

FINANCIAL TID-BITTS

Information to chew on...



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Hi Everyone,

It looks like we have turned the corner to head toward Summer. It's always a busy time of year that goes way too fast, so take time to enjoy it while it is here.

Please read through the articles and pass them along to anyone you know that they may apply to. If you have questions or I can help in any way, please don't hesitate to call. Thank you.

Steve

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Is It Wise to Trade Your Pension for a Lump Sum?

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Four Numbers You Need to Know Now



When it comes to your finances, you might easily overlook some of the numbers that really count. Here are four to pay attention to now that might really matter in the future.

1. Retirement plan contribution rate

What percentage of your salary are you contributing to a retirement plan? Making automatic contributions through an employer-sponsored plan such as a 401(k) or 403(b) plan is an easy way to save for retirement, but this out-of-sight, out-of-mind approach may result in a disparity between what you need to save and what you actually are saving for retirement. Checking your contribution rate and increasing it periodically can help you stay on track toward your retirement savings goal.

Some employer retirement plans let you sign up for automatic contribution rate increases each year, which is a simple way to bump up the percentage you're saving over time. In addition, try to boost your contributions when you receive a pay raise. Consider contributing at least enough to receive the full company match (if any) that your employer offers.

2. Credit score

When you apply for credit, such as a mortgage, a car loan, or a credit card, your credit score is one of the tools used by lenders to evaluate your creditworthiness. Your score will likely factor into the approval decision and affect the terms and the interest rate you'll pay.

The most common credit score that creditors consider is a FICO® Score, a three-digit number that ranges from 300 to 850. This score is based on a mathematical formula that uses information contained in your credit report. In general, the higher your score, the lower the credit risk you pose.

Each of the three major credit reporting agencies (Equifax, Experian, and TransUnion) calculates FICO® scores using different formulas, so you may want to check your scores from all three (fees apply). It's also a good idea to get a copy of your credit report at

least annually to check the accuracy of the information upon which your credit score is based. You're entitled to one free copy of your credit report every 12 months from each of the three credit reporting agencies. You can get your copy by visiting annualcreditreport.com.

3. Debt-to-income ratio

Your debt-to-income ratio (DTI) is another number that lenders may use when deciding whether to offer you credit. A DTI that is too high might mean that you are overextended. Your DTI is calculated by adding up your major monthly expenses and dividing that figure by your gross monthly income. The result is expressed as a percentage. For example, if your monthly expenses total \$2,200 and your gross monthly income is \$6,800, your DTI is 32%.

Lenders decide what DTIs are acceptable, based on the type of credit. For example, mortgage lenders generally require a ratio of 36% or less for conventional mortgages and 43% or less for FHA mortgages when considering overall expenses.

Once you know your DTI, you can take steps to reduce it if necessary. For example, you may be able to pay off a low-balance loan to remove it from the calculation. You may also want to avoid taking on new debt that might negatively affect your DTI. Check with your lender if you have any questions about acceptable DTIs or what expenses are included in the calculation.

4. Net worth

One of the key big-picture numbers you should know is your net worth, a snapshot of where you stand financially. To calculate your net worth, add up your assets (what you own) and subtract your liabilities (what you owe). Once you know your net worth, you can use it as a baseline to measure financial progress.

Ideally, your net worth will grow over time as you save more and pay down debt, at least until retirement. If your net worth is stagnant or even declining, then it might be time to make some adjustments to target your financial goals, such as trimming expenses or rethinking your investment strategy.

Is It Wise to Trade Your Pension for a Lump Sum?



About 41 million people are participants (active, retired, or separated vested) of PBGC-insured corporate pension plans.

Source: Congressional Budget Office, 2016

Most private employers have already replaced traditional pensions, which promise lifetime income payments in retirement, with defined contribution plans such as 401(k)s. But 15% of private-sector workers and 75% of state and local government workers still participate in traditional pensions.¹ Altogether, 35% of workers say they (and/or their spouse) have pension benefits with a current or former employer.²

Many pension plan participants have the option to take their money in a lump sum when they retire. And since 2012, an increasing number of large corporate pensions have been implementing "lump-sum windows" during which vested former employees have a limited amount of time (typically 30 to 90 days) to accept or decline buyout offers.³ (Lump-sum offers to retirees already receiving pension benefits are no longer allowed.)

By shrinking the size of a pension plan, the company can reduce the associated risks and costs, and limit the impact of future retirement obligations on current financial performance. However, what's good for a corporation's bottom line may or may not be in the best interests of plan participants and their families.

For many workers, there may be mathematical and psychological advantages to keeping the pension. On the other hand, a lump sum could provide financial flexibility that may benefit some families.

Weigh risks before letting go

A lump-sum payout transfers the risks associated with investment performance and longevity from the pension plan sponsor to the participant. The lump-sum amount is the discounted present value of an employee's future pension, set by an IRS formula based on current bond interest rates and average life expectancies.

Individuals who opt for a lump-sum payout must then make critical investment and withdrawal decisions, and determine for themselves how much risk to take in the financial markets. The resulting income is often not enough to replace the pension income given up, unless the investor can tolerate exposure to stock market risk and is able to achieve solid returns over time.

Gender is not considered when calculating lump sums, so a pension's lifetime income may be even more valuable for women, who tend to live longer than men and would have a greater chance of outliving their savings.

In addition, companies might not include the value of subsidies for early retirement or spousal benefits in lump-sum calculations.⁴ The latter could be a major disadvantage for married participants, because a healthy 65-year-old couple has about a 73% chance that one spouse will live until at least 90.⁵

When a lump sum might make sense

A lump-sum payment could benefit a person in poor health or provide financial relief for a household with little cash in the bank for emergencies. But keep in mind that pension payments (monthly or lump sum) are taxed in the year they are received, and cashing out a pension before age 59½ may trigger a 10% federal tax penalty.⁶ Rolling the lump sum into a traditional IRA postpones taxes until withdrawals are taken later in retirement.

Someone who expects to live comfortably on other sources of retirement income might also welcome a buyout offer. Pension payments end when the plan participant (or a surviving spouse) dies, but funds preserved in an IRA could be passed down to heirs.

IRA distributions are also taxed as ordinary income, and withdrawals taken prior to age 59½ may be subject to the 10% federal tax penalty, with certain exceptions. Annual minimum distributions are required starting in the year the account owner reaches age 70½.

It may also be important to consider the health of the company's pension plan, especially for plans that don't purchase annuity contracts. The "funded status" is a measure of plan assets and liabilities that must be reported annually; a plan funded at 80% or less may be struggling. Most corporate pensions are backstopped by the Pension Benefit Guaranty Corporation (PBGC), but retirees could lose a portion of the "promised" benefits if their plan fails.

The prospect of a large check might be tempting, but cashing in a pension could have costly repercussions for your retirement. It's important to have a long-term perspective and an understanding of the tradeoffs when a lump-sum option is on the table.

¹ U.S. Bureau of Labor Statistics, 2016

² Employee Benefit Research Institute, 2016

^{3, 4} *The Wall Street Journal*, June 5, 2015

⁵ Society of Actuaries, 2017

⁶ The penalty doesn't apply to employees who retire during or after the year they turn 55 (50 for qualified public safety employees).



About 20% of Americans live with a disability, and one in four of today's 20-year-olds will become disabled before retiring.

Source: SSA, Disability Facts, 2017

The average age of SSDI recipients in 2015 was 54.

Source: Fast Facts and Figures About Social Security, 2016

Expect the Unexpected: What to Do If You Become Disabled

In a recent survey, 46% of retirees said they retired earlier than planned, and not necessarily because they chose to do so. In fact, many said they had to leave the workforce early because of health issues or a disability.¹

Although you may be healthy and financially stable now, an unexpected diagnosis or injury could significantly derail your life plans. Would you know what to do, financially speaking, if you suddenly became disabled? Now may be a good time to familiarize yourself with the following information, before an emergency arises.

Understand any employer-sponsored benefits you may have

Disability insurance pays a benefit that replaces a percentage of your pay for a designated period of time. Through your employer, you may have access to both short- and long-term disability insurance. If your employer offers disability insurance, be sure to fully understand how the plan works. Review your plan's Summary Plan Description carefully to determine how to apply for benefits should you need them, and what you will need to provide for proof of disability.

Short-term disability protection typically covers a period of up to six months, while long-term disability coverage generally lasts for the length of the disability or until retirement. Your plan may offer basic coverage paid by your employer and a possible "buy-up" option that allows you to purchase additional coverage.

According to the Bureau of Labor Statistics, 40% of private industry workers have access to short-term disability insurance through their employers, while 33% have access to long-term coverage. For both types of plans, the median replacement amount is about 60% of pay, with most subject to maximum limits.²

Consider a supplemental safety net

If you do not have access to disability insurance through your employer, it might be wise to investigate other options. It may be possible to purchase both short- and long-term group disability policies through membership in a professional organization or association. Individual policies are also available from private insurers.

You can purchase policies that cover you for life, until age 65, or for shorter periods such as two or five years. An individual policy will remain in force as long as you pay the premiums. Because many disabilities do not result in a complete inability to work, some policies offer a rider that will pay you partial benefits if you are able to work part-time.

Most insurance policies have a waiting period (known as the "elimination period") before you can begin receiving benefits. For private insurance policies, this period can be anywhere from 30 to 365 days. Group policies (particularly through your employer) typically have shorter waiting periods than private policies. Disability insurance premiums paid with after-tax dollars will generally result in tax-free disability benefits. On the other hand, if your premiums are paid with pre-tax dollars, typically through your employer, your benefit payments may be taxable.

Review the Social Security disability process

The Social Security Administration (SSA) pays disability benefits through two programs: the Social Security Disability Insurance (SSDI) program and the Supplemental Security Income (SSI) program. SSDI pays benefits to people who cannot work due to a disability that is expected to last at least one year or result in death, and it's only intended to help such individuals make ends meet. Consider that the average monthly benefit in January 2017 was just \$1,171.

In order to receive SSDI, you must meet strict criteria for your disability. You must also meet requirements for how recently and how long you have worked. Meeting the medical criteria is difficult; in fact, according to the National Organization of Social Security Claimants' Representatives (NOSSCR), about two-thirds of initial SSDI applications are denied on their first submission. Denials can be appealed within 60 days of receipt of the notice.³

The application process can take up to five months, so it is advisable to apply for SSDI as soon as you become disabled. If your application is approved, benefits begin in the month following the six-month anniversary of your date of disability (as recorded by the SSA in your approval letter). Eligible family members may also be able to collect additional payments of up to 50% of your benefit amount.

SSI is a separate program, based on income needs of the aged, blind, or disabled. You can apply to both SSI and SSDI at the same time.

For more information, visit the Social Security Disability Benefits website at ssa.gov, where you will also find a link to information on the SSI program.

¹ [2016 Retirement Confidence Survey](#), Employee Benefit Research Institute

² Bureau of Labor Statistics, [National Compensation Survey](#), 2016

³ [NOSSCR](#) web site, accessed March 2017

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What is a funeral trust?

A funeral trust is an arrangement entered into with a provider of funeral or burial services. Prepaying funeral expenses may allow you to "lock in" costs for future funeral or burial services at an agreed-upon price. The funeral home sometimes serves as trustee (manager of trust assets), and you usually fund the trust with cash, bonds, or life insurance. A revocable funeral trust can be changed and revoked by you at any time. An irrevocable trust can't be changed or revoked, and you generally can't get your money out except to pay for funeral services.

Irrevocable funeral trusts may also help you qualify for long-term care benefits through Medicaid. For example, these trusts may be funded with assets that would otherwise be countable resources for Medicaid (i.e., included in determining Medicaid eligibility). They are often sold through insurance companies, in which case they are typically funded with life insurance. And you can fund the funeral trust right before entering the nursing home — there's no "look-back" period for these transfers, unlike the case with certain other transfers that can

cause a delay in the start of Medicaid benefits. Another advantage of funding your trust with life insurance is that the trust will have no taxable income to report, because life insurance cash values grow tax deferred. Otherwise, income from trust assets may be taxed to you as the grantor of the trust, unless the trustee elects to treat the trust as a qualified funeral trust by filing Form 1041-QFT with the IRS, in which case trust income is taxed to the trust.

But what happens if you want to change funeral homes, or the facility you selected goes out of business? Does your irrevocable trust allow you to change beneficiaries (e.g., funeral homes)? Are trust funds protected from creditors of the funeral home? State laws regulating prepaid funeral trusts often require funeral homes to keep trust assets separate from their own business assets, keeping them safe from funeral home creditors. And most irrevocable trusts are transferable to another funeral home should the initial business fail or you change funeral homes.

There are expenses associated with the creation of a trust and the purchase of life insurance, and benefits are not guaranteed.