.

[1] Taken from The Statistical Abstract of the United States: 2012. See Report No. 1188 - Usage of General Purpose Credit Cards by Families: 1995 to 2007. Data is from 2007.

Credit Cards

- **Charge cards:** Also known as travel and entertainment cards. Unlike bankcards, charge cards typically must be paid in full each month. Balances not paid are subject to heavy penalty fees. Like bankcards, charge cards are usually accepted widely.
- **Retail credit cards:** Retail credit cards are issued by businesses such as department stores, airlines and gasoline companies. Credit is usually provided on a revolving basis and purchases are limited to the goods and services sold by the specific card issuer.
- **Secured credit cards:** Such cards are usually general-purpose bankcards, with a specified (typically lower) credit limit. The card is secured by a deposit in an account with the issuing institution. If a consumer defaults, the card issuer can use the deposited funds to cover the shortage. Such cards are useful for individuals who do not have an established credit history or for those rebuilding their credit rating.
- **Affinity cards:** Affinity cards are issued jointly by a lending institution such as a bank or savings and loan, and some other organization such as an airline, charity or college alumni group. Using an affinity card allows a cardholder to also achieve other goals, such as earning frequent flyer miles or making charitable contributions.

Shopping for a Credit Card

When shopping for a credit card, a consumer should carefully compare the terms under which a card is offered:

- **Interest rate on unpaid balances:** The interest rate on unpaid balances can be either a fixed rate or a variable rate. Card issuers are required to state the interest rate as both an annual percentage rate (APR) and (for each billing cycle) as a periodic interest rate.
- **Unpaid balance computation:** The method by which a card issuer calculates the unpaid balance on an account. The unpaid balance, multiplied by the periodic interest rate, determines the finance charge.

Credit Cards

AVERAGE DAILY BALANCE	PREVIOUS BALANCE	ADJUSTED BALANCE
Each day the issuer subtracts any payments from, and adds new purchases to, the account balance. The daily balances for each day in a billing cycle are added together and then divided by the number of days in that cycle.	The issuer charges interest on the balance outstanding at the end of the previous billing cycle.	The issuer starts with the previous balance, subtracts any payments or credits, and charges interest on any remaining unpaid amount.

- **Fees:** Many card issuers will charge an annual fee, just to have the card. Fees may also be charged for such items as cash advances, late payments, charging over the established credit limit and lost card replacement.
- **Grace period:** The amount of time during which no interest is charged, if the entire amount is paid off.
- **Other benefits:** A card may provide other benefits such as cash advances, flight insurance, or discounts on travel or long-distance telephone charges.
- **Acceptance:** Some merchants may not accept a specific type of card.

Using a Credit Card

Many advisors recommend that consumers develop certain habits when using credit cards.

- Keep the number of open credit card accounts to a minimum.
- Understand the terms under which a card is issued.
- Sign all cards as soon as they are received.

Credit Cards

- Pay credit card bills promptly to keep interest charges as low as possible and maintain a good credit rating. Authorizing electronic payment of credit card bills from your checking or savings account can automate this process.
- Keep detailed records of credit card account numbers, expiration dates and the telephone number of card issuers. The easiest way to do this is to photocopy the front and back of each card.
- Protect credit card information to avoid unauthorized use.
- Carefully review credit card statements each month. The customer copy of charge slips should be kept, to allow comparison with the monthly statement.

Lost or Stolen Credit Cards

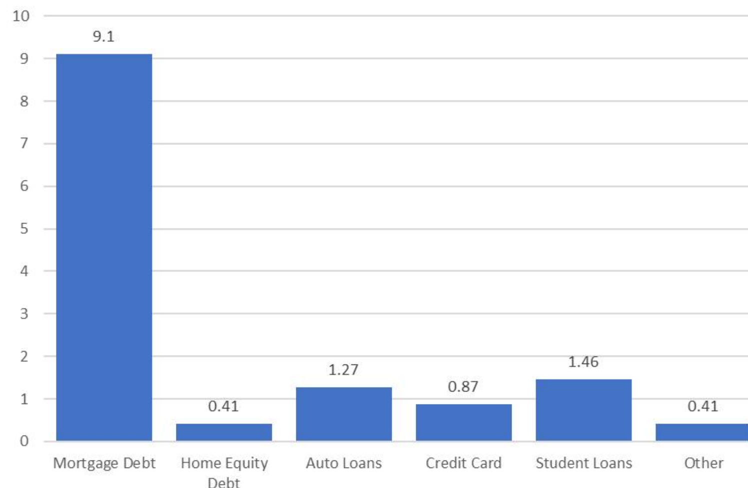
Under federal law, a cardholder can be held liable for charges of up to $50.00 per card, even though the use was unauthorized. Such unauthorized credit card use is often the result of a card being lost, stolen or even counterfeited. If the loss of a card is reported to the issuer before the card is used, however, the issuer cannot hold the consumer liable for any unauthorized use.

- **Notify issuer:** A consumer should report the loss or theft of a credit card to the issuer as soon as possible. Many card issuers have toll-free, 24-hour telephone numbers for this purpose. Written notification should also be sent to the issuer.
- **Check monthly statement:** Review the monthly card statement to be sure that no unauthorized charges were made before it was noticed that the card was missing.
- **Registration service:** A consumer who carries more than one credit card may want to use a credit card registration service. For an annual fee, such services keep a record of all of a consumer’s credit cards. In the event of a loss, the consumer makes one call, to the registration service. The registration service notifies all card issuers of the loss and, in many cases, arranges for replacement cards.

Debt Repayment Strategies

For better or worse, personal debt is a fact of modern American life. And, as a nation, we do take on a lot of personal debt. According to research by the Federal Reserve Bank of New York, at the end of 2018, Americans owed roughly $13.54 trillion.[1]

Consumer Debt, in Trillions



Source: Federal Reserve Bank of New York, Quarterly Report on Household Debt and Credit 4th Quarter, 2018. February, 2019

Not all debt is bad, of course. Debt which helps build for the future, such as student loans, home mortgages, and business development loans, is often seen as "good" debt. But too much debt, even if it's good debt, can be overwhelming. Debt can be expensive, stressful, and a financial drag on achieving other life goals.

Getting Organized

The first step in paying off debt involves getting organized:

- **What do you owe?** – List the dollar amount of each of debt, the interest rate, and the minimum monthly payment. You may find it useful to rank order your debts, either in order of their size or the interest rate you're paying.

[1] Source: Federal Reserve Bank of New York, Quarterly Report on Household Debt and Credit, 4th Quarter, 2018.

Debt Repayment Strategies

- **Cash flow** – Do you have a clear idea of how much money is coming in each month, how much is going out, and where it's going? If not, a cash flow study is in order.
- **Budget** – Once you understand your cash flow situation, develop a budget. A budget is simply a plan for using the money you do have, to allow you to reach the goals you want to achieve. Be sure to budget at least the minimum payment for each debt. You should also look for ways to reduce unnecessary spending or bring in additional cash.

Getting Organized (continued)

- **Avoid taking on additional debt** – You're already in a hole. You don't want to keep digging, to make the hole deeper.
- **Credit report** – Check your credit report regularly. Incorrect information could result in your being charged a higher rate of interest for a loan, or even being denied a loan.

Debt Repayment Strategies

The next step is to select the debt repayment strategy that works for you.

- **Highest interest rate first** – Since interest is the cost of renting money, it makes mathematical sense to focus on high-rate debt first. Assume you have three debts: Debt A at 12.5%, Debt B at 10.0%, and Debt C at 6.0%. With this strategy, start by paying off Debt A first. Once Debt A is eliminated, use the payment from Debt A and the payment for Debt B, to pay off Debt B. When Debt B is paid off, use the combined payments from Debt A, Debt B, and Debt C to pay off Debt C.

  The downside to this strategy is that you may become discouraged before you see any significant progress.

- **Smallest balance first** – Another approach is to start with the smallest balance first. Assume you have three debts: Debt D, of $1,000 at 10.0% interest; Debt E, of $2,500 at 12.0% interest; and Debt F, of $18,500 at 9.0%. Here you would start by first paying off the smallest debt, Debt D. Once Debt D is paid off, then use the payment from Debt D and the payment for Debt E, to pay off Debt E. Once Debt E is paid off, use the combined payments from Debt D, Debt E, and Debt F to pay off Debt F. This approach generally allows you to see progress fairly quickly and can keep you from being discouraged.

Debt Repayment Strategies

- **Minimum payment on all debts** – Make just the minimum payment each month on each debt. Perhaps the longest road to completely paying off all debts.
- **Debt consolidation** – In some situations, it may make sense for a borrower to take out a single large loan and use the proceeds to pay off a number of smaller loans. This can make it easier to manage the repayment process, but often results in a longer period of time needed to repay the large loan, a higher interest rate, or both.
- **Other ideas** – Some individuals may prefer to pay off certain types of debt first, for example paying off credit cards before paying off other types of debt. Setting up automatic payments can make the repayment process much less painful. Leaving room in your budget for at least a small emergency fund can avoid having to take on more higher-interest debt when an emergency does occur. If conditions allow, you may be able to refinance certain debts at a lower interest rate.

The key is to select the strategy or approach that works for you.

Get Help If You Need It

The advice and guidance of a professional financial advisor can be useful in sorting out the various options for repaying debt.

Other Resources

The federal government makes a number of resources available to the public:

- **Consumer Finance Protection Bureau:** On the internet at https://consumerfinance.gov/
- **The Federal Trade Commission** has a number of free publication available at: https//www.consumer.ftc.gov/topics/credit and loans
- **The Federal Consumer Information Center**, at https://publications.usa.gov/ has a number of free and low-cost publications on a number of personal finance topics of interest to consumers.

Managing Your Debt

While earlier generations may have followed a "cash only" spending philosophy, most Americans today cannot imagine living without at least some debt. Relatively few of us are able to pay cash for a home or car. The ability to borrow money, when it's needed and on favorable terms, is a privilege earned by carefully managing your debt obligations.

Why Borrow Money?

Many advisors regard borrowing money as a two-edged sword. It can, for example, be used to finance long-term goals such as a home, a business, or an education. Over time, these "investments" tend to increase in value and return far more than the cost to purchase them. Used to excess, or to constantly pay for short-term consumer items, such as clothing, vacations, or a night on the town, debt can become an overwhelming burden.

Managing Your Credit Record

Most lending decisions are made on the basis of your credit record, also known as your credit report. When lenders size you up to determine how much credit, if any, to grant you, they count on the three Cs:

- **Character:** How responsibly will you handle your credit obligations? Lenders will look at how well (or how poorly) you have repaid previous debts.
- **Capacity:** What is your financial ability to assume a certain amount of debt? Do you have enough money coming in the door each month to pay all of your bills?
- **Capital:** What financial assets are at your disposal to pay off debts? If you don't repay the debt as promised, do you have other financial assets that could be used by the lender to pay off the debt?

How well you manage each of these issues is reflected in your credit report. Because your credit report is constantly changing, you should review it at least once a year to check for errors, credit card fraud or identity theft.

Managing Your Debt

What Are My Choices?

Today's consumer has many methods of borrowing money. You could, for example, use your credit card to finance a college education. However, a better choice might be a government-subsidized student loan which typically carries a lower interest rate and defers payments until after the student has finished school. Similarly, you could use part of your home equity line of credit to pay for a car, but do you really want to be making car payments for the next 10 or 20 years?

Whether you do the homework yourself, or seek the help of an advisor, understanding the loan options available, and then appropriately matching the type of loan to the need, is a key part of effective debt management.

Managing the Cost of Your Debt

Interest rates constantly move up and down. Thus, the loan that you took out several years ago at what was then a great rate may not be such a good deal today. Lower interest rates may allow you to refinance an existing loan and lower your monthly payment. Or, if you keep the same monthly payments, a lower interest rate may allow you to pay off the loan sooner.

- **Mortgages and other consumer loans:** As a general rule, the interest saved must be greater than the cost (pre-payment penalties and other closing expenses) of acquiring the new loan before it makes sense to re-finance.
- **Credit cards:** The competition between credit card issuers can be intense. You can sometimes "surf" your credit card balance from one issuer to another to take advantage of issuers' low introductory rates. If you do move your balance from one card to another, be sure that you make at least the minimum payment when due; otherwise, the interest rate can permanently jump from the single digits to the high 20s.

Seek Professional Guidance

The advice and guidance of a professional financial advisor can be useful in helping sort out the various options for borrowing money. In addition, a qualified advisor can help you understand the impact of any borrowing upon your personal financial and income tax situation.

Managing Your Debt

Other Resources

The federal government makes a number of resources available to the public:

- **Consumer Financial Protection Bureau:** On the internet at https://www.consumerfinance.gov/.
- The **Federal Trade Commission** has a number of free publications available. On the internet, go to https://www.consumer.ftc.gov/topics/credit-and-loans.
- The **Federal Consumer Information Center**, at https://connect.usa.gov/publications, has a number of free and low-cost publications on a number of topics on interest to consumers.

Repaying Student Debt

For most college students, graduation is a time of new beginnings. For those who have taken out student loans to help pay for their higher education, it's also time to begin repaying those loans. For the nation as a whole, there's a lot of money to repay; according to federal statistics, at the end of 2018, outstanding student loan debt stood at $1.46 *trillion*.[1] On an individual level, the numbers are also significant. According to research by the College Board, in the 2016-2017 academic year, the average, cumulative debt load of those who had student loans and who received a Bachelor's Degree was $28,500.[2]

And repaying that debt as soon as practicable *is* important. For a recent graduate, typically beginning a lifetime career, the burden of student debt can have long -term consequences. Further education, job prospects, and saving for common goals such as retirement and buying a home are all affected by student debt.

So, what are some of the ways to repay this debt?

Federal Student Loans

The vast majority of student debt in the U.S. is provided through programs run by the federal government, via the U.S. Department of Education.[3] Recognizing that new graduates may have difficulty getting started in a career, the federal government has a number of ways this federal student loan debt may be repaid:

- Standard repayment – Payments are a fixed amount that ensures that the loans are paid off within 10 years.[4]
- Graduated repayment – Payments are lower at first and then increase, usually every two years, in an amount that will ensure the loans are paid off within 10 years.[4]
- Extended repayment – Payments may be fixed or graduated and will ensure that the loans are paid off within 25 years.

[1] Federal Reserve Bank of New York: *Quarterly Report on Household Debt and Credit*, *4th Quarter 2018*, February, 2019.
[2] Trends in College Aid 2018, published by the College Board, page 22. The value shown is the average cumulative debt of Bachelor Degree recipients at public and private nonprofit four-year institutions, in 2017 dollars.
[3] Trends in College Aid 2018, page 15. For 2017-2018, federal student loans represented 89% of total student debt.
[4] Within 10 to 30 years for consolidation loans.

Repaying Student Debt

Federal Student Loans (continued)

- Revised pay as you earn (REPAYE) – Generally, 10% of discretionary income, recalculated annually. A term of up to 20 years for loans taken out for undergraduate study and up to 25 years for loans taken out for graduate or professional study.

- Pay as you earn (PAYE) – Payments are generally 10% of discretionary income, recalculated annually, but never more than the 10-year standard repayment amount, for a term of 20 years. Any outstanding balance is forgiven if not paid after 20 years.

- Income based repayment (IBR) – Generally, 10% of discretionary income, recalculated annually, for a new borrower on or after July 1, 2014, but never more than the 10-year standard repayment amount, for a term of 20 years. For those who are *not* new borrowers on or after July 1, 2014, it is generally 15% of discretionary income, recalculated annually, but never more than the 10-year standard repayment amount, for a term of 25 years. Any outstanding balance is forgiven if not paid at the end of the loan term.

- Income contingent repayment ICR) – The lesser of (a) 20% of discretionary income, recalculated annually, or (b) what would be paid on a repayment plan with a fixed payment over the course of 12 years, adjusted according to income. Any outstanding balance is forgiven if not paid at the end of 25 years.

- Income sensitive repayment – The monthly payment is based on your annual income, but the loan will be paid in full within 15 years. The formula for determining the monthly payment can vary from lender to lender.

- Federal student loan consolidation – Federal student loans of various types may be consolidated into a single *federal* student loan. Frequently, the monthly payments can be lower, but the payment term will usually be extended.

- Loan forgiveness, cancellation, or discharge – Certain types of federal student loans can be “forgiven” in return for working for certain governmental or not-for-profit organizations. Serving in the U.S. military can result in some student debt being paid for you. Federal student loans may also be discharged in case of death or disability.

Repaying Student Debt

Other Student Loans

Other student loans come from a number of sources such as home-equity loans, credit card loans, loans from parents, signature loans, or loans from the college or university itself. Repayment of these loans is subject to the terms agreed to when the loan was made.

In certain situations, it may make sense to combine all federal student loans into one, consolidated *private* loan. However, doing this will eliminate any possibility of the federal debt being forgiven for public service employment.

Making the Repayment Process Easier

The ultimate goal is to pay off all accumulated student debt as quickly as possible. Not only does this save money (less interest is paid), but paying off the debt allows the borrower to quickly move on with his or her life. Steps to achieve this include:

- Organize – Be sure you understand the terms of each loan that you owe. Most of your federal student loans can be found at https://studentloans.gov/. Any other debt can be determined by contacting the lender or by checking your credit report at https://www.annualcreditreport.com. Being organized can help if you decide to take advantage of strategies such as repaying the loans with the highest interest rate first, or, to boost your confidence, paying off the smallest balance loan first.
- If possible, make some payments while still in school.
- Budget carefully to avoid spending money on non-essential items.
- Make more than the minimum payment; be sure the lender applies the extra payment amount to *principal*, rather than paying ahead on the next payment.
- Make payments every two weeks; a bi-weekly payment can provide surprising savings.
- Extra cash – A larger than expected income tax refund or a raise could be used to make extra principal payments.
- Automatic payment – many lenders will charge lower interest rates for loans set up to be repaid via an automatic withdrawal from your bank account.

Repaying Student Debt

Making the Repayment Process Easier (continued)

- Tax breaks – Under current federal law, up to $2,500 in higher-education loan interest can be deducted from your taxable income. Certain limits apply.

Get Help When You Need It

Navigating the maze of student loan repayment options and strategies can be confusing. There's no shame in asking for help when it's needed. The advice and guidance of qualified student loan advisers or other qualified financial professionals is highly recommended.

Online Resources

- Federal Student Aid – https://studentaid.ed.gov/sa/
- FinAid - http://www.finaid.org/
- Federal Trade Commission – https//www.consumer.ftc.gov/topics/credit and loans
- Consumer Finance Protection Bureau – https://consumerfinance.gov

Planning for Kids Going to College

For many young adults, going off to college is the first time they will be away from the family nest for any extended period of time. And frequently, it's also the first time that they will be required to deal directly with many of the financial issues and problems that characterize modern adult life.

Going to college is not only a half-step *out* of the family home; it's also a half-step *into* the adult world. The goal is not only to gain an education, but also to build the foundation for a successful life – financial and otherwise – in the years after college.

Steps to Financial Success in College

In broad outline, planning for a young adult at college is relatively simple: (1) make the best possible use of available financial resources, and (2) keep the almost inevitable accumulating debt to a minimum. Although debt is an unavoidable part of the college experience for many, the less debt accumulated going to school means less debt to pay off afterwards.

- **Budgeting:** For many families, college funds are scarce, so it's essential to make the most of the resources that are available. The self-discipline to create, and then follow, a monthly budget is a key part of meeting this goal.
- **Credit card debt:** The college years are frequently a young person's first introduction to "credit," often in the form of a credit card. Responsible credit card use can build a credit record that will be a valuable asset in future years. Irresponsible credit card usage can do just the opposite.
- **Student debt:** Relatively few students complete their undergraduate studies without at least some student debt. If a graduate degree is involved, student debt levels can become quite high. Matching the earning potential of the degree sought with the amount of debt assumed is a key calculation. Also, making sure that student debt is spent for education, and not for non-essential items, is a good way to keep the debt levels to an absolute minimum.
- **Other financial aid:** School counselors may be able to identify other types of financial aid which don't involve additional debt, such as scholarship or work-study programs.

Planning for Kids Going to College

- **Car loans:** One essential item for many students – particularly those attending schools away from home – is a car. While an expensive sports car might be nice, basic, reliable transportation is more appropriate
- **Self-help:** It doesn't hurt to have the student work, at least part-time, and help pay for college with his or her own labor.

And if Professional Help is Needed?

Many families have existing relationships with financial professionals who will be glad to extend their services to a younger generation. Friends and family are also good sources of referrals to people they work with and trust.

Planning for the Recent College Graduate

Graduating from college marks an important milestone in the lives of young adults. For many, it's the first time that they will be completely responsible for their own financial lives. And how well, or how poorly, they deal with these new financial responsibilities can have an impact that extends far into the future.

So, what steps should a recent college graduate take to get started on the right financial footing?

Beginning Steps to Financial Security

Graduating from college equips an individual with the intellectual tools necessary for career success. That's not necessarily the case when it comes to understanding money and how to manage it. But the basic steps to get started are usually quite simple:

- **Budgeting:** Create a monthly budget that includes all of your expenses, so you don't live beyond your means. Budgeting can help identify opportunities to make better use of current income.
- **Debt:** Many college graduates start their professional careers with significant student debt. Start with the highest interest rate debt first and pay down your debt as aggressively as you can. Don't add to your debt unnecessarily.
- **Savings:** Pay yourself first! Start by building an emergency fund with the goal of saving enough to cover six months' expenses. Then, target other savings goals such as a down payment on a home.
- **Risk management:** Protect yourself with necessary health, life, and disability insurance. Protect your possessions with auto and renter's or homeowner's insurance. Get the most out of your company's employee benefits program by taking advantage of any available group insurance.
- **Retirement:** Start contributing to your employer's 401(k), 403(b), or other pension plan. If a 401(k) plan is available, contribute at least the minimum percentage to qualify for the full employer match. If your employer doesn't offer a retirement plan, open an IRA and set up automatic contributions.

Planning for the Recent College Graduate

- **Estate plan:** Work with an attorney to develop a will and an estate plan that transfers your assets as efficiently as possible and with the least tax burden. Control the health care decisions that directly affect the life of you and your family by working with your attorney to legally document your wishes.
- **Get a "financial" education:** Learn how to "use" money. It's important to have a good understanding of investing, insurance, income taxes, and employee benefits.

Get Help When It's Needed

The advice and guidance of trained, experienced financial professionals can be invaluable. Many families have existing relationships with financial professionals who will be glad to extend their services to a younger generation. Friends and co-workers are also good sources of referrals to those they work with and trust.

Planning for the Adult Child at Home

An "empty nest" is a term frequently used by those who have finished raising their children. Trouble finding a job, heavy student debt loads, and other personal issues have forced many adult children back to the shelter of the parental home. They're commonly known as "boomerang" children.

When they were first born, these boomerang kids didn't come with an instruction manual. As a parent, you likely followed the basic principles set by your parents, and then improvised when needed. In planning for an adult child at home, this same basic approach still works. Keep a few key principles in mind, and adjust your response to meet individual needs.

Points to Consider

- **Target the basic issue:** What brought the child back to the parental home? Begin by identifying the key problem and then list the steps needed to overcome it. Is there more than one problem? At the same time, move toward re-establishing the child's financial independence from the parents. There should be regular reviews of progress as well as firm deadlines for resolving each issue.

- **Employment:** If the adult child is unemployed, finding a new job should become the child's full-time "job." In an internet age, don't overlook "human" networking. Family, friends, teachers, coaches, and other community leaders are all good sources; frequently they are eager to help. As with all goals, periodically review how things are going.

- **Financial:** The parents and the adult child should create and follow a budget. Set limits on how much you're willing to supplement the cash needs of an adult child. Support is one thing; a free ride is something else. If a child is working, consider having them contribute to the monthly household expenses. Insist on a savings program, to help fund the "re-launch" into the wider world.

- **Living arrangements:** Everybody pitches in on the household chores, including the adult child. Set ground rules to cover how after-hours entrances, parties, and overnight guests will be handled. What about smoking or alcohol use? How and when can they use the family car?

Planning for the Adult Child at Home

- **Don't be afraid to say "No":** Sometimes saying "no" is the only right answer. At some point, an adult child needs to be able to survive – even if it means struggling - without the help of the parents.

And if Professional Help is Needed?

Many families have existing relationships with financial professionals who will be glad to extend their services to a younger generation. Friends and family are also good sources of referrals to people they work with and trust.

Coping With Market Volatility

During periods of economic uncertainty, financial markets are often characterized by wide swings in market value. Such “market volatility,” with prices sharply rising and falling, is a reflection of changeable investor sentiment as well as more substantive economic or political events. Even during more stable times, financial markets will fluctuate, although price movements tend to be more moderate. By their very nature, financial markets rise and fall constantly, with an ever-present potential for gain or loss.

So, how does an individual cope with constant market volatility?

Avoid an Emotional Response

When markets fall sharply, some investors will panic, sell all or part of their holdings, and shift assets into what are seen as “safer” investments. Such emotion-based selling after a market decline simply turns paper losses into real ones and limits any possible gains should the markets recover. Some individuals will respond emotionally and buy when the markets are “hot” and values are rising. The end result is often an investor who buys high, sells low, and then wonders, “What happened?”

“Timing” the Market

Some investors attempt to “time” the markets, buying when the market is low and then selling when the market is high. The problem is that it’s never clear just when the market has reached a trough or a peak. In the classic Wall Street phrase, “No one rings a bell.” Market timing is a concept that, in theory at least, seems logical. In practice, however, no one has yet devised a system for consistently and accurately identifying market tops and bottoms.

Diversify Your Portfolio - Asset Allocation

Asset allocation is an investment strategy that seeks to reduce investment risk by spreading an investor’s portfolio over a number of different asset types. This approach takes advantage of the tendency of different asset types to move in different cycles, and thus smooth out the ups and downs of the entire portfolio. Stocks, bonds, and cash (or cash equivalents) are the investments normally used. Tangible assets, such as real estate or gold, may also be included.

Coping With Market Volatility

The asset allocation process normally begins with an analysis of the historical levels of risk and return for each asset type being considered.[1] These historical values are then used as a guide to structuring a portfolio that matches the investor's individual goals and overall risk tolerance level.

Regularly Review Your Investment Strategy

An investor's portfolio allocation should reflect factors such as the investment goal, timeframe, need for liquidity, risk tolerance, and income tax bracket. As time passes, and as market and economic conditions change, it is likely that an investor's goals, and the optimal portfolio mix to reach those goals, will also change. Adjusting the asset allocation, known as "rebalancing," is a regular part of good investment management, in both up and down markets.

Take a Long-Term View

Historically, the long-term trend in equity markets has been upward, although there have been periods when the markets declined.

An investor can more easily ride out periodic economic storms by clearly understanding his or her long-term investment goals and rebalancing the portfolio accordingly. Additionally, a portion of the portfolio can be placed in safer, more liquid assets, which can then be used to meet immediate cash needs. The balance of the portfolio remains invested for the long term.

Automatic Investing

Rather than making a single, lump-sum investment, some investors feel more comfortable investing an equal dollar amount at regular intervals. Also known as "dollar cost averaging," this strategy does not guarantee a profit, nor does it protect against losses in a declining market. It does have the advantage of buying more shares when the price is low and fewer shares when the price is higher.

Seek Professional Guidance

In both bull and bear markets, the guidance of trained financial professionals is strongly advised.

[1] Historical data, while useful as a general guide, cannot be considered an accurate indicator of future results. There is no guarantee that past performance is a predictor of future investment performance.

Basic Investment Tools

Individuals with investable funds often have a desire to put those "extra" dollars to work to meet a specific purpose. For some, there may be a desire to accumulate funds for a future purchase, or a need to generate more income to pay current expenses. For others, it may be to put money aside for a "rainy day," or simply to "get rich." Whatever the investment goal, an investor should clearly understand both the role and the potential risks and rewards of each type of investment tool.

Stocks

The terms "stock" and "share" both refer to a fractional ownership interest in a corporation. As "owners," stockholders vote for the company's Board of Directors, and receive information on the firm's activities and business results. Stockholders may share in profits through "dividends" declared by the firm's Board.

When a corporate business is first organized, investors contribute money to fund the enterprise, and in return receive shares of stock representing their ownership in the company. If the business is successful, it will grow and have increasing profits, and the shares generally become more valuable. If the business is not successful, the value of the shares usually declines.

- **Uses:** Investors typically buy and hold stock for its long-term growth potential. Stocks with a history of regular dividends are often held for both income and growth.
- **Risks:** As the long-term growth of a company cannot be predicted, the short-term market value of the company's stock will fluctuate up and down. If the market price of the stock is higher than the purchase price when the stock is sold, a capital gain will result. If the market price of the stock is lower than the purchase price when the stock is sold, the result will be a capital loss.

Bonds

While stocks represent ownership in a business, bonds are debt. Issued by institutions such as the federal government, corporations, and state and local governments, a bond is evidence of money borrowed by the bond issuer. In return, bondholders receive interest and, at "maturity," the principal amount of the bond.

Basic Investment Tools

When first issued, a bond will have a specified rate of return, or "yield." For example, a 6.0% bond will pay $60.00 per year for each $1,000 invested. If a bond is traded on a public exchange, the market price will fluctuate, generally with changes in interest rates. Later investors will receive a yield that may be more, or less, than 6.0%, depending on the price paid for the bond in the open market.

- **Uses:** Bonds are typically bought by investors seeking current income. In some instances, bonds are also used for capital growth.
- **Risks:** Like stocks, the market price of bonds will fluctuate up and down. If an investor sells a bond before it matures, a capital gain or loss may result. Unless the issuer defaults, bonds held to maturity will recover the principal amount. Since a bond pays a fixed return, inflation risk can be a problem; over time, the dollars received will buy less and less. Also, the interest income received may be subject to current income taxation.

Savings Accounts

Most investors are familiar with a savings account at a bank, savings and loan, or credit union. For many, the generic term "savings account" includes both the traditional savings account (allowing for deposits and withdrawals of small amounts), as well as fixed-term certificates of deposit (CDs), for larger sums. Savings accounts are usually prized by investors for two primary characteristics: safety of principal, and liquidity. Such accounts are insured (against a failure of the savings institution) by agencies of the Federal government, such as the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Administration (NCUA), for up to $250,000 per account.

- **Uses:** Savings accounts are often used as a reservoir for emergency funds, or as a "warehouse" for dollars ultimately earmarked for some other purpose. Some investors also use such accounts to generate current income.
- **Risks:** Because there is little risk of principal loss, savings accounts typically have a lower yield than other investments. One "risk" to such accounts is the potential additional interest income foregone in exchange for safety of principal. The relatively low yield can also be heavily impacted by inflation and current income taxes.

Basic Investment Tools

Life Insurance

The life insurance industry has developed a number of products that combine the protection of life insurance death benefits, with a significant cash value element. Policies such as universal life, indexed universal life, variable life, and variable universal life allow an individual to purchase a single financial instrument providing for both life insurance and long-term accumulation goals. Such policies may serve as a form of "forced investment" for those who find it difficult to put funds aside on a regular basis, but who routinely pay their bills. Additionally, life insurance company "annuities," either fixed annuities, variable annuities, or indexed annuities, offer a tax-deferred method of accumulating additional retirement funds.

- **Uses:** While life insurance products are primarily used for death benefit protection, they are also used for long-term accumulation goals. Available cash values may also serve as an "emergency reserve," if needed, or a source of loans, since life policies frequently include features permitting borrowing against these cash values.[1]
- **Risks:** Fixed contracts rely on the financial strength of the issuing life insurance company. Inflation may negatively impact a fixed return contract. Variable contracts share the risks of the underlying investments. Loans and withdrawals must be carefully structured to avoid negative income tax results.[1]

Real Estate

Real estate has long been a favored investment for those seeking tax benefits and a hedge against inflation. "Improved" real estate refers to land with apartments, a home, office, store, or other rentable enhancement. Rental income in excess of expenses may provide a "positive" cash flow. Additionally, depreciation may shelter a portion of the cash flow from current income tax. If all goes well, inflation will gradually increase rental income, thus raising the market value of the property.

Real estate investors may also choose to invest in "unimproved" or "raw" land. Typically such land generates no current cash flow, unless rented for agricultural purposes such as animal grazing or farming. Investors in raw land usually try to buy property in the path of expected, long-term growth, with the hope of selling the property at a gain when future demand pushes market prices up.

[1] A policy loan or withdrawal will generally reduce cash values and death benefits. If a policy lapses or is surrendered with a loan outstanding, the loan will be treated as taxable income in the current year, to the extent of gain in the policy. Policies considered to be modified endowment contracts (MECs) are subject to special rules.

Basic Investment Tools

- **Uses:** Investors in improved real estate typically seek tax-sheltered, current income along with long-term capital growth. Investors in unimproved real estate primarily seek long-term capital gains. Real estate serves as a hedge against inflation.
- **Risks:** An investor may find it difficult to keep a property rented, and thus not receive the expected cash flow. Deflation may decrease both rents and property values. Expected long-term growth in a geographical area may not occur. Real estate can be very illiquid; a quick sale may require a substantial reduction in price. Changes in tax law may reduce or eliminate anticipated tax benefits.

Gold

For centuries gold has served as an enduring store of value during periods of political and social turmoil. It has also functioned to preserve purchasing power during times of high inflation. Demand for gold, for jewelry and industrial purposes, also impacts the price of gold.

There are a number of different ways for an individual to invest in gold. For example, an investor can purchase bars of gold bullion (gold refined to a high level of purity). Gold bullion coins, such as the South African Kruggerand or U.S. Eagle offer a more portable way to own the metal. Risk-oriented speculators can participate in gold markets indirectly via gold futures on commodities exchanges. More conservative individuals may choose to invest in mutual funds which specialize in the stocks of companies mining gold.

- **Uses:** Gold serves as a permanent store of value during periods of economic and political anxiety. It also acts as a hedge against inflation.
- **Risks:** The market value of gold can fluctuate widely. Selling gold when the market is down can result in a capital loss. It can be difficult to own and protect. Direct ownership provides no current income.

Asset Allocation

Asset allocation is an investment strategy that seeks to reduce investment risk, while maintaining a desired rate of return, by spreading an individual's investments over a number of asset types. It takes advantage of the tendency of different asset types to move in different cycles, and thus smooth out the ups and downs of the entire portfolio. Stocks, bonds, and cash (or cash equivalents) are the investments normally used. Depending on individual needs or preferences, other asset types may also be included.

Asset allocation does not guarantee a profit or protect against a loss in declining markets. There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio or that diversification among asset classes will reduce risk.

A Personal Choice

There is no single asset allocation model to fit every investor, or for every stage of a person's life. The asset allocation decision is a highly individual one, and involves carefully answering a number of key questions:

- **Investment goals:** Why are you investing? Is the primary need for income, to pay current living expenses, or as a source of emergency funds? Or are you accumulating money for a future need?
- **Time horizon:** When will the money be needed? At retirement, or sooner, to send a child to college, for example?
- **Liquidity needs:** How quickly do you need to be able to turn your investment into cash?
- **Risk tolerance:** How comfortable are you with the inevitable ups and downs of the financial markets?
- **Tax impact:** How will the investments affect your tax situation?
- **Economic conditions:** Inflation, interest rates, and the state of the economy are essential factors to consider.
- **International exposure:** How comfortable are you investing in foreign markets?

Although no guarantee of how an investment may perform in the future, an analysis of historical data can provide information about the levels of risk and return for each investment type being considered. These historical values are then used as a guide to structuring a portfolio that matches the investor's individual goals and overall risk tolerance level.

Asset Allocation

A Changing Choice

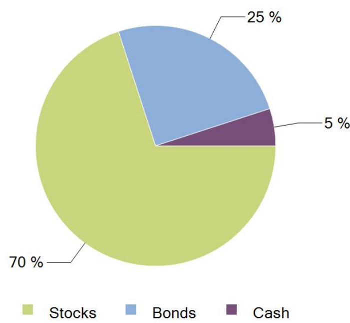
Over time, financial markets and an individual's goals and situation will change. Periodically, an investor must review his or her situation to ensure that past investment allocations are still appropriate. If not, adjustments should be made.

Representative Asset Allocation Models

The charts below illustrate three hypothetical asset allocation models, for three age groups, or types of investor. These models are intended to serve only as representative samples of how asset allocation might work, and are not intended to serve as investment or portfolio recommendations.

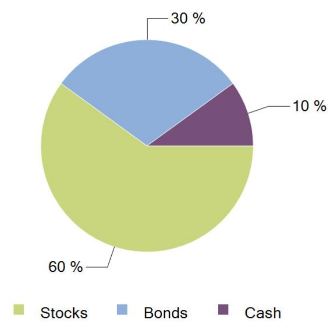
Asset Allocation Portfolio #1

Younger or Higher Risk Investors



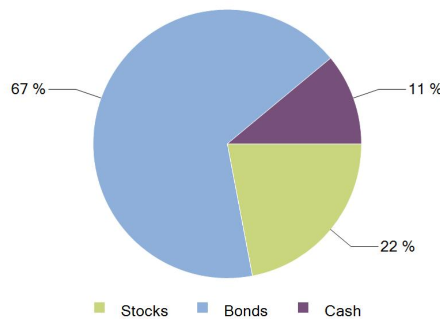
Asset Allocation Portfolio #2

Medium Risk Investors, Those Near Retirement



Asset Allocation Portfolio #3

Retired or Low Risk Investors



General Purposes of Life Insurance

Life insurance is a unique asset that can be used to help solve some of life's perplexing financial problems.

Death Benefit Uses for Life Insurance

- Create an estate: Where time or other circumstances have kept the estate owner from accumulating sufficient assets to care for his or her loved ones, life insurance can help create an instant estate.
- Pay death taxes and other estate settlement costs: These costs can vary from a low of three to four percent to over 40 percent of the estate. Federal Estate Taxes are due nine months after death.
- Fund a business transfer: Business owners often agree to buy a deceased owner's share from his or her estate after death. Life insurance provides the ready cash to help finance the transaction.
- Pay off a home mortgage: Many people would like to pass the family residence to their spouse or children free of any mortgage. Often a decreasing term policy is used, which decreases in face amount as the mortgage balance is paid down.
- Protect a business from the loss of a key employee: Key employees are difficult to attract and retain. Their untimely death may cause a severe financial strain on the business.
- Replace a charitable gift: Gifts of appreciated assets to a charitable remainder trust can provide income and estate tax benefits. Life insurance can be used to help replace the value of the donated assets. Proceeds from life insurance policies can also be paid directly to a charity.
- Pay off loans: Personal or business loans can be paid off with insurance proceeds.
- Equalize inheritances: When the family business passes to children who are active in it, life insurance can help give an equal amount to the other children.

General Purposes of Life Insurance

- Accelerated death benefits: Federal tax law allows a “terminally ill” individual to receive the death benefits of a life insurance policy on his or her life income tax free. Such “living benefits”, received prior to death, can allow a person to pay medical bills or other expenses and help maintain his or her dignity by not dying destitute. If certain conditions are met, a “chronically ill” person may also receive accelerated death benefits free of federal income tax.[1]

  Existing life insurance policies should be reviewed to verify that policy provisions allow for payment of such “accelerated death” benefits.

Other Uses for Life Insurance

While life insurance products are primarily used for death benefit protection, they are also used for long-term accumulation goals.

- College fund for children or grandchildren: Cash value increases in a policy on a minor’s life (or the parent’s life) can be used to help fund college expenses.
- Supplement retirement funds: Many current insurance products provide competitive returns and may be a prudent way of accumulating additional funds for retirement.

Available cash values may also serve as an “emergency reserve,” if needed, or a source of loans, since life policies frequently include features permitting borrowing against these cash values [2]

[1] The discussion here concerns federal income tax law; state or local tax law may vary.

[2] A policy loan or withdrawal will generally reduce cash values and death benefits. If a policy lapses or is surrendered with a loan outstanding, the loan will be treated as taxable income in the current year, to the extent of gain in the policy. Policies considered to be modified endowment contracts (MECs) are subject to special rules.

Considerations in the Purchase of Life Insurance

Who Will Be the Owner of the Policy?

Life insurance proceeds are included in the estate of a deceased if he or she has any incidents of ownership in the policy. Ownership by adult children or an irrevocable life insurance trust should be considered if there is an estate tax problem.

How Much Life Insurance?

This will depend on the need it is fulfilling. Amounts needed to fund a business transfer or to pay death taxes may be readily determined.

Calculating the value of a human life to a family is more difficult. Consider these projected total earnings up to age 65 assuming a 5% annual increase including inflation.

Projected Total Earnings to Age 65

Current Age	Current Monthly Income		
	$2,000	$4,000	$8,000
25	$3,044,154	$6,088,309	$12,176,618
35	1,674,259	3,348,518	6,697,036
45	833,262	1,666,524	3,333,048
55	316,963	633,926	1,267,852

What Type of Policy Should Be Purchased?

A person trained in life insurance can explain the many different policies available and assist in selecting the one which best fits your needs.

How Should the Premium Be Paid?

Sometimes the amount of the premium can be paid from current income, while other times it may be prudent to reposition other assets so as to be able to acquire sufficient insurance protection.

Considerations in the Purchase of Life Insurance

If the insured is a business owner or executive, a corporation may assist in paying premiums. Other times it may be better to have the corporation own the policy and use the proceeds to purchase part or all of the owner's interest at death.

Insurance can also be purchased in certain qualified retirement plans.

How Much Life Insurance?

1. Annual living expenses of survivors[1] (spouse, children, etc.)
   a. After-tax living expenses $__________
   b. Average tax rate[2] (as decimal value) __________
   c. Tax factor (one minus line 1b) __________
   Pre-tax annual living expenses of survivors (1a divided by 1c) __________
2. Less: Expected pre-tax annual income
   a. Social Security benefits __________
   b. Survivor's pension benefits __________
   c. Survivor's earned income __________
   d. Other income __________
   Total expected pre-tax annual income __________
3. Equals: Annual net living expense shortage, if any.[3] (1-2) __________
4. Capital required to produce income to meet the annual living expense shortage
   a. Pre-tax annual rate of return _______%
   b. Annual inflation rate _______%
   c. Years of income required ______yrs
   d. Multiplication factor[4] _________
   Capital required due to shortage (3 times 4d) __________
5. Plus: Lump-sum expenses
   a. Final expenses and/or estate costs __________
   b. Mortgage/other debt payoff __________
   c. Emergency fund __________
   d. Other fund (education, etc.) __________
   Total lump-sum expenses __________
6. Total capital required (Line 4 plus line 5) __________
7. Less: Existing capital
   a. Income producing assets __________
   b. Life insurance __________
   Total Present Capital __________
8. Amount of capital to be added, if any (Line 6 minus line 7) $__________

[1] Consider using 70% of current family living expenses.

[2] This value should be based on the total income and payroll taxes divided by total gross income.

[3] If Line 2 is greater than Line 1, enter a zero value for Lines 3 and 4, then skip to Line 5.

[4] See tables on following pages.

How Much Life Insurance?

Multiplication Factors (for line 4d)

Years of Income	1% Pre-Tax Annual Return			2% Pre-Tax Annual Return		
	Inflation at 3.00%	Inflation at 4.00%	Inflation at 5.00%	Inflation at 3.00%	Inflation at 4.00%	Inflation at 5.00%
5	5.20	5.31	5.41	5.10	5.20	5.30
10	10.94	11.45	11.98	10.45	10.93	11.43
15	17.27	18.56	19.96	16.07	17.24	18.52
20	24.25	26.79	29.66	21.98	24.20	26.71
25	31.95	36.32	41.42	28.17	31.87	36.18
30	40.44	47.35	55.72	34.68	40.32	47.12
35	49.81	60.12	73.07	41.51	49.63	59.78
40	60.14	74.90	94.14	48.69	59.89	74.40
45	71.54	92.01	119.73	56.22	71.20	91.31

Years of Income	3% Pre-Tax Annual Return			4% Pre-Tax Annual Return		
	Inflation at 3.00%	Inflation at 4.00%	Inflation at 5.00%	Inflation at 3.00%	Inflation at 4.00%	Inflation at 5.00%
5	5.00	5.10	5.20	4.90	5.00	5.10
10	10.00	10.45	10.92	9.58	10.00	10.44
15	15.00	16.06	17.22	14.03	15.00	16.05
20	20.00	21.96	24.16	18.27	20.00	21.94
25	25.00	28.14	31.79	22.32	25.00	28.11
30	30.00	34.63	40.20	26.17	30.00	34.58
35	35.00	41.44	49.46	29.84	35.00	41.38
40	40.00	48.59	59.65	33.34	40.00	48.50
45	45.00	56.10	70.86	36.67	45.00	55.97

How Much Life Insurance?

Multiplication Factors (for line 4d)

Years of Income	5% Pre-Tax Annual Return			6% Pre-Tax Annual Return		
	Inflation at 3.00%	Inflation at 4.00%	Inflation at 5.00%	Inflation at 3.00%	Inflation at 4.00%	Inflation at 5.00%
5	4.81	4.91	5.00	4.72	4.81	4.91
10	9.18	9.58	10.00	8.82	9.19	9.59
15	13.16	14.04	15.00	12.36	13.17	14.05
20	16.76	18.29	20.00	15.44	16.79	18.31
25	20.04	22.34	25.00	18.10	20.08	22.36
30	23.02	26.20	30.00	20.40	23.07	26.24
35	25.72	29.88	35.00	22.40	25.79	29.93
40	28.17	33.39	40.00	24.13	28.26	33.45
45	30.40	36.74	45.00	25.63	30.51	36.81

Years of Income	7% Pre-Tax Annual Return			8% Pre-Tax Annual Return		
	Inflation at 3.00%	Inflation at 4.00%	Inflation at 5.00%	Inflation at 3.00%	Inflation at 4.00%	Inflation at 5.00%
5	4.64	4.73	4.82	4.56	4.64	4.73
10	8.47	8.83	9.20	8.15	8.49	8.84
15	11.64	12.39	13.19	10.99	11.67	12.41
20	14.26	15.47	16.82	13.23	14.31	15.51
25	16.43	18.15	20.12	15.00	16.49	18.20
30	18.22	20.47	23.12	16.39	18.30	20.54
35	19.70	22.48	25.86	17.49	19.79	22.57
40	20.92	24.23	28.35	18.36	21.03	24.33
45	21.93	25.75	30.61	19.04	22.06	25.87

How Much Life Insurance?

Multiplication Factors (for line 4d)

Years of Income	9% Pre-Tax Annual Return			10% Pre-Tax Annual Return		
	Inflation at 3.00%	Inflation at 4.00%	Inflation at 5.00%	Inflation at 3.00%	Inflation at 4.00%	Inflation at 5.00%
5	4.48	4.56	4.65	4.40	4.48	4.57
10	7.85	8.17	8.50	7.57	7.87	8.18
15	10.40	11.02	11.70	9.85	10.43	11.05
20	12.31	13.28	14.35	11.50	12.36	13.32
25	13.76	15.06	16.55	12.68	13.82	15.12
30	14.84	16.47	18.37	13.53	14.93	16.55
35	15.66	17.59	19.89	14.14	15.76	17.68
40	16.28	18.47	21.14	14.58	16.39	18.58
45	16.75	19.17	22.18	14.90	16.86	19.29

Years of Income	11% Pre-Tax Annual Return			12% Pre-Tax Annual Return		
	Inflation at 3.00%	Inflation at 4.00%	Inflation at 5.00%	Inflation at 3.00%	Inflation at 4.00%	Inflation at 5.00%
5	4.33	4.41	4.49	4.26	4.33	4.41
10	7.31	7.59	7.89	7.06	7.33	7.61
15	9.36	9.89	10.46	8.90	9.39	9.92
20	10.77	11.55	12.41	10.11	10.82	11.60
25	11.74	12.75	13.89	10.91	11.80	12.81
30	12.40	13.61	15.01	11.44	12.48	13.69
35	12.86	14.24	15.85	11.78	12.95	14.33
40	13.18	14.69	16.50	12.01	13.28	14.79
45	13.40	15.01	16.98	12.16	13.50	15.12

Using Cash Value Life Insurance

Accumulating Funds to Meet Savings Goals

Saving money to reach an accumulation goal is a problem many of us face. Some goals, such as retirement or a college fund for a child, are long-term savings goals. Many of us also have shorter-term savings goals such as a vacation or a Christmas or holiday fund.

Whatever the objective, the basic problem is the same, i.e. where to put money aside to reach a particular savings goal. For many short-term goals, a savings account at a local bank or credit union is a popular choice. For college funding, Coverdell IRAs or IRC Sec. 529 plans are often used. For retirement savings, many individuals depend on Individual Retirement Accounts (IRAs) or employer-sponsored retirement plans such as an IRC Sec. 401(k) plan.

An additional option for long-term savings, one that is sometimes overlooked, is using a cash value life insurance policy.

What is Cash Value Life Insurance?

Life insurance comes in two basic variations, “term” insurance and “cash value” life insurance. Term life insurance can be compared to auto insurance. Protection is provided for a specified period of time or “term.” No death benefits are paid unless the insured dies during the term the policy is in force. If the insured lives beyond the term period, the policy generally expires with nothing returned to the policy owner.

In addition to providing a death benefit, “cash value” life insurance also provides for the tax-deferred accumulation of money inside the policy. These funds can be used by the policy owner while the insured is alive to provide the resources for needs such as funding a college education, making improvements to the home, or starting a business. When the policy owner uses the cash values to meet such needs, he or she is said to have used the “living benefits” of a cash value life insurance policy.

When to Consider Cash Value Life Insurance

Using a cash value life insurance policy to reach a saving goal works best in certain situations:

Using Cash Value Life Insurance

- **A need for life insurance death benefit:** Apart from the need for additional savings, an individual should have a need for the death benefit that life insurance provides. For example, such a need exists when an individual has a dependent spouse or children who would suffer economically if the individual died. Someone with a large estate might need additional cash at death to pay estate and other taxes as well as final expenses.
- **Other savings aren't enough:** Because of limitations in federal tax law,[1] other accumulation vehicles might not allow enough money to be put aside to meet a particular savings goal.
- **Time frame:** Ideally, there should be at least 10 to 15 years between today and the time the money will be needed. Because of mortality expenses and other policy charges, significant cash value accumulations are generally deferred until a policy has been in force for a number of years. Additionally, federal income tax law affects the design of cash value life insurance policies as well as the taxation of cash value withdrawals in the early years a policy is in force.
- **Insurable:** The insured needs to be healthy enough to have a policy issued on his or her life.
- **An ongoing obligation:** Cash value life insurance policies tend to have a higher premium cost than comparable term life policies. Paying the premiums over a number of years represents an ongoing financial obligation, to both keep the policy in force and achieve the savings goal.

Income Tax Considerations

There are a number of income tax issues to keep in mind when considering any life insurance policy. The death benefit payable under a life insurance contract because of the death of the insured is generally received income-tax free. Federal income taxation of life insurance "living benefits" is more complicated:

- **Tax-deferred growth:** The growth of cash value inside a life insurance policy is tax-deferred.

[1] The discussion here concerns federal income tax law. State or local tax law may vary widely.

Using Cash Value Life Insurance

- **Cost recovery rule:** Amounts withdrawn from a cash-value life insurance contract are included in gross income (and become subject to tax) only when they exceed the policy owner's basis in the policy. This basis is also known as the "investment in the contract." This effectively treats withdrawals from the policy first as a non-taxable return of premium and secondly as taxable income.
- **Investment in the contract:** The total of all premiums paid less any policy dividends and any other prior tax-free distributions received.
- **Policy dividends:** Some "participating" life policies pay what are termed "dividends." Such dividends are a return of a portion of the policy owner's previously paid premiums. Policy dividends are not taxable until they exceed the owner's basis in the life insurance contract.
- **Policy loans:** Some cash value life insurance policies allow the policy owner to borrow at interest a portion of the accumulated cash value. While a policy is in force, policy loans are generally not taxable. However, if a policy is surrendered with a loan outstanding, taxable income will result to the extent that the unpaid loan amount exceeds the owner's basis in the contract.
- **Modified Endowment Contracts (MECs):** Some life insurance policies – primarily because there are large premium payments in the early years of the contract – are termed "Modified Endowment Contracts," or MECs. Under federal income tax law, distributions from a policy considered to be a MEC are treated differently than distributions from non-MEC policies. Withdrawals from a MEC (including a policy loan) will first be taxed as current income until all of the policy earnings have been taxed. If the owner is under age 59½, a 10% penalty also applies, unless the payments are due to disability or are annuity type payments. Once all policy earnings have been distributed (and taxed), any further withdrawals are treated as a non-taxable return of premium.

Accessing the Contract's Cash Values

When the time comes to use the accumulated cash values, withdrawals from the policy should be done in such a way as to avoid current income taxation (to the extent possible) and keep the policy in force.

- **Withdrawal to basis:** Initially a policy owner can take withdrawals (partial policy surrenders) until he or she has withdrawn an amount equal to the basis in the policy.

Using Cash Value Life Insurance

- **Switching to policy loans:** Once the basis has been withdrawn, the policy owner then begins using non-taxable policy loans. The interest payable on these policy loans is typically much less than a loan from a commercial bank or credit union.
- **A combination:** A policy owner can also use a combination of withdrawals and policy loans.
- **Caveats:** There are a number of issues that a policy owner needs to keep in mind:
  - Withdrawals reduce the death benefit available under the policy.
  - If an insured dies with a policy loan outstanding, the policy's death benefit is reduced by the amount of the loan balance.
  - Excessive use of withdrawals and policy loans can result in the policy lapsing. Such a lapse can result in unexpected, negative tax results as well as the loss of a valuable financial asset.

A Multi-function Tool

Used appropriately, cash value life insurance can serve as financial tool with multiple uses. It can be used, in conjunction with more traditional savings vehicles, as a way to accumulate funds for long-term savings goals. At the same time the policy can, if the insured dies, provide a death benefit when the funds are most needed.

Seek Professional Guidance

Determining the appropriate amount of life insurance, the best type of policy to meet the needs of an individual's specific situation, and planning when and how to access a policy's cash values can be complex and confusing. The advice and guidance of trained insurance, tax, and other financial professionals is strongly recommended.

Individual Disability Income Insurance

One approach to the problem of providing income during an extended period of disability is to purchase individual disability income insurance.

What to Look for in a Disability Policy

- **Definition of disability:** Are education, experience, and past earnings taken into account in determining whether the insured is qualified to resume work? Many policies provide for an initial "own occupation"[1] definition of disability, for a specified period of time, after which a different definition of disability applies.

- **Partial or residual benefits:** Partial or residual disability benefits may be paid in some policies when the impairment allows the insured to perform only a portion of his or her duties. This provision may also pay benefits in the event the disability reduces the insured's income by a certain amount (e.g. 20% or more) from pre-disability levels.

- **Cost of living adjustment:** Is there a cost of living adjustment (COLA) which would increase benefit payments after a disability occurs?

- **Cancelability and renewability of policy:** Except for nonpayment of premiums, is the policy noncancelable or guaranteed renewable? Noncancelable generally means the insurer cannot cancel the policy, change the policy provisions or increase policy premiums after issue, as long as premiums are paid on a timely basis. Guaranteed renewable is similar, but allows the insurance company to increase the premium.

- **Waiting and elimination period:** Is the waiting or "elimination" period proper for the insured's circumstances? Commonly available periods may include 30, 60, 90, 180 and 360 days. Naturally, the longer the elimination period one selects, the lower his or her premium payments will be. However, a person's needs, cash reserves and income sources should be the deciding factors in selecting a proper elimination/waiting period.

[1] "Own occupation" generally means the insured's current occupation. The own occupation definition of disability may not be available for all occupations or professions.

Individual Disability Income Insurance

- **Benefit period:** What benefit period should be selected? Since a long-term medical disability can be financially devastating, one should elect a long-term benefit where possible. Some companies offer lifetime benefit periods, but periods as short as 24 months to 60 months are also available.

Types of Disability Contracts

Several other specialized disability contracts are available to the businessperson:

- **Business overhead expense:** Covers expenses such as staff salaries, rent, telephone, utilities, malpractice insurance, and other expenses necessary to keep a business open.
- **Key person disability:** Reimburses the business for the loss of a key employee and allows funding of temporary replacement or training of a successor.
- **Disability buyout:** Provides income to fund a buy-sell agreement triggered by the total disability of a shareholder/business owner. Payouts may come in the form of a lump sum, monthly installments, or a combination of the two.

Caution: Highly-compensated employees should be aware of payment caps in many group long-term disability policies. While some programs will provide disability income payments at 60% or 66% of salary, many have a relatively low dollar limitation, such as $3,000 per month.

COBRA Coverage Continuation

An employer who has 20 or more full-time-equivalent employees on at least 50% of its working days during the prior year must meet the requirements of IRC Sec. 4980B, also known as COBRA.

Failure to comply with COBRA requirements may result in serious penalties.

Under COBRA, an employer must give his covered employees (including spouses and dependent children who are covered) the opportunity to elect continuation coverage under an employer-maintained group health plan (including plans to which the employer does not contribute financially) after any of the following events that would otherwise result in loss of coverage:

- The death of the covered employee.
- The divorce or legal separation of the covered employee.
- The termination of the employee's employment, unless for gross misconduct, or a reduction in hours that results in a loss of coverage.
- The covered employee becomes eligible for Medicare.
- A dependent child ceases to be covered by the plan due to his or her attained age.
- For retired employees, the filing by the employer for Chapter 11 bankruptcy.

Continuation Coverage

The continued coverage offered must be identical to the coverage offered prior to the event causing the continuation.

The plan may require the covered employee (spouse or dependents) to pay a premium, but it generally cannot exceed 102% of the cost to the plan for a person in a similar situation.

Terminated employees and employees with reduced hours must be provided coverage for up to 18 months (up to 29 months if disabled [by Social Security definition] during the first 60 days of COBRA coverage). Widows, divorced spouses, spouses of employees or retirees who lose coverage due to Medicare eligibility and dependent children who become ineligible are given up to 36 months of coverage.

Each health plan must give written notice to each covered employee of his or her continuation coverage rights.

COBRA Coverage Continuation

Notice and Election Requirements

COBRA contains detailed rules and timelines specifying when employers, covered employees and health plans/plan administrators must provide notices of certain events or take certain actions. The most important of these is the notice of an individual's right to elect continuation coverage. An individual normally has only 60 days from the date of the COBRA election notice (triggered by a loss of group health coverage due to one of the aforementioned events) in which to elect continuation coverage. If they do not elect continuation coverage during this period, they normally give up their rights under COBRA to choose continuation coverage.

The Department of Labor (DOL) has issued proposed changes to the required employer notices, to include information regarding the availability of health insurance coverage through the Patient Protection and Affordable Care Act (PPACA) established healthcare marketplaces. This PPACA coverage may be less expensive than that provided under COBRA.

Failure to Comply

Employers who fail to comply with the COBRA Rules may incur an excise tax of $100 per qualified beneficiary for each day of noncompliance (with a maximum of $200 per day per covered family). COBRA Administrators who fail to provide the initial COBRA notice or the COBRA election notice when a qualifying event occurs are subject to a penalty of up to $110 per affected beneficiary per day under the Employee Retirement Income Security Act. If the failure to comply is not intentional, but due to reasonable cause, the maximum excise tax is limited to 10% of the prior year's group health plan costs (with a maximum of $500,000).

Long-Term Care

Long-term care (LTC) is the term used to describe a variety of services in the area of health, personal care, and social needs of persons who are chronically disabled, ill or infirm. Depending on the needs of the individual, long-term care may include services such as nursing home care, assisted living, home health care, or adult day care.

Who Needs Long-Term Care?

The need for long-term care is generally defined by an individual's inability to perform the normal activities of daily living (ADL) such as bathing, dressing, eating, toileting, continence, and moving around. Conditions such as AIDS, spinal cord or head injuries, stroke, mental illness, Alzheimer's disease or other forms of dementia, or physical weakness and frailty due to advancing age can all result in the need for long-term care.

While the need for long-term care can occur at any age, older individuals are the typical recipients of such care.

Individuals with Disabilities, by Age[1]

Age Range	No Disability	With a Disability
5-17 Years	94%	6%
18-34 Years	94%	6%
35-64 Years	88%	12%
65-74 Years	76%	24%
75 Years and over	52%	48%

What Is The Cost of Long-Term Care?

Apart from the unpaid services of family and friends, long-term care is expensive. The following table lists national average costs (regional costs can vary widely) for typical long-term care services. One federal government study found that the "average length of time since admission for all current nursing home residents was 835 days."[2]

[1] Source: U.S. Census Bureau, 2018 American Community Survey 1-Year Estimates, Sex by Age by Disability Status for the Civilian noninstitutionalized population, male and female, Table B18101.

[2] The National Nursing Home Survey: 2004 Overview. U.S. Department of Health and Human Services, Centers for Disease Control and Prevention, National Center for Health Statistics.

Long-Term Care

Service	2019[1]
Assisted living facility	$4,051 per month ($48,612 per year)
Nursing home (Private room)	$280 per day ($102,200 per year)
Nursing home (Semi-private room)	$247 per day ($90,155 per year)
Home health aide	$23 per hour
Homemaker/companion	$22.50 per hour

Paying for Long-Term Care – Personal Resources

Much long-term care is paid for from personal resources:

- Out-of-Pocket: Expenses paid from personal savings and investments.
- Reverse Mortgage: Certain homeowners may qualify for a reverse mortgage, allowing them to tap the equity in the home while retaining ownership.
- Accelerated Death Benefits: Certain life insurance policies provide for "accelerated death benefits" (also known as a living benefit) if the insured becomes terminally or chronically ill.
- Private Health Insurance: Some private health insurance policies cover a limited period of at-home or nursing home care, usually related to a covered illness or injury.
- Long-Term Care Insurance: Private insurance designed to pay for long-term care services, at home or in an institution, either skilled or unskilled. Benefits will vary from policy to policy.

Paying for Long-Term Care – Government Resources

Long-term care that is paid for by government comes from two primary sources:

- Medicare: Medicare is a health insurance program operated by the federal government. Benefits are available to qualifying individuals age 65 and older, certain disabled individuals under age 65, and those suffering from end-stage renal disease. A limited amount of nursing home care is available under Medicare Part A, Hospital

[1] Source: Genworth 2019 Cost of Care Survey, page 2.

Long-Term Care

Insurance. An unlimited amount of home health care is also available, if made under a physician's treatment plan.

- Medicaid: Medicaid is a welfare program funded by both federal and state governments, designed to provide health care for the truly impoverished. Eligibility for benefits under Medicaid is typically based on an individual's income and assets; eligibility rules vary by state.

In the past, some individuals have attempted to artificially qualify themselves for Medicaid by gifting or otherwise disposing of assets for less than fair market value. Sometimes known as "Medicaid spend-down", this strategy has been the subject of legislation such as the Omnibus Budget Reconciliation Act of 1993 (OBRA '93). Among other restrictions, OBRA '93 provided that gifts of assets within 36 months (60 months for certain trusts) before applying for Medicaid could delay benefit eligibility.

The Deficit Reduction Act of 2005 (DRA) further tightened the requirements to qualify for Medicaid by extending the "look-back" period for all gifts from 36 to 60 months. Under this law, the beginning of the ineligibility (or penalty) period was generally changed to the later of: (1) the date of the gift; or, (2) the date the individual would otherwise have qualified to receive Medicaid benefits. This legislation also clarified certain "spousal impoverishment" rules, while making it more difficult to use certain types of annuities as a means of transferring assets for less than fair market value.

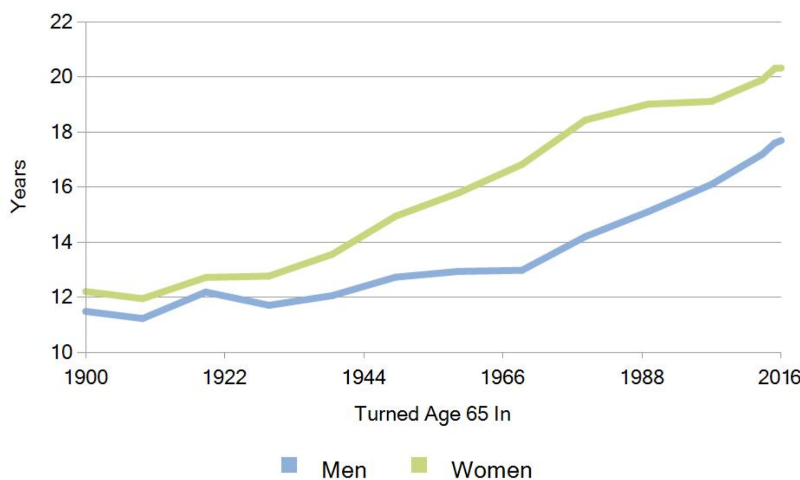
Average Life Expectancy at Age 65

While no one knows how long he or she will live, average life expectancy in the United States has been increasing. The tables and graph below show how the average number of years of life remaining at age 65 has increased since the turn of the 20th century.[1]

Male	
Turned Age 65 In	Average Years of Life Remaining
1909-1911	11.24
1919-1921	12.20
1929-1931	11.72
1939-1941	12.07
1949-1951	12.74
1959-1961	12.95
1969-1971	12.99
1979-1981	14.21
1989-1991	15.12
1999-2001	16.11
2017	18.04

Female	
Turned Age 65 In	Average Years of Life Remaining
1909-1911	11.96
1919-1921	12.73
1929-1931	12.78
1939-1941	13.57
1949-1951	14.95
1959-1961	15.80
1969-1971	16.83
1979-1981	18.44
1989-1991	19.02
1999-2001	19.12
2017	20.60

Average Remaining Life Expectancy At Age 65



[1] Source: National Vital Statistics Reports, Volume 68, Number 7, United States Life Tables, 2017, Table 21. June 24, 2019.

Do You Desire "Retirement Peace of Mind?"

In December, 2012, a landmark study was launched to determine a national retirement peace of mind.[1] It included more than 6,000 respondents age 45 and older. It found that average Americans have a lot of challenges and a lot of expectations for their retirement years.

Retirement Expectations

Traditionally, many Americans have viewed retirement as a time of leisure. Today, more and more of us expect to work during our retirement years. Seven out of ten of those surveyed in the study said that their ideal plan for balancing work and leisure in retirement would be to include some work.

The reasons are not purely economic. Many Americans see retirement as a time for renewal and accomplishment. When asked if they would seek the same kind of work in retirement or pursue a different career, half of those surveyed said they would seek a different line of work.

A desire for more money and economic security was the most important reason for working in retirement according to a majority of the survey participants, but 48 percent said a desire for stimulation and satisfaction was their top reason for continuing to work during retirement.

When asked about their most important financial goal, 88 percent said they would like to save enough money to have financial peace of mind, versus 12% who said they would like to accumulate as much wealth as possible.

Retirement Challenges

The study also sought information on the greatest concerns facing those nearing retirement. Not surprisingly, in today's complex economic and social climate, they found many complications that could make the task of retirement planning even more challenging.

- **Health problems:** Americans are expected to live longer than ever before. When asked what concerned them about living a long life, 72% of those surveyed said they feared

[1] "Americans' Perspectives on New Retirement Realities and the Longevity Bonus, a 2013 Merrill Lynch Retirement Study, conducted in partnership with Age Wave." © 2013 Bank of America; All rights reserved

Do You Desire "Retirement Peace of Mind?"

serious health problems, making it the top retirement worry. This compares with 47% who said they worried they would run out of the money they need to live a comfortable retirement.

There is good reason for concern. The study found that the top reason for early retirement given by those already retired was due to personal health problems. Fully 57% of study participants who had already retired reported they retired earlier than they had planned.

- **Caring for family members:** More and more Americans today are left caring for others in their families: adult children, grandchildren, parents or in-laws, siblings. These Americans are often referred to as the "Sandwich Generation", finding their own needs for saving and retirement security squeezed by the needs of others they love.

Among study participants aged 45 or older with children, over half said they expected to have to continue to provide support to adult children. More than a third expected to have to support grandchildren. Fewer said they expected to have to support parents (16%) or their siblings (10%).

The types of support they expected to provide included financial support (cash or loans), housing (sharing a home or helping pay for housing), education and healthcare. The study also found a relationship between income and expectations for providing support: participants with higher incomes were two times more likely to say they expected to provide support to their adult children, grandchildren and parents than those with lower incomes.

Do You Have "Retirement Peace of Mind?"

The study tried to determine how close participants were to achieving retirement peace of mind by asking them to respond to these survey questions:

Question
• I feel content and comfortable about how I will spend my retirement years.
• I have many worries about what might happen during my retirement.
• Thinking about my retirement gives me feelings of security and stability.
• I feel anxious and uneasy about how I will support myself and my family during retirement.
• I feel well prepared for whatever may happen during my retirement.

Do You Desire “Retirement Peace of Mind?”

The study found that participants had an average score of 5.3, based on a scale of 1 to 10, or slightly above average. Scores varied, though, by gender, the amount of savings, and if the participant worked with a financial advisor.

- Men were more likely than women to have retirement peace of mind. The average score for male participants was 5.6 while female participants averaged 5.0.
- Participants with $500,000 or more in investable savings averaged a score of 7.5 while those with under $250,000 in investable savings averaged 4.8.
- Participants who worked with a financial advisor at the time of the study had an average score of 6.3, while those who did not work with a financial advisor had a score of 4.7.

How Can You Improve Your Retirement Peace of Mind?

The results of the national study suggest several steps you can take today to improve your peace of mind during retirement:

- **What is your most important financial goal?** Are you like the 88 percent who said they would like to save enough money to have financial peace of mind? Or, are you more like the 12% who said they would like to accumulate as much wealth as possible? The answer may help determine your retirement savings and investment strategy.
- **Do you intend to work during retirement?** Will you stay in the same line of work, or start a new career… maybe even a business of your own? If you do intend to work, it could affect the Social Security benefits for which you qualify. You will want to research the impact carefully.
- **What will you do for personal satisfaction?** While a desire for more income and security was the top reason for working in retirement, almost half of the study participants said they intended to do so for personal stimulation and satisfaction. What will you do for stimulation and satisfaction? Do you wish to travel? Start a new career? Volunteer in your community? Whatever your choices, look carefully to see how they may affect your retirement savings goals. Do you need to save money to start a business? To complete a college education? To travel?
- **Are you prepared for any personal healthcare issues that could arise?** Problems with personal health lead more people to retire earlier than planned more than any other

Do You Desire "Retirement Peace of Mind?"

cause. Do you understand your medical care and long-term care options? Does your employer offer extended healthcare benefits to retirees or will you be required to provide your own? Is disability insurance appropriate for your situation?

- **Do you have any other family obligations to consider?** More and more retirees today find they must continue to provide financial support for their adult children, grandchildren, parents or siblings. Are you supporting family members today? Do you intend to support family members during retirement? How is supporting family today affecting your ability to save for retirement? Are there other strategies you should consider? Is life insurance something you should consider to help care for survivors or heirs?
- **Would you benefit from professional financial advice?** Participants in the nation-wide study reported overall higher levels of retirement peace of mind when they worked with a financial advisor. Would discussing your retirement goals and challenges with a professional help you?

Whatever your expectations for retirement, like all important things in life, it pays to have a plan to achieve them and to regularly measure your progress towards your goals.

Evaluating Early Retirement Offers

In recent years cost-cutting and restructuring measures have forced a number of companies to offer many of their employees early retirement packages. Although initially attractive, these packages require careful analysis. In deciding to either accept or reject an early retirement offer, several key questions must be answered:

- Do you want to retire?
- If you don't want to retire, what happens if you reject the offer?
- If you do want to retire, can you realistically afford retirement?

Common Elements in Early Retirement Packages

Early retirement offers are carefully structured and may include "sweeteners" such as:

- **Cash:** A cash bonus, either as a lump-sum or periodic payments, may be included. Consider your cash-flow and income tax situation before deciding which to take.

- **Defined benefit pensions:** For companies with defined benefit retirement plans, retirement income is often based on years of service, age at retirement, and a percentage of the highest three years earnings. Any or all of these factors can be adjusted to give an employee a higher pension benefit.

- **Defined contribution pensions:** Employers who sponsor defined contribution plans such as 401(k) or 403(b) plans may allow employees who take early retirement to keep their funds in the company plan.

- **Other fringe benefits:** Some early retirement offers will include valuable benefits such as group health or life insurance, counseling by financial professionals, and education or job placement assistance, if the employee wishes to continue working.

Do You Want to Retire?

Before the offer was made, what were your plans for the future? Were you already considering early retirement or were you planning on working for a few more years? For some, continuing to work is not only enjoyable, but it also helps in reaching goals such as putting a child or grandchild through college or paying off a mortgage. For others, the freedom retirement offers to pursue more personal goals is a life-long dream.

Evaluating Early Retirement Offers

What Happens if You Decide to Reject the Offer?

Sometimes remaining with your current employer is a realistic option, sometimes it isn't. Refusing an early retirement offer may lead to promotions or salary increases that, in the long run, could result in a higher retirement benefit. Also, working longer allows you to save more and reduces the number of retirement years. Alternatively, rejecting an offer may result in being demoted or simply let go when your position is eliminated. Often, you have only a very brief period of time to make this critical decision, typically 60 to 90 days.

Can You Afford to Retire?

For most of us the key question frequently comes down to whether or not we can financially afford to retire. There are a number of issues to consider when answering this question, focusing on how much income you need and where it will come from:

- **A longer retirement:** Early retirement effectively means that your retirement will last longer. With people living longer, some of us may spend as much as 1/3 of our lives in retirement.

- **Taxes and inflation:** When planning your income needs, be sure to keep the impact of both taxes and inflation in mind. What will your marginal tax rate be in retirement? To offset inflation, your income goal cannot remain level, but must increase each year.

- **Lower pension and Social Security income:** Early retirement often results in lower pension income as well as reduced Social Security retirement benefits.

- **Less time to plan and save:** Early retirement leaves you less time to plan for the psychological adjustment needed when you retire. It also leaves less time to save for what will likely be a longer period of retirement.

- **Health care:** Medical care is expensive and as we age we typically need more of it. During our working years, employer provided health insurance is an extremely valuable benefit. After retirement, however, we are much more on our own. Medicare is generally available once you reach age 65, but Medicare has specific limits. Often, additional medical insurance is necessary, but the individual typically has to personally pay for this extra coverage.

Evaluating Early Retirement Offers

- **Continue working:** Some of us, either because we enjoy working, or because we need the income, will want to consider continued employment.

Seek Professional Guidance

Evaluating an early retirement offer from your employer can be a complex and confusing task. The guidance of financial professionals is strongly recommended.

The Need for Retirement Planning

For much of the 20th century, retirement in America was traditionally defined in terms of its relationship to participation in the active work force. An individual would work full-time until a certain age, and then leave employment to spend a few years quietly rocking on the front porch. Declining health often made retirement short and unpleasant. Retirement planning, as such, typically focused on saving enough to guarantee minimal survival for a relatively brief period of time.

More recently, however, many individuals are beginning to recognize that for a number of reasons, this traditional view of retirement is no longer accurate. Some individuals, for example, are voluntarily choosing to retire early, in their 40s or 50s. Others, because they enjoy working, choose to remain employed well past the traditional retirement age of 65. And, many retirees do more than just rock on the front porch. Retirement is now often defined by activities such as travel, returning to school, volunteer work, or the pursuit of favorite hobbies or sports.

This changed the face of retirement, however, with all of its possibilities, does not happen automatically. Many of the issues associated with retirement, such as ill health, and the need to provide income, still exist. With proper planning, however, these needs can be met.

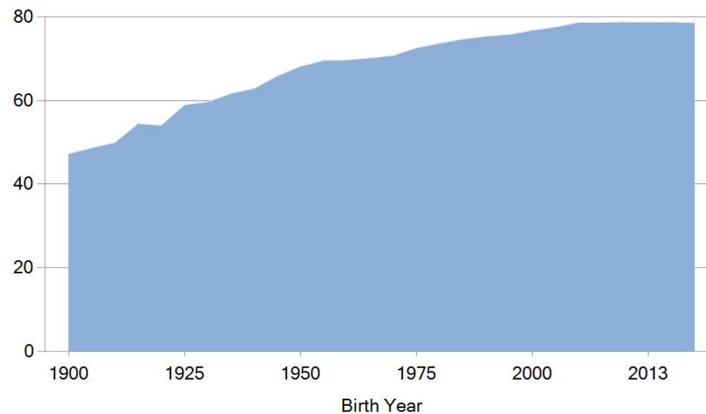
Longer Lives

The single most important factor in this changed retirement picture is the fact that we now live much longer than before. A child born in 1900, for example, had an average life expectancy of 47.3 years. For a child born in 2017, however, average life expectancy had increased to 78.6 years. The following graph[1] illustrates this change.

[1] Source: National Vital Statistics Reports, Volume 68, Number 7 – United States Life Tables, 2017, Table 19. June 24, 2019.

The Need for Retirement Planning

Average U.S. Life Expectancy (1900 – 2017)



Common Retirement Planning Issues

Planning for a much longer life span involves addressing problems not faced by earlier generations. Some of the key issues include the following:

- **Paying for retirement:** Providing a steady income is often the key problem involved in retirement planning. Longer life spans raise the issue of the impact of inflation on fixed dollar payments, as well as the possibility of outliving accumulated personal savings. Social Security retirement benefits and income from employer-sponsored retirement plans typically provide only a portion of the total income required. If income is insufficient, a retiree may be forced to either continue working, or face a reduced standard of living.
- **Health care:** The health benefits provided through the federal government's Medicare program are generally considered to be only a foundation. Often a supplemental Medigap policy is needed, as is a long-term care policy, to provide needed benefits not available through Medicare. Health care planning should also consider a health care proxy, allowing someone else to make medical decisions when an individual is temporarily incapacitated, as well as a living will that expresses an individual's wishes when no hope of recovery is possible.
- **Estate planning:** Retirement planning inevitably must consider what happens to an individual's assets after retirement is over. Estate planning should ensure not only

The Need for Retirement Planning

that assets are transferred to the individuals or organizations chosen by the owner, but also that the transfer is done with the least amount of tax.

- **Housing:** This question involves not only the size and type of home (condo, house, shared housing, assisted living), but also its location. Such factors as climate and proximity to close family members and medical care are often important. Completely paying off a home loan can reduce monthly income needs. A reverse mortgage may provide additional monthly income.
- **Lifestyle:** Some individuals, accustomed to a busy work life, find it difficult to enjoy the freedom offered by retirement. Planning ahead can make this transition easier.

Seek Professional Guidance

Developing a successful retirement plan involves carefully considering a wide range of issues and potential problems. Finding solutions to these questions often requires both personal education and the guidance of knowledgeable individuals, from many professional disciplines. The key is to begin planning as early as possible.

Deferred Income Annuities

Retirement income planning in today's world needs to deal with several key realities:

- **We're living longer:** A child born in 1900 had an average life expectancy of 47.3 years. For a child born in 2017, however, average life expectancy had increased to 78.6 years.[1]
- **We're on our own, more and more:** Over the past few decades, many employers have changed from defined *benefit* plans, providing predictable, stable lifetime income, to defined *contribution* plans, such as 401(k), 403(b), or 457[2] plans. A worker can also have an individual retirement account, either a traditional IRA or a Roth IRA. In defined contribution plans, the individual contributes (in some cases the employer also contributes) to a tax-deferred retirement account. At retirement, the accumulated cash, whatever it amounts to, is used to generate retirement income.[3] This change from defined benefit to defined contribution plans has effectively shifted the risk involved in managing these retirement assets from the employer to the *employee*.
- **Social Security? Maybe, maybe not:** Social Security is a "pay-as-you-go" system with current workers supporting those already receiving benefits. As the baby boom generation retires (the "Silver Tsunami"), the number of individuals left in the workforce to support them will grow smaller. Although politically unpleasant, fiscal reality may force higher payroll taxes, retirement benefit cuts, or both.

Unless these retirement assets are very carefully managed, it is possible to literally "run out of money." How, then, does a retiree create a stable income stream that will last a lifetime? One possible answer is a type of life insurance annuity contract known as a "Deferred Income Annuity."

What's an Annuity?

The word "annuity" derives from a Latin term meaning "annual" and generally refers to any

[1] Source: National Vital Statistics Reports, Volume 68, Number 7 – United States Life Tables, 2017, Table 19. June 24, 2019.
[2] These refer to the section of the Internal Revenue Code which authorizes these different types of retirement plans.
[3] From 1985 to 2000, the rate of participation in defined benefit plans by full-time employees of medium and large private firms dropped from 80% to 36%. (See "Employee Participation in Defined Benefit and Defined Contribution Plans, 1985-2000. U.S. Bureau of Labor Statistics, update June 16, 2004). A survey by the Bureau of Labor Statistics, published in 2019, found that only 21% of workers in the U.S. participated in defined benefit plans. See: National Compensation Survey: Employee Benefits in the United States, March 2019, Table 2.

circumstance where principal and interest are liquidated through a series of regular payments. A commercial annuity is a special type of contract issued by a life insurance company. In a typical situation, the contract owner contributes funds to the annuity. In return, the insurance company agrees to make periodic payments over a specified period of time, the life of an individual, or the joint lives of two individuals. In essence, an annuity allows the contract owner to shift the investment risk to the insurance company.

The dollar amount the annuity pays depends on a number of factors, including:

- **Premium paid:** Generally, the larger the payment, the larger the income stream.
- **Age:** Older individuals (with shorter life expectancies) typically receive larger periodic payments.
- **Deferral period:** Waiting a longer period of time before beginning annuity payments usually results in a larger periodic payment.
- **Payout period selected:** A shorter payout period usually results in a larger payment.

Deferred Income Annuities

For many individuals, a "deferred" annuity (one which begins payments at a future date) provides part of their retirement income. In many cases, the annuity contract owner purchases the annuity while relatively young, and then structures the contract so that annuity payments begin at the same time as retirement, receiving payments over his or her remaining lifetime. Since the individual's retirement years may extend over a lengthy period of time, for each dollar invested in the contract, the periodic payments will generally be less than if the contract covered a shorter period of time.

Recently, individuals close to retirement age have begun to utilize a deferred annuity that begins paying not at the beginning of retirement, but at a more advanced age, such as 75, 80, or 85. These annuities are known as "deferred income annuities," or, more popularly, "longevity annuities." When planning for not running out of money in retirement, deferred income annuities have several advantages:

Deferred Income Annuities

- **Security:** Once the annuity is purchased, the income is guaranteed for the rest of your life, no matter how long that may be. The income amount is fixed and is not subject to change based on market fluctuations.
- **Higher payment amounts:** Monthly income payments are generally higher than those available from traditional deferred annuities.
- **Simplicity:** Once the annuity is purchased, there is nothing more to do or decide. The income will automatically begin on the specified future date.

For a number of years, deferred income annuities were paid for exclusively with funds that had already been taxed.

Qualified Retirement Plans and Deferred Income Annuities

An alternative source of funds to purchase a deferred income annuity is the cash saved in individual retirement plans such as a traditional or Roth IRA, or in employer-sponsored qualified[1] retirement plans such as 401(K), 403(b), or 457 plans. In the past, a key roadblock to using these funds was the federal income tax requirement that the money be distributed (generally beginning at age 72), known as a Required Minimum Distribution, or RMD.[2] However, regulations published in July, 2014[3] by the Internal Revenue Service provide a way to purchase a deferred income annuity with qualified plan funds without tripping over the RMD requirements. These changes reflect an IRS concern that long-lived retirees might exhaust their qualified retirement plan funds too soon, due to the RMD requirements.

Under these regulations, if a deferred income annuity purchased with qualified plan funds meets certain requirements, the funds invested in the contract are *excluded* from the normal RMD requirement calculations prior to the date annuity payments begin, even if the start date is beyond age 72. Such a contract is referred to a "Qualified Longevity Annuity Contract," or QLAC. In general, these requirements are as follows:

[1] These plans are termed "qualified" as they meet certain requirements in the Internal Revenue Code.

[2] The discussion here concerns federal income tax law; state or local income tax law may differ. The age 72 "trigger" date applies to distributions required to be made after December 31, 2019, to individuals who reach age 70½ after that date. Under prior law, age 70½ was the mandated age for beginning RMDs. Roth IRAs are not subject to the RMD rules during the lifetime of the account owner. There are RMD requirements for *inherited* Roth IRA accounts.

[3] See Treasury Decision 9673, published on July 1, 2014, effective for contracts purchased or exchanged on or after July 2, 2014.

Deferred Income Annuities

- **Limitations on premiums:** No more than the *lesser* of $135,000 (2020 value) or 25% of the account balance may be used to purchase the deferred income annuity. The $135,000 premium limitation is subject to adjustment for inflation in future years.
- **Maximum age at commencement:** The annuity starting date must be no later than the first day of the month following the month the employee reaches age 85. This maximum age may be adjusted by the IRS for future changes in mortality experience.
- **Return of premium:** A QLAC may provide for a return of premium (ROP) feature. With this provision, if the employee and/or a designated beneficiary die before the entire premium has been returned in the form of annuity payments, a single, lump-sum payment of the un-recovered difference may be made.
- **Underlying earnings:** A deferred income annuity will be considered a QLAC only if the earnings under the contract are derived from contractual guarantees. Such an arrangement is commonly referred to as a “fixed” annuity, an annuity which pays a known rate of return. Generally, this rate is guaranteed[1] for a certain period of time after which a new rate is calculated, based on market conditions. Most insurance companies offer a guaranteed[1] minimum rate of return throughout the life of the annuity contract.
- **Other points:** The contract must be identified as a QLAC and the employee must be so notified. Because Roth IRAs are not subject to the RMD requirements during the owner’s lifetime, a deferred income annuity purchased within a Roth IRA is not considered to be a QLAC.

Seek Professional Guidance

For many individuals, a deferred income annuity can play an important role in their retirement income planning. However, because annuities are complex products, the advice and guidance of a trained financial professional is highly recommended.

[1] Such guarantees are based upon the claims-paying ability of the issuing insurance company.

Deferred Annuities

What Is a Deferred Annuity?

Life insurance is used to create an estate for an individual if he or she dies too soon. A deferred annuity, however, can provide protection against the possibility that an individual will live too long and outlive his or her accumulated assets.

The term "annuity" derives from a Latin term meaning "annual" and generally refers to any circumstance where principal and interest are liquidated through a series of regular payments made over a period of time. A "deferred" annuity is an annuity in which both the income, and any taxes due on growth inside the contract, are pushed into the future, until they are actually received by the owner.[1]

A commercial[2] deferred annuity is a special type of policy issued by an insurance company. In a typical situation, the policyowner contributes funds to the annuity. The money put into the policy is then allowed to grow for a period of time. At a future date, the policy may be "annuitized" and the accumulated funds paid out, generally through periodic payments made over either a specified period of time, or the life of an individual, or the joint lives of a couple.

Parties to an Annuity

There are four parties involved in a typical annuity:

- **Insurance company:** This is the issuer of the annuity.
- **Policyowner:** This is the individual or entity that contributes the funds. The policyowner typically has the right to terminate the annuity, to gift it to someone else, to withdraw funds from it, and to change the annuitant or beneficiary. Depending on the type of annuity, a policyowner may have other rights as well.

[1] Under federal law, the deferral of income tax on growth inside the policy is available only to natural persons; the tax-deferral is generally not permitted if the annuity owner is a non-natural person such as a trust or corporation.
[2] A private annuity is an agreement between individuals, usually exchanging a valuable asset (such as a business) for a lifetime income. The party promising to pay the annuity is someone who is not in the business of issuing annuities.

Deferred Annuities

- **Annuitant:** This is the individual whose life is used to determine the payments during annuitization. An annuity will remain in force unless terminated by the owner, or as a result of the death of the owner, or the annuitant dies.
- **Beneficiary:** This is the individual or entity that receives any proceeds payable on the death of the annuitant or the policyowner, depending on whether the annuity is “annuitant driven” or “owner driven.”

A single individual may be the policyowner, annuitant, and the beneficiary, although this is not usually recommended. More commonly, these roles are held by different individuals or entities.

Types of Deferred Annuities

There are many different ways to classify deferred annuities:

- **Method of purchase:** Annuities can be purchased with a single lump-sum of cash; such annuities are often referred to as single premium annuities. They may also be purchased with installment payments over time, either of a fixed dollar amount on a regular basis or with flexible payments.
- **When annuity payments begin:** Payments under a deferred annuity typically begin at some future time. In comparison, an "immediate" annuity, is purchased with a single premium, with annuity payments beginning one payment period (monthly, annual, etc.) later.
- **Investment options:** During the period before a policy is annuitized or completely liquidated, the funds invested by the policyowner are put to work. Depending on the type of annuity, the underlying investment vehicle will vary.
  - **Fixed annuity:** In a fixed annuity, the issuing life insurance company will guarantee a certain rate of interest, for a specified period of time, typically 1-10 years. Such annuities are useful for conservative, risk-averse individuals. The investment risk rests on the insurance company and any annuity payments are relatively predictable.

Deferred Annuities

- **Variable annuity:** A buyer of a variable annuity has the option of placing the funds in the policy in a variety of investment options. The investment risk rests largely on the policyowner. Annuity payments are linked to the value of the underlying investments, which can fluctuate up or down.

- **Indexed annuity:** An indexed annuity is a type of fixed-rate annuity which combines a guaranteed minimum interest rate with a potential for greater growth, with returns being based on a formula related to a specific market index such as the Standard & Poor's 500 index. If the chosen index rises sufficiently during a specific period, a greater rate is credited to the policyowner's account for that period. Unlike variable annuities, where poor market performance can lead to decreased policy values, indexed annuities are structured to not lose value due to a declining stock market. However, because of surrender charges, an investor may lose principal value if an indexed annuity is surrendered early.

Payments from an Annuity

There are a number of ways that money may be withdrawn or received from a deferred annuity:

- **Lump-sum withdrawal:** A policyowner can withdraw all of the funds in an annuity in a single lump sum. Such a withdrawal is considered a surrender of the policy and the annuity ends. Depending on the policy and the length of time it has been in force, the insurance company may impose surrender charges, generally expressed as a percentage of the balance.

- **Partial withdrawal:** Many annuity policies allow an owner to withdraw a certain portion of the balance each year (usually 10% - 15%), without a surrender charge.

- **Partial annuitization:** Federal income tax law allows a portion of a nonqualified annuity contract, endowment, or life insurance contract to be annuitized while the balance is not annuitized, provided that the annuitization period is for 10 years or more, or is for the lives of one or more individuals.

- **Life only annuity:** Regular payments are made for as long as the annuitant lives. When the annuitant dies, payments cease and no refund is made, even if the policyowner has not recovered the initial investment.

Deferred Annuities

- **Life with term certain:** Regular payments are made for the life of the annuitant, or a specified number of years. If the annuitant dies before the specified term has passed, annuity payments continue to a beneficiary for the remainder of the term.
- **Joint and survivor:** Regular payments are made over the lives of two individuals. When one dies, annuity payments (or a specified portion) continue to the survivor.
- **Refund options:** Regular payments are made over the life of the annuitant. However, if the annuitant dies before the policyowner's investment has been recovered, the balance is refunded to a named beneficiary through either a lump-sump payment or continued annuity payments.
- **Specified period:** Regular payments are made for a pre-selected number of years. If the annuitant dies before the specified period has expired, payments are continued to a named beneficiary for the remaining term.
- **Specified amount:** Payments of a set amount are paid out regularly as long as there is money in the account.

Taxation of Annuity Payments

The tax treatment of payments made from a deferred annuity will vary, depending on whether the funds used to purchase the annuity have been taxed or not,[1] and on where in the life cycle of the annuity the payments are made. In general, the following rules apply:[2]

- **Before annuitization:** Funds withdrawn from an annuity prior to annuitization are considered to be made first from interest or other growth.[3] These earnings are taxable as ordinary income. If the annuity owner is under age 59½ at the time a withdrawal is made, the earnings are also subject to a 10% federal tax penalty, unless an exception applies. If earnings are completely withdrawn and payments are then made from the owner's initial investment, the payment is treated as a tax-free recovery of basis.

---

[1] "Qualified" annuities are annuities purchased inside of a retirement plan such as a 401(k) or IRA, generally with pre-tax funds. "Nonqualified" annuities are purchased outside of an IRA or retirement plan, with money that has already been taxed. The taxation discussion here concerns nonqualified annuities.

[2] This information is based on federal law. State law may vary.

[3] Withdrawals from annuity policies entered into before August 14, 1982 were treated as first coming from principal, to the extent of premiums contributed before August 14, 1982.

Deferred Annuities

- **After annuitization:** Regular annuity payments are treated as being composed of part earnings and part return of investment. The earnings portion is taxable as ordinary income. Once the owner has completely recovered his or her investment, all remaining payments are fully taxable as ordinary income. In some situations, if the owner is under age 59½ when payments are received, a 10% federal penalty tax may apply.
- **Estate taxes:** Any amount payable to a beneficiary under an annuity by reason of an owner's death is includible in the owner's gross estate. If an annuitant/owner receiving payments under a life-only annuity dies, no further payments are due and nothing is includible in his or her estate.

Other Common Annuity Provisions

There are several standard provisions commonly found in annuity policies:

- **Bailout provision:** The bailout provision applies only to fixed annuity policies. In a fixed annuity, an insurer will typically offer a guaranteed rate of interest for a specified period of time. For any subsequent time periods, a different rate of interest will usually be offered. Under the bailout provision, generally, if a renewal interest rate is more than 1% less than that offered in the previous period, the policy owner has the option of terminating the policy without paying any insurance company surrender charges. Interest or other growth withdrawn will generally be subject to current income tax and may also be subject to the 10% penalty tax if taken before age 59½.
- **Surrender charges:** Most commercial annuities do not charge a commission when an annuity is purchased. Many, however, impose a surrender charge if withdrawals in excess of a certain amount are made, or if the policy is surrendered completely. Surrender charges can range from 0% to 10% and typically decline over time.
- **Prospectus:** Variable annuities are considered by the Securities and Exchange Commission (SEC) to be a security. The SEC requires that the purchaser of a variable annuity be given a prospectus, which provides detailed information on how the annuity works, the investment options available, the risks involved, and any expenses or charges. The SEC also requires individuals selling variable annuities to be licensed to sell securities.

Deferred Annuities

Certain optional provisions may be available by paying an additional charge:

- **Guaranteed death benefit:** The guaranteed death benefit provision applies only to variable annuities. If an annuitant, or owner in some contracts, dies before annuity payments begin, the policy will pay the named beneficiary the greater of the investment in the policy (less any withdrawals) or the policy value on the date of death.
- **Enhanced death benefit:** Some variable annuities offer an enhanced death benefit option. This feature provides that upon the death of the annuitant, or owner in some contracts, the beneficiary will receive the greater of the policy's value on the date of death, or the original principal (plus any additions) compounded at 5% per year. Other enhanced death benefits include percentage increases and highest anniversary valuation.

Seek Professional Guidance

Deferred annuities are primarily intended to be long-term investments. Because of this, and because of the complexity of many annuity policies, an individual considering the purchase of a deferred annuity should carefully consider all aspects. The guidance of appropriate tax, legal, and other advisors is highly recommended.

Annuities in Retirement Income Planning

For much of the recent past, individuals entering retirement could look to a number of potential sources for the steady income needed to maintain a decent standard of living:

- **Defined benefit (DB) employer pensions:** In these plans the employer promises to pay a specified monthly amount for the life of the retiree and/or spouse.
- **Social Security:** Designed to replace only a part of an individual's working income, Social Security provides a known benefit for the life of a retiree and his or her spouse.
- **Defined contribution (DC) plans:** Such as 401(k), 403(b), or 457[1] plans, which allow for contributions from the employee (in some cases from the employer as well) to a retirement account. The funds in the account, whatever they amount to at retirement, provide retirement income.
- **Individual retirement plans:** Such as Traditional IRAs or Roth IRAs. These are "individual" versions of employer-sponsored DC plans. The funds in the IRA at retirement, whatever the amount, are used to provide retirement income.

The Changing Face of Retirement

The saying that "life is what happens when you're making other plans" is particularly true when it comes to retirement income planning, for several key reasons:

- **Fewer employer pensions:** Over the past several decades, many employers have changed from defined benefit to defined contribution plans. From 1985 to 2000, for example, the rate of participation in defined benefit plans by full-time employees of medium and large private firms dropped from 80% to 36%.[2] A survey by the Bureau of Labor Statistics, published in 2018, found that only 22% of civilian workers in the U.S. participated in defined benefit pension plans.[3]

[1] These refer to the sections of the Internal Revenue Code which authorize these different types of retirement plans.

[2] See, "Employee Participation in Defined Benefit and Defined Contribution Plans, 1985-2000." U.S. Bureau of Labor Statistics, updated June 16, 2004.

[3] National Compensation Survey: Employee Benefits in the United States, March 2018, Table 2.

Annuities in Retirement Income Planning

- **Social Security:** Social Security is a "pay-as-you-go" system, with current workers supporting those already receiving benefits. As the baby boom generation retires, the number of individuals remaining in the workforce to support them grows smaller. Although politically unpleasant, fiscal reality may force higher payroll taxes, reductions in benefits, or both.

- **We're living longer:** A child born in 1900 had an average life expectancy of 47.3 years. For a child born in 2014, however, average life expectancy had increased to 78.9 years.[1]

With the stable, lifetime income stream from employer pensions and Social Security playing an ever shrinking role, retirement income planning demands that each individual accept a higher degree of personal responsibility for both accumulating and managing the assets needed to pay for retirement. And managing these assets has to be done in a world where constant inflation, fluctuating interest rates, and sometimes volatile financial markets are a fact of life.

Longer lives mean the money has to last longer, although exactly how long is unknown.

One Possible Answer – Immediate Annuities

Life insurance is designed to help solve the problems created when someone dies prematurely. An annuity, on the other hand, is designed to protect against the possibility of living too long. An "immediate" annuity is a contract between an individual and an insurance company. In exchange for a single, lump-sum premium, the insurance company agrees to begin paying a regular income to the purchaser for a period of years or for life. The periodic payment amount depends on a number of factors:

- **Premium paid:** Generally the larger the payment, the larger the income stream.

- **Age:** Older individuals typically receive larger periodic payments.

- **Payout period selected:** A shorter payout period usually results in a larger payment.

- **Underlying investment medium:** Generally, either a fixed or a variable annuity.

[1] Source: National Vital Statistics Reports, Volume 66, Number 4. United States Life Tables, 2014, Table 19. August 14, 2017.

Annuities in Retirement Income Planning

FIXED ANNUITY	VARIABLE ANNUITY
A fixed annuity pays a fixed rate of return. The insurance company invests in a portfolio of debt securities such as mortgages or bonds and pays out a fixed rate of return. Generally, this rate of return is guaranteed for a certain period of time after which a new rate is calculated. Most insurance companies offer a guaranteed minimum rate throughout the life of the contract. Such guarantees are based upon the claims-paying ability of the issuing insurance company.	A variable annuity offers the potential for higher returns in exchange for assuming a higher level of risk. You can choose from among several types of investment portfolios, such as stocks or bonds. The amount of each annuity payment will fluctuate depending on the performance of the underlying investments. Variable annuities are long-term investments designed for retirement purposes. They have certain limitations, exclusions, charges, termination provisions, and terms for keeping them in force, and are sold by prospectus only.[1]

Annuities are not insured by the FDIC or any government agency. Since an annuity may be payable far into the future, dealing with a financially solid insurer is essential. Credit rating companies such as A.M. Best, Standard and Poor's, or Moody's can provide an objective measure of a firm's financial stability.

Seek Professional Guidance

For many individuals, an immediate annuity can form an important part of their retirement income planning. Because an immediate annuity is a complex product, the advice and guidance of a trained financial professional is highly recommended.

[1] The prospectus for a variable annuity contains complete information including investment objectives, risk factors, fees, surrender charges, and any other applicable costs.

An Overview of Social Security Benefits

What Is Social Security?

Social Security is a system of social insurance benefits available to all covered workers in the United States. Begun in 1937, the Social Security system covers a wide range of social programs. The term "Social Security," as it is commonly used, refers to the benefits provided under one part of the system, known by its acronym, OASDI, or Old-Age, Survivors, and Disability Insurance.

OASDI benefits are funded primarily by payroll taxes paid by covered employees, employers, and self-employed individuals. Both the OASDI portion of the payroll tax, as well as that part of the tax that goes to finance hospital insurance, HI (Medicare), are provided for under the Federal Insurance Contributions Act, FICA.

Insured Status

To qualify for benefits, a worker must be either "fully" insured or "currently" insured. An insured status is acquired by earning "credits", based on the wages or self-employment income earned during a year. In 2020, an individual must earn $1,410 in covered earnings to receive one credit and $5,640 to earn the maximum of four credits for the year.

A worker generally becomes fully insured by earning 40 credits, typically by working 10 years in covered employment.[1] To be considered currently insured, a worker must have at least six credits in the last 13 calendar quarters, ending with the quarter in which he or she became entitled to benefits.

All benefits are available if a worker is fully insured. Some benefits are not available if the worker is only currently insured. Special requirements apply to disability benefits.

What Benefits Are Available?

- **Worker's benefit:** This is a monthly income for a retired or disabled worker.
- **Spouse's benefit:** Refers to monthly income for the spouse or former spouse of a retired or disabled worker.

[1] For those working less than 10 years, an alternative test to determine fully-insured status may apply.

An Overview of Social Security Benefits

- **Widow(er)'s benefit:** Refers to monthly retirement income for the surviving spouse or former spouse of a deceased worker.
- **Child's benefit:** A monthly income for the dependent child of a deceased, disabled, or retired worker. To qualify, a child must be under age 18, or 18 or 19 and a full-time elementary or high school student, or 18 or over and disabled before 22.
- **Mother's or father's benefit:** Monthly income paid to a surviving spouse who is caring for a worker's dependent child who is under age 16 or disabled before age 22. If under age 62, the spouse of a retired worker receives the same benefit.
- **Parent's benefit:** Monthly income paid to the surviving dependent parent or dependent parents of a deceased worker.

On What Is the Amount of a Social Security Benefit Based?

In general, a covered worker's benefits, and those of his or her family members, are based on the worker's earnings record. The earnings taken into account are only those reported to the Social Security Administration (SSA), up to a certain annual maximum known as the "wage base." The wage base is indexed for inflation each year and effectively places a cap on the amount of Social Security benefits a worker can receive, regardless of earnings. The wage base for 2020 is $137,700.[1]

Using a worker's earnings record, the SSA calculates a number known as the Primary Insurance Amount, or PIA. The PIA is the basic value used to determine the dollar amount of benefits available to a worker and his or her family.

What Is the Benefit Amount?

The table below summarizes the benefit amounts generally payable under OASDI in the event of a worker's death, disability, or retirement. All monthly benefit amounts are subject to reduction to meet a "family maximum" limit. Individual benefits may also be reduced if the recipient has earned income in excess of specified limits.

[1] The wage base for 2019 was $132,900.

An Overview of Social Security Benefits

	Death[1]	Disability[2]	Retirement[3]
Worker's benefit		100% of PIA	100% of PIA
Spouse's benefit	N/A	50% of PIA	50% of PIA
Widow(er)'s benefit	100% of PIA	N/A	N/A
Child's benefit	75% of PIA	50% of PIA	50% of PIA
Mother's or father's benefit	75% of PIA	50% of PIA	50% of PIA
Parent's benefit	82.5% of PIA[4]	N/A	N/A

Workers age 60 or older and who are not receiving Social Security benefits automatically receive a paper Social Security Statement each year, listing the worker's earnings as well as providing estimated retirement, disability, and survivors benefits.

Earnings information may also be verified by calling the SSA directly at (800) 772-1213; TTY (800) 325-0778, Monday through Friday, 7:00AM to 7:00PM. On the internet, the SSA can be found at https://www.ssa.gov/.

[1] Reduced widow(er)'s benefits are available at age 60.

[2] Disability benefits are subject to a very strict definition of disability. At full retirement age (FRA), disability benefits cease and retirement benefits begin.

[3] Unreduced benefits are available at FRA. For those born before 1938, FRA is age 65. For individuals born after 1937, FRA gradually increases from age 65 to age 67. For example, for baby boomers born between 1943 -1954, FRA is age 66. A larger retirement benefit is available to those who continue to work past FRA.

[4] If one parent qualifies, the benefit is 82.5% of the PIA. If both parents qualify, the benefit is 75% of the PIA to each.

Medicaid

Medicaid is a jointly-funded, federal-state welfare program which provides medical care to individuals and families with very low resources and income. Each state administers its own program and, within guidelines set by the federal government, establishes its own rules regarding program eligibility and the type, duration, and scope of services provided.

Qualifying For Medicaid

Just being poor is no guarantee that an individual will qualify to receive Medicaid. An individual must belong to one of several specified groups as well as meet certain income and asset limitation tests.

To qualify for federal funds, states must provide care for certain, targeted populations. Included in the mandatory category are persons receiving federally assisted income maintenance payments, such as Supplemental Security Income (SSI), or Aid to Families With Dependent Children (AFDC).

A state may choose to provide healthcare services to certain "categorically needy" populations, individuals and families whose financial situation is similar to those in the mandatory group, but with different qualifying criteria. Medicaid benefits may also be offered to "medically needy" persons, those with incomes too high to qualify under any other category. Such individuals can "spend down" their excess income by incurring medical and/or remedial care expenses, reducing the excess income to a level below the maximum allowed under the state's plan.

What Medical Services Are Provided?

A wide range of services is provided to Medicaid beneficiaries. Some services are mandatory under federal rules, while others are optional. Provided services can include:

- Inpatient hospital services.
- Outpatient hospital services.
- Nursing facility services for beneficiaries age 21 and older.
- Prenatal and delivery services as well as postpartum care.
- Physicians' services and medical and surgical services of a dentist.

Medicaid

- Home health services for beneficiaries who are entitled to nursing facility services under the state's Medicaid plan.
- Early and periodic screening, diagnostic, and treatment (EPSDT) services for children under age 21, including vaccines.
- Payment of Medicare premiums (Part A and/or Part B) for certain needy elderly or disabled individuals.
- Long-term care (LTC).

Resource and Income Limitations

Generally, a single individual cannot have more than $2,000 in assets and still qualify for Medicaid. In this calculation, certain assets are "exempt" and are not counted:

Asset	Observation
Personal residence	Generally, with no more than $585,000 of equity. A state may raise this limit to $878,000.
Cash value life insurance	With a face value of up to $1,500.
Household goods, personal effects	Furniture, appliances, artwork, clothing, jewelry.
Automobile	One car, generally limited to a value of $4,500.
Burial funds	Generally limited to $1,500.
Burial space	Burial plot, grave marker, urn, crypt, mausoleum.
Business assets	Property employed in a trade or business, if essential to self-support.
Jointly owned residence	Exempt if other resident owners would be forced to move if property were sold.

Those applying for Medicaid must also meet certain monthly income limitations, which vary by state. These income limitations generally change from year to year.

Transferring Assets To Qualify For Medicaid

Some individuals, often those needing expensive nursing home care, will attempt to meet Medicaid's asset limitations by gifting or otherwise transferring assets to others for less than

Medicaid

fair market value. However, such transfers can result in a delay in benefit eligibility if made within a "look-back" period of 60 months before the application date.[1]

To avoid a period of ineligibility, an individual who anticipates needing care can either (1) transfer assets more than 60 months before applying for Medicaid benefits; or, (2) keep enough assets to pay for needed care for 60 months, transfer the remainder, and not apply for Medicaid benefits until 60 months have elapsed after the last transfer.

The period of ineligibility is generally determined by dividing the value of the assets transferred by the average monthly cost of nursing home care to a private patient in the local community. Ineligibility begins on the later of: (1) the date of the gift or transfer; or, (2) the date the individual would otherwise have qualified to receive Medicaid benefits.[2]

Example: George lives in a state where the average monthly cost of nursing home care is $6,000 per month. If he transfers property worth $120,000, he will be ineligible for Medicaid benefits for 20 months ($120,000 ÷ $6,000 = 20).

Annuities

The purchase of a commercial annuity is considered in the same light as a gift or transfer of assets for less than fair market value, unless certain requirements are met. In general, an annuity is not counted as an asset if it is: (1) irrevocable; (2) non-transferrable; (3) actuarially sound, compared to the beneficiary's life expectancy; and; (4) provides for equal payments during the annuity's term.

Additionally, there can be no payment deferral or balloon payments and the state must be named as the primary remainder beneficiary (in some cases the secondary remainder beneficiary) for the amounts paid by Medicaid for the beneficiary's care.[3]

[1] Under federal rules, some transfers, such as those made for the benefit of a spouse, a blind or disabled child, or a disabled individual under age 65, will not trigger a period of benefit ineligibility.

[2] Under the Deficit Reduction Act of 2005, the 60 month look-back period applies to transfers made on or after February 8, 2006. For transfers before that date, a 36 month look-back period generally applied (60 months in the case of certain trusts).

[3] Annuities purchased before February 8, 2006, the effective date of the Deficit Reduction Act of 2005, were subject to individual state rules.

Medicaid

Trusts

If an individual, or his or her spouse, or anyone acting on the individual's behalf, establishes a trust using at least some of the individual's funds, that trust can be considered available to the individual for determining Medicaid eligibility.

In general, payments actually made to or for the benefit of the individual are treated as income to the individual. Amounts that could be paid to or for the benefit of the individual, but are not, are treated as available resources. Amounts that could be paid to or for the benefit of the individual, but are paid to someone else, are treated as transfers for less than fair market value. Amounts that cannot, in any way, be paid to or for the benefit of the individual are also treated as transfers for less than fair market value.[1]

Certain trusts, for disabled or institutionalized individuals, are not counted as being available to the individual. These trusts must provide that the state receives any funds, up to the amount of Medicaid benefits paid on behalf of the individual, remaining in the trust when the individual dies.

Spousal Impoverishment

The high cost of nursing home care can rapidly exhaust the savings of almost anyone. Because of this, Congress has enacted laws to prevent what has been called "spousal impoverishment," which can leave the spouse who is still living at home (the "community spouse") with little or no income or resources. These provisions help ensure that the community spouse will be able to live out his or her life with independence and dignity. These spousal impoverishment rules apply when one member of a couple enters a nursing home or other medical institution and is expected to remain there for at least 30 days.

When the couple applies for Medicaid, an assessment of their combined (regardless of ownership) resources is made. The couple's home, household goods, an auto, and burial funds are not included in the accounting. The result is the couple's combined countable resources. This total is then used to determine a "Protected Resource Amount" (PRA) for the community spouse.[2] After the PRA is subtracted from the couple's combined resources, the

[1] Transfers from trusts for less than fair market value are subject to the same 60-month "look-back" period applicable to other transfers.

[2] The PRA may also be determined by either a court order or by a state hearing officer.

Medicaid

remainder is considered available to the spouse residing in the medical institution as countable resources. If the amount of countable resources is below the state's resource standard, the individual is eligible for Medicaid.

The community spouse's income is not considered available to the spouse who is in the medical facility and the two individuals are not considered a couple for income eligibility purposes. The state uses the income eligibility standard for one person rather than two. If most of the couple's income is in the name of the institutionalized spouse, and the community spouse has insufficient income in his or her own right to live on, a separate calculation is made which allocates a portion of the institutionalized spouse's income to support the community spouse and any other family members living in the household.

Estate Recovery

When a Medicaid beneficiary dies, federal law requires the states to seek recovery of amounts paid by the state for many of the services provided to Medicaid beneficiaries, unless undue hardship would result. Generally, recovery is made from property held in the beneficiary's name only. Some states may seek also recovery from a life estate, assets held in a revocable "living" trust, or jointly held assets. Assets that pass to a surviving spouse are exempt from recovery as long as that spouse is alive.

Long-Term Care Partnership

In a Long-Term Care Partnership, a state government and private health insurers work together to make available to residents of that state LTC insurance policies that are "linked" to Medicaid. If a buyer of a partnership LTC policy later faces long-term care needs that exceed the policy's limits, he or she may apply for assistance from the state's Medicaid program under more relaxed eligibility rules. In what is termed an "asset disregard," the policy owner may keep a larger amount of assets than would normally be allowed under standard Medicaid rules. These relaxed eligibility rules apply only to the amount of assets than an individual can retain; all other normal Medicaid eligibility requirements apply.

Patient Protection and Affordable Care Act (PPACA)

Beginning in 2014, PPACA expanded eligibility for Medicaid to individuals not currently eligible for Medicare (generally, individuals under age 65). This expansion embraced

children, pregnant women, and adults without dependent children, with incomes up to 133% of the federal poverty level (FPL). Coverage is provided through an essential health benefits package purchased through a state's American Health Benefits Exchange.

Seek Professional Guidance

Qualifying for Medicaid services requires meeting complex legal and regulatory requirements. The guidance of trained financial professionals is highly recommended.

See the general information made available by the federal government's Centers for Medicare and Medicaid Services at: https://www.medicaid.gov/.

Medicare Parts A and B

Consider What Medicare Does and Does Not Cover

Medicare is a health insurance program operated by the federal government. Benefits are available to qualifying individuals age 65 or older, certain disabled individuals under age 65, and those suffering from end-stage renal disease. The traditional Medicare program consists of two main parts: Part A, Hospital Insurance and Part B, Medical Insurance. There are clearly defined limits as to what Medicare will, and will not, pay.

Medicare (Part A) 2020 Hospital Insurance Covered Services per Benefit Period

Service	Benefit	Medicare Pays	You Pay
Hospitalization: Semiprivate room and board, general nursing and miscellaneous hospital services and supplies. Includes meals, special care units, drugs, lab tests, diagnostic X-rays, medical supplies, operating and recovery room, anesthesia and rehabilitation services.	Medicare pays all covered costs for first 60 days, except the first $1,408. For the 61st through 90th days, it pays all except $352 a day. There are also 60 nonrenewable reserve days that can be used when the 90 days are past. Medicare pays all except the first $704 for each reserve day.		
Post-hospital skilled nursing facility care (in a facility approved by Medicare): You must have been in a hospital for at least three days in a row and enter the facility within 30 days after having been discharged from the hospital.	**First 20 days.**	All costs.	Nothing.
	Next 80 days.	All but $176.00	$176.00 per day
	Medicare and private insurance will not pay for most nursing home care, and you pay for custodial care.		
Home health care: Post-institutional care. You must have been in a hospital for at least three days in a row or have been in a skilled nursing facility following a hospital stay.	Pays the cost of 100 home visits, if made under a physician's treatment plan.	Full cost.	Nothing for services; 20% of approved amount for durable medical equipment.
Hospice care: May exceed the 210 days of care if recertified as terminally ill.	Two 90-day periods and one 30-day period.	All but limited costs for outpatient drugs and inpatient respite care.	Limited cost sharing for outpatient drugs and inpatient respite care.
Blood.	Blood.	All but first three pints.	For first three pints.

Medicare Parts A and B

Medicare (Part B) 2020 Medical Insurance Covered Services per Calendar Year Standard Monthly Premium: $144.60

Service	Benefit	Medicare Pays	You Pay[1]
Medical expense: Doctor's services, inpatient and outpatient medical services and supplies, physical and speech therapy, ambulance, etc.	Medicare pays for medical services in or out of hospital. Some insurance policies pay less (or nothing) for hospital outpatient medical services in a doctor's office.	80% of approved amount (after $198.00 deductible). 50% of approved charges for most outpatient mental health services.	$198.00 deductible[2] plus 20% of approved amount and limited charges above approved amount.[3] 50% of approved charges for mental health services.
Home health care[4].	Unlimited, if made under a physician's treatment plan.	Full cost.	Nothing for services; 20% of approved amount for durable medical equipment.
Outpatient hospital treatment.	Unlimited if medically necessary.	80% of approved amount (after $198.00 deductible).	$198.00 deductible[1] plus 20% of balance of approved amount.
Blood: Any blood deductibles satisfied under Part B will reduce the blood deductible requirements.	Blood.	80% of approved amount (after first three pints).	$198.00 deductible[1] plus first three pints plus 20% of balance of approved amount.

Note: If the period of hospitalization covers two calendar years, no new deductible is required for the new year. These figures are for 2020 and are subject to change each year.

[1] You pay for charges higher than the amount approved by Medicare unless the doctor or supplier agrees to accept Medicare's approved amount as the total charge for services rendered.

[2] Once you have had $198.00 of expense for covered services in 2020, the Part B deductible does not apply to any further covered services you receive the rest of the year.

[3] Federal law limits charges for physician services.

[4] Home health care is provided under Part B only if not covered under Part A.

Medicare Parts A and B

Part B Premium for Certain Beneficiaries

Pursuant to one provision of the Bipartisan Budget Act of 2015, certain Medicare beneficiaries will pay a higher Part B premium in 2020. The minimum premium for those in this group will be $144.60. Individuals in this group include:

- Medicare beneficiaries not receiving Social Security benefits.
- Those who enroll in Part B for the first time in 2020.
- Those who have both Medicare and Medicaid, and Medicaid pays the Medicare premiums.

- Those whose income in 2018 exceeded certain limits. The *total* premium for those in this group will also include an income-related monthly adjustment amount. Based on their filing status and income.[1]

The table below shows the 2020 Part B premiums for these Medicare beneficiaries.

Unmarried Individuals	Married Filing Jointly	Total Monthly Premium
Equal to or less than $87,000	Equal to or less than $174,000	$144.60
$87,001 to $109,000	$174,001 to $218,000	$202.40
$109,001 to $136,000	$218,001 to $272,000	$289.20
$136,001 to $163,000	$272,001 to $326,000	$376.00
$163,001 to $500,000	$326,001 to $749,999	$462.70
Greater than or equal to $500,000	Greater than or equal to $750,000	$491.60

Married Filing Separately	Total Monthly Premium
Equal to or less than $87,000	$144.60
$87,001 to $413,000	$462.70
Greater than or equal to $413,000	$491.60

[1] The measure used is modified adjusted gross income. Generally adjusted gross income plus any tax free interest or any excluded foreign earned income. An appeals process is available in case of a major life change such as the death of a spouse, divorce, or marriage.

Medicare Part C – Medicare Advantage

The original Medicare program, created in 1965, consists of Part A (hospital insurance) and Part B (medical insurance) and operates as a "fee-for-service" system. Under this program, a Medicare beneficiary can go to any physician or health facility nationwide which accepts Medicare payments.

An Alternative To Traditional Medicare

In 1997, the federal government created, as Medicare Part C, the Medicare+Choice program. This new program was designed to give Medicare beneficiaries access to a wide array of more cost-effective, private health plan choices, as an alternative to the traditional Parts A and B. In 2003, Medicare+Choice was renamed as "Medicare Advantage", as part of the Medicare Prescription Drug, Improvement, and Modernization Act.

Options Under Medicare Advantage

In general, each Medicare beneficiary is entitled to choose to receive benefits through either the original Medicare fee-for-service program under Parts A and B or through a Medicare Advantage plan. The Medicare Advantage options include:

- Health Maintenance Organizations (HMO) plans
- Preferred Provider Organization (PPO) plans
- Private Fee-for-Service (PFFS) plans
- Special Needs Plans (SNPs)
- HMO Point-of-Service (HMOPOS) plans
- Medical Savings Account (MSA) plans

Benefits Under Medicare Advantage

Medicare Advantage plans are required to provide the same benefits that are covered under the traditional fee-for-service plan, except for hospice care; original Medicare will cover the cost for hospice care. Most Medicare Advantage plans offer extra coverage, for example vision, hearing, dental, and other health and wellness programs. Most include Medicare prescription drug coverage (Part D). In addition to the Part B premium, an enrollee in a Medicare Advantage plan may have to pay an additional monthly premium.

Medicare Part C – Medicare Advantage

Medicare Advantage plans have a yearly limit on an enrollee's out-of-pocket costs for medical services. Once this limit is reached, an enrollee will pay nothing for covered services. Each plan has a different limit and the limit can change from year to year.

Making a Choice

Once a plan has been elected, that choice will remain in effect until the beneficiary changes it or the plan chosen no longer services the area in which the beneficiary resides.[1] If a beneficiary fails to make an election, he or she will remain in the traditional fee-for-service program.

- **Initial Medicare eligibility:** A beneficiary may enroll in a Medicare Advantage plan when he or she first becomes eligible for Medicare (the Initial Enrollment Period). Such an individual may change to another Medicare Advantage plan or go back to original Medicare within the first three months of having Medicare.
- **Annual open enrollment:** An annual open enrollment takes place each fall, from October 15 through December 7. Elections made during this open enrollment period take effect on January 1st of the following year.
- **Medicare Advantage Open Enrollment Period:** Between January 1-March 31 each year, a beneficiary can make certain changes: (1) switch from one Medicare Advantage plan to another Medicare Advantage plan; and (2) disenroll from a Medicare Advantage plan and return to original Medicare. If a beneficiary chooses to do so, her or she will be able to join a Medicare Prescription Drug plan; the beneficiary may not be able to buy a Medigap policy.
- **Special Enrollment Periods:** A beneficiary may be able to join, switch, or drop a Medicare Advantage Plan during a Special Enrollment Period. Examples of this are: (1) the beneficiary moves out of the plan's service area; (2) the beneficiary has (or loses) Medicaid; (3) the beneficiary qualifies for (or loses) Extra Help paying certain expenses; and (4) the beneficiary lives in an institution such as a nursing home.

[1] Not all Medicare Advantage options are available in all geographical areas.

Medicare Part C – Medicare Advantage

- **5-Star Special Enrollment Period:** A beneficiary may change to a Medicare Advantage Plan that has five stars for its overall star rating from December 8, 2019 to November 3, 2020. A beneficiary may only use this Special Enrollment Period once during this timeframe.

- **Medigap "trial" rights:** A beneficiary who joins a Medicare Advantage plan for the first time, and who later decides that the plan isn't right for him or her, has special rights, a "trial right," to buy a Medigap policy. This right applies if the beneficiary returns to original Medicare within 12 months of joining the Medicare Advantage plan.

Medicare Part D – Prescription Drug Coverage

Medicare Part D provides insurance coverage for prescription medications. Under this program, insurance companies and other private firms contract with Medicare (Medicare pays most of the premium) to provide prescription drug benefits to Medicare beneficiaries.

Each eligible Medicare beneficiary must select a drug plan and pay a monthly premium to receive the drug coverage. All drug plans (the choice varies by state) must provide coverage at least as good as the standard coverage specified by Medicare. Some plans may offer extra benefits such as no deductible, higher coverage limits, or cover additional drugs, in exchange for a higher monthly premium. Individuals with limited income and resources may qualify for help in paying for drug coverage.

Making a Choice

There are a number of factors to consider in making a choice about drug plans, including:

- **Initial enrollment:** A new Medicare beneficiary may enroll in a prescription drug plan during the seven-month period beginning three months before he or she turns age 65 until three months after reaching age 65. An individual who has lost "creditable coverage" (prescription drug coverage from some other source that is at least as good as the standard Medicare prescription coverage) has 63 days to select and join a Medicare prescription drug plan. An eligible beneficiary who does not enroll in a prescription drug plan within the prescribed time limits faces a penalty for late enrollment.

- **Penalty for late enrollment:** Individuals who delay joining a Medicare prescription drug plan beyond their initial eligibility face a monthly premium that will increase by at least 1% per month for each month of delay. This increased premium applies for as long as the individual is enrolled in a Medicare drug plan.

- **Changing plans:** Each year, from October 15 to December 7, a beneficiary can change to a different prescription drug plan.

Medicare Part D - Prescription Drug Coverage

- **Current prescription coverage:** Individuals who currently have prescription drug coverage from another source may not wish to enroll in a Medicare prescription drug program. In some cases the benefits provided under these other plans are better than those provided under the standard Medicare prescription drug plan.
- **Medication coverage:** Consider what medications are needed. Compare the needed medications with those covered by each plan. Each plan will have a list (termed a "formulary") showing the drugs (generic and brand-name) the plan will pay for.
- **Out-of-pocket cost:** A prescription drug plan can vary in how much it charges and how much coverage is provided. Issues such as the monthly premium, yearly deductible, any co-insurance or co-payments, and coverage limits must all be considered.
- **Pharmacy convenience:** Not all pharmacies will be contracted with all plans. Some plans will allow a beneficiary to receive prescriptions by mail.
- **Future health changes:** Even though an individual takes few or no medications now, joining a prescription drug plan now means paying the lowest possible monthly premium. Future health changes may require increased use of prescription drugs.

Standard Coverage

The standard coverage for 2020 as set by Medicare is shown in the following table:

	$435 Deductible	$436 to $4020	$4021 Until Out of Pocket Totals $6350	Above $6350 in Out of Pocket Costs
Individual Pays	$435.00	25% up to $896	$5,019	5%
Plan Pays	$0.00	75% up to $2689	$0.00	95%
Total Drug Expense	$435.00	$4,020.00	$9,039	

In 2020, once total drug spending reaches $4,020 (where the coverage gap begins), a Medicare Part D enrollee will pay 25% of the plan's cost for both covered brand-name prescription drugs and covered generic drugs. The amount paid by the enrollee – as well as any discount paid by the drug company – count as "out-of-pocket" spending, helping the enrollee get out of the coverage gap.

Medicare Part D - Prescription Drug Coverage

Monthly Adjustment Amount

Beginning in 2011, the Patient Protection and Affordable Care Act (PPACA) required Medicare Part D enrollees whose incomes exceed the same thresholds that apply to higher-income Part B enrollees, to pay a monthly adjustment amount. High-income enrollees will pay the regular plan premium to their Part D plan and the monthly adjustment amount to Medicare. The 2020 Part D monthly adjustment amounts are shown in the following tables:

Unmarried Individuals	Married Filing Jointly	Monthly Adjustment Amount
Equal to or less than $85,000	Equal to or less than $170,000	$0.00
$85,001 to $107,000	$170,001 to $214,000	$12.40
$107,001 to $133,500	$214,001 to $267,000	$31.90
$133,501 to $160,000	$267,001 to $320,000	$51.40
$160,001 to $499,999	$320,001 to $749,999	$70.90
Greater than or equal to $500,000	Greater than or equal to $750,000	$77.40

Married Filing Separately	Monthly Adjustment Amount
Equal to or less than $85,000	$0.00
$85,001 to $414,999	$70.90
Greater than or equal to $415,000	$77.40

For Those Who Currently Have Prescription Drug Coverage

Some retirees may already have prescription drug coverage. For these individuals a key step is to compare the current coverage with that provided through a Medicare plan. The benefits administrator or insurance carrier can provide additional information.

- **Coverage provided by employer or union:** If the drug coverage provided by an employer or union is, on average, at least as good as the standard Medicare coverage, the individual may choose to keep the current plan for as long as it is offered. If the plan is discontinued in the future, the individual can join a Medicare drug plan without penalty within 63 days of the coverage ending.

Medicare Part D - Prescription Drug Coverage

- **Medicare Advantage or other Medicare health plan:** Some Medicare Advantage or other Medicare health plans cover prescription drugs. If a plan does not offer prescription drug coverage, an individual may wish to switch to another Medicare Advantage or other Medicare health plan that does cover prescription drugs, or change to the original Medicare plan and join a Medicare prescription drug plan.
- **Other government insurance:** Generally, the prescription drug benefits provided by TRICARE, the Department of Veterans Affairs (VA), Federal Employee's Health Benefits Program (FEHB), or Indian Health Services are as good as the standard Medicare prescription drug plan. In most cases it will be to the individual's advantage to keep the current plan. If coverage is lost in the future, the individual can join a Medicare drug plan without penalty within 63 days of the coverage ending.

Seek Professional Guidance

The process of making decisions concerning health care insurance can be confusing and complex. The advice and counsel of trained advisers is strongly recommended. Additional information is also available from:

- **On the web:** www.medicare.gov
- **By telephone:** Contact Medicare at 1-(800) 633-4227 (TTY users: 1-(877) 486-2048)

Medigap Policies

Medigap policies are supplemental health insurance policies sold by private insurers, designed to fill some of the "gaps" in health coverage provided by Medicare. Although Medicare covers many health care costs, you still have to pay certain coinsurance and deductible amounts, as well as paying from your own pocket for services that Medicare does not cover.

Who Can Buy a Medigap Policy?

Generally, you must be enrolled in the original Medicare Parts A and B before you're able to purchase a Medigap insurance policy. Other types of health insurance coverage, such as Medicare Advantage, other Medicare health plans, Medicaid, or employer-provided health insurance, do not work with Medigap policies.

Standardized Policies

Under federal regulations, private insurers may only sell "standardized" Medigap policies, identified as plans A, B, C, D, F, G, K, L, M, and N. The various policies differ in the benefits they provide and in their cost.

These standardized policies allow you to compare "apples with apples." For example, a Plan F policy will provide the same benefits, no matter which insurance company it is purchased from. However, a plan C policy will provide different coverage than a plan D policy. All Medigap policies must provide certain "core" benefits.

Through May 31, 2010, there were 12 standardized Medigap policies, plans A, B, C, D, E, F, G, H, I, J, K, and L. Effective June 1, 2010, plans E, H, I, and J could no longer be sold, and Plans M and N were added. Individuals who had purchased a plan E, H, I, or J before June 1, 2010 were allowed to keep those plans.

Beginning January 1, 2020, Medigap plans sold to new people with Medicare won't be allowed to cover the Part B deductible. Thus, Plans C and F (including the high deductible version of Plan F), will no longer be available to people new to Medicare starting on January 1, 2020. If you already have one of these plans, or are covered by one of these plans prior to January 1, 2020, you will be able to keep your plan. If you were eligible for Medicare before January 1, 2020, but not yet enrolled, you may be able to buy one of these plans.

Medigap Policies

These standardized plans are not available to those living in Massachusetts, Minnesota, or Wisconsin; there are separate Medigap policies available for residents of these states.

Choosing a Policy

There are two primary factors to consider when choosing a Medigap policy.

- **Needed benefits:** Carefully consider what benefits you are most likely to need; you may not need the most comprehensive plan.
- **Cost:** Once you have decided which benefits you will need, shop for the policy that provides those benefits at the lowest cost.

Policy Costs Can Differ

- **Discounts:** Some insurers may offer discounts to certain classes of people, such as women, non-smokers, or married couples.
- **Medical underwriting:** An insurance company may require you to fill out a detailed questionnaire on your health. The information you provide is used to determine whether or not a policy will be issued, or what premium to charge.
- **Pre-existing conditions:** If you have a "pre-existing condition," a known health problem, before you apply for a Medigap policy, you may have to wait up to six months before that problem is covered.
- **High deductible:** There are two options for Plan F: (1) a standard option, and (2) a "high deductible" option. Choosing the high deductible option means that you must pay more of the costs before the policy begins to provide benefits. Monthly premiums for high deductible policies are typically less.
- **Medicare SELECT:** Medicare SELECT policies are sold in a few states by a few insurers. Except for emergencies, these policies require you to use pre-selected hospitals and physicians.

Medigap Policies

- **Guaranteed renewable:** Medigap policies issued after 1992 are generally guaranteed renewable. This means that as long as you pay the premiums, are honest about health issues, and the insurance company doesn't go bankrupt, the insurer can't drop your coverage. In some states, policies issued before 1992 may not be guaranteed renewable.

- **Insurer pricing methods:** The table below shows three common methods by which an insurance company will price its Medigap policies:

Pricing Method	Payment	Other Issues
Community (No-Age)	Each insured pays the same premium, regardless of age.	Premiums may increase due to inflation.
Issue-Age	Policy premium is based on your age when you purchase the policy.	Younger buyers pay lower premiums. Premiums may increase due to inflation.
Attained-Age	Premiums are based on your age each year, thus premiums increase annually.	Younger buyers pay lower premiums. Premiums can increase each year. Premiums may also increase due to inflation.

Other Resources

Professional guidance in dealing with any aspect of a Medigap policy is strongly recommended. Other available resources include:

- **Medicare:** The federal government's Centers for Medicare & Medicaid Services (CMS) has a great deal of information available on their website at www.medicare.gov. You can also reach them by phone at (800) 633-4227. TTY users should call (877) 486-2048.

- **State Health Insurance Assistance Programs:** Many states operate health insurance assistance programs designed to provide assistance and information regarding Medicare, Medigap policies, and long-term care policies.

- **State insurance department:** Each state has an insurance department that regulates the sale of all types of insurance within the state. These state agencies can provide information about Medigap policies.

Medigap Policies Compared

Medigap policies are designed to fill the "gaps" in health insurance provided under original Medicare, Parts A and B. These supplemental policies must provide standardized coverage as specified by the federal government.

The following tables compare and contrast the major components of the different policies. Not all policies are available in all states. The policies shown are not available to residents of the states of Massachusetts, Minnesota, or Wisconsin; there are separate standardized policies for residents of those states.

Medigap Plans Sold On or After June 1, 2010[1]

Plan	Core Benefits	Skilled Nursing	Part A Deductible	Part A Hospice	Part B Deductible	Part B Excess Charges	Emergency Foreign Travel	Preventive Care
A	Yes			Yes				Yes
B	Yes		Yes	Yes				Yes
C	Yes	Yes	Yes	Yes	Yes[2]		80%	Yes
D	Yes	Yes	Yes	Yes			80%	Yes
F[3]	Yes	Yes	Yes	Yes	Yes[2]	Yes	80%	Yes
G	Yes	Yes	Yes	Yes		Yes	80%	Yes
K[4]	Some	50%	50%	50%				Yes
L[4]	Some	75%	75%	75%				Yes
M	Yes	Yes	50%	Yes			80%	Yes
N	Yes	Yes	Yes	Yes			80%	Yes

[1] Through May 31, 2010, 12 standardized Medigap policies could be sold, identified as plans A, B, C, D, E, F, G,H, I, J, K, and L. Effective June 1, 2010, plans E, H, I, and J could no longer be sold, and new plans N and M were added. Individuals who purchased a plan E, H, I, or J before June 1, 2010, may keep those plans.

[2] Beginning January 1, 2020, Medigap plans sold to new people with Medicare won't be allowed to cover the Part B deductible. Thus, Plans C and F (including the high deductible version of Plan F), will no longer be available to people new to Medicare starting on January 1, 2020. If you already have one of these plans, or are covered by one of these plans prior to January 1, 2020, you will be able to keep your plan. If you were eligible for Medicare before January 1, 2020, but not yet enrolled, you may be able to buy one of these plans.

[3] Plan F has two options: (1) a standard option and (2) a "high deductible" option with a 2020 deductible of $2,340.00.

[4] In 2020, Plan K has an annual out-of-pocket limit of $5,880.00; Plan L has an annual out-of-pocket limit of $2,940.00.

Medigap Policies Compared

What's included?

- **Core benefits:** Plans A-G, M and N - For Part A hospitalization, cover 100% of all copayments except that for days 1-60 of hospitalization ($1,408 in 2020), plus adding 365 lifetime days of hospital coverage after the standard benefit of 150 days is exhausted; 100% of Part B coinsurance amounts[1] after meeting the yearly deductible ($198.00 in 2020); the first three pints of blood. Plans K and L – For Part A hospitalization, cover 100% of all copayments except that for days 1-60 of hospitalization, plus adding 365 lifetime days of hospital coverage after the standard benefit of 150 days is exhausted; for Part B, Plan K pays 50% of the coinsurance amount after the annual deductible is met; Plan L pays 75% of the Part B coinsurance amount after the annual deductible is met; Plan K pays 50% of the cost of the first three pints of blood; Plan L pays 75% of the cost of the first three pints of blood.
- **Part A skilled nursing:** Plans C-G, M and N – Pay 100% of the coinsurance amount Plans C-G, M and N – Pay 100% of the coinsurance amount ($176.00 per day in 2020) for days 21-100 in a skilled nursing facility. Plans K and L – Pay the percentage shown of the coinsurance amount for days 21-100 in a skilled nursing facility.
- **Part A deductible:** Plans B-G, and N – Pay 100% of the Part A deductible ($1,408 in 2020) for the first 60 days of hospitalization. Plans K, L, and M – Pay the percentage shown of the Part A deductible for the first 60 days of hospitalization.
- **Part A hospice:** Plans A-G, M and N – Pay 100% of the Part A hospice copayment. Plans K and L – Pay the percentage shown of the Part A hospice copayment.
- **Part B deductible:** Plans C and F – Pay 100% of the annual Part B deductible ($198.00 in 2020).
- **Part B excess charges:** Plans F and G – Pay 100% of the Part B excess charges.
- **Emergency foreign travel:** Plans C-G, M and N – The insured pays a $250 deductible and then 20% of any remaining costs of emergency health care. This benefit is typically limited to a $50,000 lifetime maximum and the first 60 days of each trip.
- **Part B preventive care:** All plans – Pay 100% of the coinsurance for preventive care.

[1] Plan N pays 100% of the Part B coinsurance except for a co-payment of up to $20 for office visits and $50 for emergency department visits that do not result in inpatient admission.

Medigap Policies Compared

Other Resources

Professional guidance in dealing with any aspect of a Medigap policy is strongly recommended.

Other available resources include:

- **Medicare:** The federal government's Centers for Medicare & Medicaid Services (CMS) has a great deal of information available on their website at https://www.medicare.gov/. You can also reach them by phone at (800) 632-4227; TTY users should call (877) 486-2048.
- **State Health Insurance Assistance Programs:** Many states operate health insurance assistance programs designed to provide assistance and information regarding Medicare, Medigap policies, and long-term care policies.
- **State insurance departments:** Each state has an insurance department that regulates the sales of all types of insurance within the state. These state agencies can provide information about Medigap policies.

How Often Should Legal Documents Be Reviewed?

Once a legal document is completed and signed, it is often carefully laid to rest in a safe deposit box or file drawer and comes out again only when a party dies or a conflict arises.

Prudent persons periodically review and update their legal documents. Just how often depends, of course, on the document and which circumstances have changed. The following list sets forth some events that may require the updating of a legal document.

Life Events

- Marriage.
- Dissolution of a marriage (divorce).
- Death of a spouse.
- Disability of a spouse or child.
- A substantial change in estate size.
- A move to another state.
- Death of executor, trustee or guardian.
- Birth or adoption.
- Serious illness of family member.
- Change in business interest.
- Retirement.
- Change in health.
- Change in insurability for life insurance.
- Acquisition of property in another state.
- Changes in tax, property or probate and trust law.
- A change in beneficiary attitudes.
- Financial responsibility of a child.

If there is any question as to the effect of a change in circumstances on your will, trust, buy-sell agreement, asset titles and beneficiary designations, etc., contact the appropriate member of your team and have it reviewed before a crisis arises.