Retirement Planning

Course Manual

A Course in Personal Finance

BYU MARRIOTT
SCHOOL OF BUSINESS

Bryan L. Sudweeks | PhD, CFA | September 2019 | 12th Edition 2019-2020

Introduction by the Dean

Welcome to the BYU Marriott project on personal finance. A solid understanding of basic financial principles and the ability to manage finances wisely are important factors in the well-being of individuals and families. This project is one of our many efforts to increase the financial literacy and self-reliance of our students as well as of families and friends outside the University.

As you work through this course, I hope you will take the time to do three things.

First, read and study the material. Each chapter offers valuable information that will enrich your understanding of personal finance. The chapters have been carefully reviewed by the faculty and staff at BYU Marriott. We think they are informative and clearly written. They are organized to be useful to young people with little financial knowledge, people who have extensive experience in financial matters, and everyone in between.

Second, as you read, focus on the principles taught in the course. We emphasize principles because principles don't change over time. Types of financial assets, investment vehicles, and even financial theories may change, but principles do not. This focus will help you stay on course as you make financial decisions for yourself and your family over time, even as the financial environment around you changes.

Finally, apply these principles to your life by developing your own "Personal Financial Plan." Spencer W. Kimball has counseled, "To be sure your life will be full and abundant, you must plan your life" (*Ensign*, May 1974, 86). Think through and write down your vision and goals, the things you want to achieve in life. Develop a financial plan to help you accomplish your goals and then work to implement your plan. Such planning may be the most important tool for achieving your personal and financial goals.

Thank you for your interest in this course. May this be the start of even greater learning and understanding as you work toward greater financial self-reliance.

Sincerely,

Brigette C. Madrian
Dean and Marriott Distinguished Professor
Brigham Young University Marriott School of Business

Author's Note

Welcome to this manual and the accompanying website at http://personalfinance.byu.edu on Personal Finance. We have compiled information on what we consider the most important areas of personal finance for students, individuals, and families. We have developed a principles- and applications-based framework that we hope is clear and concise, and that applies the best practices used in the industry. While there may be differences of opinion as to what are the best practices in the areas discussed, this platform was developed to facilitate review and discussion of those practices.

The ideas presented in this manual were written for a Christian audience with membership in The Church of Jesus Christ of Latter-day Saint; however, the principles taught can be extended to members of any Christian faith. Readers who are not of the this faith may encounter a few unfamiliar terms within this text. While these terms may provide valuable insights to members of the Church of Jesus Christ, a thorough understanding of these terms is not required to understand the financial principles taught here. If you have questions about any of these terms, feel free to contact me at personalfinance@byu.edu, or visit The Church of Jesus Christ of Latter-day Saints' website (http://ChurchofJesusChrist.org/topics) for more information.

This manual and website are updated every year for new information, changes to tax laws, improvements in teaching methodologies, etc. As such, I would appreciate feedback to help make the manual and website better and more useful. While I have tried to present the material in as fair and balanced a framework as possible and am incorporating changes as they become apparent, there may be errors of omission or commission. While this personal finance manual and the website have been approved by Brigham Young University's Marriott School of Business for distribution, they remain the work of the author. Any errors are solely my responsibility and are not the responsibility of the Marriott School of Business, the faculty, or Brigham Young University.

Bryan L. Sudweeks, Ph.D., CFA

August 2019

How This Course Is Different

Dave Ramsey, a nationally syndicated radio talk show host, commented, "Personal finance is more personal than it is finance: it is more behavior than it is math" (KNBR, May 23, 2007). Learning about personal finance requires more than learning the languages of finance and math and more than just a change in spending habits—it requires a change in behavior. The four characteristics that make this course different from other courses on personal finance can help effect this change in behavior.

First, we take a different perspective on personal finance. Perspective—the way we look at things—influences our financial self-reliance because it influences the choices we make. Concerning perspective, the historian Will Durant wrote, "We need 'to seize the value and perspective of passing things. . . . We want to know that the little things are little, and the big things big, before it is too late; we want to see things now as they will seem forever—'in the light of eternity.'"[1]

Our perspective in this manual is unique. It is that personal finance is not separate from our Christian lives. Rather, personal finance is simply part of our Christian lives, and part of living the gospel of Jesus Christ. In this course, our perspective on personal finance is based on a long-term view of what truly matters, which will guide you as you make financial choices.

Second, we take a principles, doctrines and applications-based approach to personal finance. This helps us change our perspective on what we are doing. Unlike investment theory, investment vehicles, and financial assets, principles and doctrines never change. A sound understanding of the correct principles and doctrines of personal finance will act as a compass to guide you as you work toward achieving your personal and family goals. Richard G. Scott commented:

> [The] inspired statement, "I teach them correct principles, and they govern themselves," still applies. The Lord uses that pattern with us. . . Your consistent adherence to principle overcomes the alluring yet false life-styles that surround you. Your faithful compliance to correct principles will generate criticism and ridicule from others, yet the results are so eternally worthwhile that they warrant your every sacrifice.[2]

In this course you will learn how principles, doctrines and application relate to every aspect of your personal finances. Understanding correct principles and doctrines helps increase our motivation to act and makes it easier to follow and apply the concepts discussed in this manual and website to our personal lives.

Third, we don't just talk about what you can do, we give plans and strategies to help you in creating your own personal plans in 16 important areas. Seeing what others have done and are doing in specific areas can give you ideas and strategies on how you can create your vision in those areas.

Finally, we take an applications-based or creative approach to personal finance. Application is an invitation to learn and create. We discuss the creative process in terms of how we are all creators of our vision, goals and lives. It is not enough to know what you want to do in our lives and families—we must do it. Accordingly, the final difference is that we apply the things learned in this manual in the creation of your individual or family Personal Financial Plan. This is part of Ezra Taft Benson's advice to "Plan your financial future early, then live your plan."[3]

To help you apply your learning and planning, we offer a multi-disciplinary companion website at http://personalfinance.byu.edu. As one of the advanced lessons, it includes this book,

PowerPoint presentations, learning tools, videos of personal finance classes taught at BYU, and other personal finance manuals compiled and developed by the faculty and staff at Brigham Young University. These tools will help you catch your vision, set goals, and develop plans and strategies to help you create a budget, work toward getting out of debt, evaluate different investments, buy a house or a car, invest wisely, save for retirement, and more. You will also receive extensive instructions for developing your own Personal Financial Plan, including helpful examples of completed financial plans.

We believe that by changing your perspective, learning the doctrines, principles and applications that support successful financial management, giving examples of visions, goals and strategies in each key area, and then having you apply this knowledge to your own life in creating your own personal Financial Plan with the tools we've provided, will increase your financial literacy and motivation, and will help you achieve the vision and goals that are most important to you and your family. If you do this thoughtfully, carefully and prayerfully, it will help change behavior. Best of luck to you as you begin this wonderful journey to increased financial self-reliance.

Special Thanks

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Copyright and Other Restrictions

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[1] *The Story of Philosophy*, New York: Simon and Schuster, 1927, 1
[2] "The Power of Correct Principles," *Ensign*, May 1993, 32
[3] Ezra Taft Benson, "To the Elderly in the Church," *Ensign*, Nov 1989, 4.

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1. Building a Strong Foundation: Another Perspective on Wealth[1]

Introduction

Personal finance. These two words can bring either fear or excitement into the heart of the reader. Why such varied responses to a simple two-word phrase? There are many different reasons.

One of the most prevalent is a lack of education. It is hard to make important decisions when you feel you are in unchartered territory. Other responses have been due to "misguided" information. Some individuals and companies have used personal finance as a tool to earn huge commissions on selling insurance and investment products without regard to the needs of the investors they supposedly serve, resulting in poor performance for the investors and uncertainty over missed goals. Still others have made unwise decisions based on solely acquiring assets and investments, but to the detriment of their spouses, families, and real success. While they may have acquired financial security, they have lost the things that will bring them what they desire most: happiness and joy. Others have learned how to bring Christ into their finances, learned their available options, determined the key doctrines, principles and applications, applied them in a creative process to their financial habits and goals, and have accomplished the vision and goals that they have set for themselves and their families, including happiness in this life and eternal life in the world to come. The purpose of this manual and the accompanying website is to help you come to understand the process of personal finance or financial planning for yourself and those you love, and to apply it in your lives.

Objectives

A. Understand how to bring Christ into your finances.
B. Understand the importance of perspective and our perspective for this course.
C. Understand our framework for learning: doctrines, principles and application.
D. Understand the implications of that learning framework.
E. Remember that "Life is Good."

Understand how to bring Christ into your finances

As we have read and studied scriptures, it is apparent that Jesus Christ wants to be a greater part of our lives and finances. He will not barge in and tell us what to do; He cannot, as He will not violate our moral agency. But He will plead, exhort, counsel and guide us back to our Father if we will allow Him more into our lives and finances.

Why do we want to bring Christ more into our finances? M. Russell Ballard reminded us: "In my judgment, we never will have balance in our lives unless our finances are securely under control."[2] Christ can help us bring balance and control into our lives and finances. How do we bring Christ more into our lives and finances?

Seek to learn and love the Savior and His atonement more. We study, pray, learn more about Him, and contemplate His amazing atonement and what it means in our lives. Christ knows us by name and loves us perfectly, and has designed a detailed, individual, and customized curriculum (called life) exactly tailored to our needs, mission and destiny. Managing our finances is one of the pieces of that curriculum, and personal finance is simply part of the gospel of Jesus Christ.[3]

Strive to change daily and become more like Him. God's grace, repentance and the atonement of Jesus Christ are perfect tools to help us change and to become more like our Savior. He has given us everything we need to become more like Him. He has taught through His servants that "a" pattern to change behavior is to understand doctrines and principles, and have them confirmed by the Spirit.[4] Boyd K. Packer said: "True doctrine, understood, changes attitudes and behavior. The study of the doctrines of the gospel will improve behavior quicker than a study of behavior will improve behavior. . . That is why we stress so forcefully the study of the doctrines of the gospel."[5] However, it is not enough to know the doctrines—we must understand them as well. David A. Bednar commented, "President Packer did not teach that simply knowing true doctrine changes us. Rather, doctrine must be understood. . . Thus, true doctrine confirmed in the heart as true by the witness of the Holy Ghost changes attitudes and behavior.[6] He also reminds us "The answers are always in the doctrines and principles, and the doctrines and principles need to be in us."[7]

Learn to apply His words and create our lives more closely with Him. As we strive to develop and grow, application is an invitation to learn and create.[8] As we do, we become creators with God of ourselves, our families and our lives. We learn important lessons from the creation[9] that we can use in our lives as we remember that "Creation is a spiritual gift."[10] We were born creators, and had our first lessons in creation when as pre-existent spirits we helped create the earth we live on.[11] We create each day in our prayers, families, the environment in our homes, budgets, goals and our lives. We are all creators, and learn best when we learn and follow the Master Creator, even Jesus Christ. Not only does He know the way, He is the way.[12]

Always remember Him. We need Christ's inspiration and guidance daily if we are to return with our families to His presence. We already covenant to "always remember Him" each week in the Sacrament. We must strive to keep those and our other covenants. We must remember that our conduct on our journey is as important as our final destination.[13] We must, like the pioneers, make "a covenant and a promise to keep all the commandments and statues of the Lord"[14] as we daily remember the Savior and follow the covenant path.

To bring Christ more into our finances, we must bring Him more into our lives. If we want to have balance in our lives, we must bring our finances securely under control. We can do this best with Christ's help. We bring Christ into our finances as we seek to learn and love the Savior and His atonement more, work to change and become more like Him, learn to apply and create with the Creator of the World, and always remember Him. Then with His help, we can accomplish all things.

Understand the Importance of Perspective and Our Perspective for this Course

The dictionary defines *perspective* as "one's point of view, the choice of a context for opinions, beliefs, and experiences."[15] The historian Will Durant wrote of the human need "to seize the value and perspective of passing things. . . We want to know that the little things are little, and the big things big, before it is too late; we want to see things now as they will seem forever—'in the light of eternity.'"[16]

The challenge then is to see things in a consistent perspective--as they will be forever. Neal A. Maxwell wrote of those without this perspective, "Living without God in the world brings a functional lack of consistent perspective. If there were no eternal truths, to what principles would mortals look for guidance? If not accountable to God, to whom are we ultimately accountable?"[17]

Our perspective—how we look at things—makes a difference in the choices we make. Do we recognize our difference in perspective as we look at the world around us? Do we recognize the implications of our differences in outlook, the differences of our eternal perspective as we go about our daily lives? Neal A. Maxwell commented:

> We see the world and the people in it differently, because, as C. S. Lewis observed, it is by the light and illumination of the gospel that we see everything else. . . The gospel is like the lens of a cosmic kaleidoscope that, instead of showing life, man, and the universe as senseless, unconnected fragments, shows us pattern, beauty, and purpose! It is this vision that can give us a special sense of proportion about the things in life that matter most. . . This perspective can make so many differences in so many ways that, unintentionally, we may be unconscious of the implications of our difference in outlook.[18]

The purpose of this section is to articulate "another" perspective on wealth, an eternal perspective. This perspective is critical for us to understand, and it has a major influence on how we make choices.

In this manual and website, we take a different view from the world. We disagree with the belief that "money buys happiness." The media continues to bombard us with the illusion that we have to spend money to be content or that to be happy, a person must be beautiful, sexy, thin, rich, or whatever it is they are selling at the moment.

Most of us are not conscious of the effects of our perspectives on our everyday lives. When we have a proper perspective on life, there is pattern, beauty, and purpose instead of senseless, unconnected fragments. Along with that knowledge of the purpose of life, it is important that we understand correct principles so that we can make good choices.

On the subject of choices, Spencer W. Kimball said:

> We hope we can help our young men and young women to realize, even sooner than they do now, that they need to make *certain* decisions only *once* . . . We can make a single decision about certain things that we will incorporate in our lives and then make them ours—without having to brood and re-decide a hundred times what it is we will do and what we will not do.… My young brothers [and sisters], if you have not done so yet, *decide to decide*![19]

The purpose of this series is to help you in your understanding of perspective as it relates to personal finance and then to help you "decide to decide" to be wise in the management of your personal finances. When we have an eternal perspective, we understand things differently, view events differently, and make choices differently with respect to our families, friends, work and finances.

Our perspective is simple: *Wise money management is simply living the gospel of Jesus Christ*. It is putting Christ first in our lives, not our pocketbooks. "But seek ye first the kingdom of God, and his righteousness; and all these things shall be added unto you".[20] It is the temporal application of eternal principles.

Understand our Framework for Learning: Doctrines, Principles and Application

Our learning framework for this class is unique. We use the framework for learning used by David A. Bednar in his book "Increase in Learning." It is based on doctrines (the whys"), principles (the "whats"), and application (the "hows"). It brings balance to the things we do. Bednar calls it, "A flexible tool that can be used to enhance our gospel learning and can be a useful aid as we apply the principles of prayerful inquiry and the pattern of asking, seeking, and knocking."[21]

Too often when we encounter problems in life, we are drawn to application as the way to make life better. But is it the best way? Bednar writes:

> Somehow we seem to be drawn to application as the primary way to 'fix" things, to make life better. . . And far too often we emphasize application without the necessary understanding and divorced from the doctrinal content. . . Whatever the reasons, emphasizing the application to the exclusion of fundamental doctrines and principles does not produce spiritual power, protection, and direction. . . Appropriate applications are necessary but can never stand alone. What is needed is a balance among doctrines,

> principles and application. . . *The answers always are in the doctrines and principles*. And the doctrines and principles need to be in us.[22]

This learning framework is unique. It asks three critical questions that can lead us to learning and life. They are:

> 1. Why should we *learn and become better at personal finance*? (this is a "why" or doctrine question).
>
> 2. What are the principles on which how we *learn and become better at personal finance are based*? (this is a "what" or principles question).
>
> 3. How do we *learn about and become better at personal finance*? (this is a "how" or application question).

Doctrines or "Whys" of Personal Finance

Doctrines are the truth about ourselves, our lives, our history, and our relationship to our Father in Heaven and his Son Jesus Christ. Boyd K. Packer said, "True doctrine, understood, changes attitudes and behavior. The study of the doctrines of the gospel will improve behavior quicker than a study of behavior will improve behavior. . . That is why we stress so forcefully the study of the doctrines of the gospel."[23]

David A. Bednar reminds us,

> President Packer did not teach that simply knowing true doctrine changes us. Rather, doctrine must be understood. The word understanding in the scriptures frequently is linked to and associated with the heart and refers to a revealed result or conclusion. Thus, true doctrine confirmed in the heart as true by the witness of the Holy Ghost changes attitudes and behavior. Knowing true doctrine is necessary but is not sufficient.[24]

Why should we learn doctrines? Doctrines are critical as they give us the perspective, motivation and strength to do the right things even when they are difficult.

We have been counseled to understand the "why" or doctrines of the gospel of Jesus Christ. Dieter F. Uchtdorf said:

> Seek out the majesty, the beauty, and the exhilarating joy of the 'why' of the gospel of Jesus Christ. "The 'what' and 'how' of obedience mark the way and keep us on the right path. The 'why' of obedience sanctifies our actions, transforming the mundane into the majestic. It magnifies our small acts of obedience into holy acts of consecration.[25]

Before we can decide more about wise money management, we must understand and answer the question, "Why should we learn and become better at family finance?"

While there are likely many different "whys", let me share a few thoughts on doctrines of why we believe God wants us to learn personal finance. Since perspective is so important, this question must be addressed from many different perspectives. Possible perspectives include spiritual, temporal, family, and personal. While there are an innumerable number of perspectives, these four seem to be important and will be addressed here.

Spiritual: Personal finance can help bring us to Christ. From a spiritual perspective, the ultimate purpose of everything we do, and God does, is to bring us to Christ. Because God's work and glory is to bring to pass the "immortality and eternal life of man"[26] and the only way we can have eternal life is through Jesus Christ[27], then the purpose of all mortal experience is to bring us to Christ, who then brings us to the Father. Learning to manage our finances according to gospel principles will help us grow spiritually as well as help build up our families and the kingdom of God.

C. Max Caldwell said:

> Whatever the problem may be in a person's life—failure to pay tithing, breaking the Word of Wisdom, casual church attendance, [or, I add, poor financial habits, the]—real issue is faith in Jesus Christ. If we can help people obtain the gift of faith in Christ, good works will follow. The end purpose of any law of God is to bring us to Christ. And how well will the law work? It depends on what we think of the Author of the law.[28]

We have also been commanded by prophets and the scriptures to be financially wise.

> [We] have been counseled for many years to prepare for adversity by having a little money set aside. Doing so adds immeasurably to security and well-being. Every family has a responsibility to provide for its own needs to the extent possible . . . If you have paid your debts and have a financial reserve, even though it be small, you and your family will feel more secure and enjoy greater peace in your hearts. May the Lord bless you in your family financial efforts.[29]

Perspective also adds significantly to motivation. Whether we view this counsel on being financially wise as a nice thing to do or a commandment of God will provide a great difference in our motivation to do these things.

Temporal: Personal finance can help us become wiser stewards. From a temporal perspective, managing resources is a skill that Heavenly Father wants us to develop during mortality. "For he who is faithful and wise in time is accounted worthy to inherit the mansions prepared for him of my Father."[30]

Personal finance helps us learn to be wiser financial stewards over the things with which God has blessed us. Joe J. Christensen said, "Our resources are a stewardship, not our possessions. I am confident that we will literally be called upon to make an accounting before God concerning how we have used them to bless lives and build the kingdom."[31]

I believe a critical question at judgment day from our Savior will not be, "How much money did you make?" Rather, it will be, "How well did you use the resources I blessed you with in the service of your family and fellow men?"

Family: Personal finance can help us return with our families back to Heavenly Father's presence. The third perspective is family. An eternal perspective on finances helps us keep our priorities in order. David O. McKay reminded us, "No other success can compensate for failure in the home."[32]

We show our love for our Savior as we pay our tithes and offerings. We are examples to our children as we put the Lord first and sacrifice through service, hard work, church and temple attendance. We build our communities and nation as we seek opportunities for service to our family, friends and fellowmen.

We will be disappointed in life if we gain the world's riches and lose our spouses and families. We must learn to better apply personal finance in the Lord's way, using His plan and obeying His commandments. In short, an eternal perspective on finances can prepare us for eternal marriage, strengthen existing marriages, and be a conduit for positive parenting.

Individual: Personal finance can help us prepare for and accomplish our divine missions. The fourth perspective is individual. We all have divine missions to perform here on earth, and personal finance can help us learn the lessons and develop the skills we need to accomplish those missions. Many of our missions will required material resources. Gene R. Cook said, "I bear testimony of the fact that if you keep the commandments, He nourishes you, strengthens you, and provides you means for accomplishing all things necessary to faithfully finish your divine mission here on earth."[33]

We are all at an important time in our lives, regardless of our age. Ask yourself, "Do I really believe that I have a mission here on earth to perform and am I performing it?"

Clearly, perspective is important, and by looking at many different perspectives we can understand more fully "why we should learn and become better at family finance."

So if money management is part of the gospel of Jesus of Christ, are there principles upon which wise money management is based? Let me propose a few principles that are the foundation upon which this perspective is based. I call these my "Principles of Finance."

Principles or "What's" of Personal Finance

Principles are fundamental laws or doctrines, which, if understood, will allow us to live or act according to truth. Richard G. Scott commented:

> [The] inspired statement, "I teach them correct principles, and they govern themselves," still applies. The Lord uses that pattern with us. You will find correct principles in the

> teachings of the Savior, His prophets, and the scriptures. While easy to find, true principles are not easy to live until they become an established pattern of life . . . Yet, as you resolutely follow correct principles, you will forge strength of character available to you in times of urgent need. Your consistent adherence to principle overcomes the alluring yet false life-styles that surround you. Your faithful compliance to correct principles will generate criticism and ridicule from others, yet the results are so eternally worthwhile that they warrant your every sacrifice.[34]

What are those principles or "what's" to which we must adhere whose results are so eternally worthwhile that they merit our every sacrifice? Let me propose a few principles that relate to understanding and using wealth wisely.

Principle 1: Ownership. Everything we have is the Lord's. The Psalmist wrote, "The earth is the Lord's, and the fullness thereof; the world, and they that dwell therein."[35] The apostle Paul, writing to the Corinthians, stated the same message, "For the earth is the Lord's, and the fullness thereof."[36]

We know from scriptures that the Lord was the creator of the earth[37], the supplier of our breath[38], the giver of our knowledge[39], the provider of our life[40], and the giver of all we have and are.[41]

Nothing we have is our own—it is all God's. As such, there should be no feeling of pride for the things we have or are. These things do not belong to us, but are on loan from a loving Heavenly Father and His Son, Jesus Christ. These blessings should encourage us to demonstrate greater obedience to God's commandments. As we realize that all we have and all that we have become are gifts from a generous Heavenly Father and Son, we will find gratitude and obedience rather than pride.

Principle 2: Stewardship. We are stewards over all that the Lord has, is, or will share with us. A steward is one who actively directs the affairs of another. The apostle Paul stated, "Let a man so account of us, as of the ministers of Christ, and stewards of the mysteries of God. Moreover it is required in stewards, that a man be found faithful."[42] The Lord stated, "It is expedient that I, the Lord, should make every man accountable, as a steward over earthly blessings, which I have made and prepared for my creatures."[43]

Being blessed with material things in life should not be seen only as a blessing but also as a responsibility. We will be required to give an account of our stewardship to Heavenly Father. In order for us to be wise stewards, it is our responsibility to learn everything we can about our stewardship so we can manage it to the best of our abilities. The purpose of this manual and website is to help you understand and manage your stewardship better as it relates to personal finance.

Principle 3: Agency. The gift of "choice" is man's most precious inheritance. President Thomas S. Monson taught, "When we came to the earth, we brought with us that great gift from God—even our agency. In thousands of ways we are privileged to choose for ourselves."[44]

The prophet Joshua counseled the people about agency when he said, "Choose you this day whom ye will serve; . . . but as for me and my house, we will serve the Lord."[45]

David O. McKay wrote, "Next to the bestowal of life itself, the right to direct that life is God's greatest gift to man . . . Freedom of choice is more to be treasured than any possession earth can give.[46]

We should do everything in our power to thank God for this wonderful right to choose, and then use that agency as wisely as we can.

Principle 4: Accountability. We are accountable for every choice we make, including our financial choices. We have been blessed with the gift of agency, but we will also be held accountable for its use. The Lord counseled, "For it is required of the Lord, at the hand of every steward, to render an account of his stewardship, both in time and in eternity."[47]

The blessing of agency is an unconditional gift of God, and how we use that gift shows how much we love Him and His Son Jesus Christ. The first three principles outlined above are God's gift to us. The fourth principle is our gift to God. We can, through our wise choices, show our Heavenly Father how much we love Him by obeying His commandments and covenants and striving to become more like His Son.

These four principles establish a spiritual foundation for understanding wealth that is based on our dependence on God and our need for financial self-reliance to fulfill His purposes.

Neal A. Maxwell put things of this world into a correct perspective when he taught:

> The submission of one's will is really the only uniquely personal thing we have to place on God's altar. The many other things we "give," brothers and sisters, are actually the things He has already given or loaned to us. However, when you and I finally submit ourselves, by letting our individual wills be swallowed up in God's will, then we are really giving something to Him! It is the only possession which is truly ours to give![48]

Everything we have is God's, and the things we receive are all blessings from Him. They are not ours, but they have been given to us as a stewardship for which we can make choices. We should choose well, as we will be held responsible for what we choose and do.

Application or the "How's" of Personal Finance

Once we understand the doctrines and principles of finance, it is important to understand how to apply what you are learning to your daily lives. I call this application or the creative process. Question 3 then becomes "How do we learn about and become better at family finance?"

In 2019 we took 24 BYU students to Europe for a Global Finance Investment Internship. One of the companies we visited in Germany was a large sport and apparel manufacturer. I was impressed with their marketing slogan "Calling all Creators."[49] Their point was we all are

creators, which we truly are.

On the importance of creation, Elder McConkie said, "The three pillars of eternity, the three events, preeminent and transcendent above all others, are the creation, the fall, and the atonement."[50] Why is it so important that we understand the creation? I believe it is because this knowledge will help us to be better creators ourselves. Let me share eight lessons that I have learned from the creation. You will likely have your own lessons from your reading and study.

God is creative. The creation shows that Heavenly Father and His son are very creative beings. We are taught in the scriptures that we are created in the image of Heavenly parents and in Their likeness. As such, we should also very creative beings. We were meant to create, and this capacity is God-given.

Christ worked under the direction of the Father. The restored gospel has helped us to know that Jesus Christ created the heavens and the earth under the direction of the Father. Likewise when we create, we should be under the direction of the Father as well. To really accomplish all we need to in this life, we will need His help.

The earth was created from existing matter. The earth was created, not from nothing, as many suppose; rather, it was organized from existing matter.[51] Likewise, when we create, we are not starting from nothing. We take our existing vision, education, talents, skills and abilities, and match those with the resources and materials we have in our home, neighborhood, community or nation.

Creation is a two-step process. The Lord speaking to Moses said, "For I, the Lord God, created all things, of which I have spoken, spiritually, before they were naturally upon the face of the earth."[52] Once He created things spiritually, then came the physical creation of everything on the earth. We likewise must create things spiritually through our vision, goals and plans, and then we can create it physically—and we can create with confidence.

There is an order in creation. Notice that there is an order in creation, first the world was organized, and then light came into the world. Next the waters were divided. Clearly there is order in creation and in the universe. Likewise, there is order in our creative processes, and we must learn what that order is.

Creation takes time. The creation of the earth did not happen overnight, but took six creative periods. How long those periods were has not been revealed, but we do know it was a long time. Likewise, when we create, we should realize that this is a time-consuming process.

Creation was a planned event. The creation was planned from the beginning under the direction of Heavenly Parents. The creation, fall and atonement of Jesus Christ were all part of the Father's plan, "to bring to pass the immortality and eternal life"[53] of His children. We should make sure, as we go through our lives, that we to have a plan on how we will live our lives, so that we can, under the direction of the Father, support His same work and return to His presence.

We create every day of our lives. Some do not think they create; however the reality is that we create every day of our lives. Perhaps a few creations can help make the point.

Prayer. David A. Bednar commented on our spiritual and physical creation of each day. On the subject of prayer, he said,

> We learn from these verses that the spiritual creation preceded the temporal creation. In a similar way, meaningful morning prayer is an important element in the spiritual creation of each day—and precedes the temporal creation or the actual execution of the day. Just as the temporal creation was linked to and a continuation of the spiritual creation, so meaningful morning and evening prayers are linked to and are a continuation of each other.[54]

Family. We are co-creators with God in the creation of our families. We work with Him as creators of our marriages and in which our children are raised. We should make sure, as we work to create the environment in our marriages and in which our children are raised, that we do it as co-creators with Heavenly Father. We are reminded to always, "Create homes filled with love and serenity. Relieve suffering. Create enduring testimonies of eternal truths in ourselves and others."[55]

Vision and Goals. When we set and work toward our vision and goals, it is again the spiritual creation followed by the physical creation. Alma uses different words to describe this spiritual creation, such as "Do you exercise faith," "Do you look forward with an eye of faith," and "Can you imagine to yourselves."[56] God's ultimate goal for us is to learn both the spiritual and physical creation process so we live in such a way as we, with our families and through the Savior's atonement, can return to live with Him eternally.

Finances. Regarding our finances, the preparation of our budgets can be envisioned as the spiritual creation first, followed by the physical creation second as we spend the money. President Kimball said" "Every family should have a budget."[57] Living on a budget does not mean that you do not spend money; rather, you spend money on things that are planned for (the spiritual creation) and that are important to you.

Ourselves. Finally, the reality is that we create ourselves in every day and in everything we do. Our life then is the sum of each of our daily individual creations. As such, we recognize the importance of our daily creations in the creation of our overall lives.

Creation is a wonderful subject for additional study. We were born creators, and had our first lessons in creation when as pre-existent spirits we helped create the earth we live on.[58] David O. McKay taught, "Sculptors of life are we, with our uncarved souls before us. Everyone of us is carving a soul."[59] That we might help create and carve ours and other souls well is our prayer for each of you.

The application or the creative process is how we go from the spiritual creation to the physical

creation. It entails five steps. Each of these steps is important to the process, and this process can be applied to all areas of our lives. While it is possible to create without thinking through the creative process and many do exactly that, if we understand and apply this process it can help us to accomplish more and to be even more creative in our lives and our finances.

The Lord speaking to Joseph Smith said, "I will give you a pattern in all things, that ye may not be deceived."[60] David A. Bednar reminds us,

> Interestingly, the Lord gave us "a" and not "the" pattern for all things. I do not believe the Lord is suggesting with the language "a pattern in all things" that He has only one pattern to be used in every situation. Rather, the Lord's way includes a variety of patterns that can be employed to achieve different spiritual objectives.[61]

Let me share one possible pattern.

The Creative Process

Vision: We Catch our Vision. The scriptures teach "Where there is no vision, the people perish."[62] Why is vision so important? Vision is a critical precursor to effective goals, planning, writing, and accomplishing our personal and family goals. The best vision is from the longest perspective. Patricia T. Holland said, "Our prayers ought to be to see as God sees, to adjust our minds so we may see things from an eternal perspective. If we listen too often to the voices of the world, we will become confused and tainted. We must anchor ourselves in the spirit and that requires daily vigilance."[63]

Goals: We Develop our Goals. Goals are tools to help us keep us focused on our vision. Robert D. Hales gave advice on your choice of goals. He recommended:

> I would like to suggest a few of the most important goals in life that will give you joy as you fulfill your mission on this earth—eternal goals that will help you return with honor to your Father in Heaven. They include: Marry in the temple and cultivate eternal family relationships by prayerfully balancing the many facets of life, such as family, occupation, continuing education, hobbies, and entertainment. Faithfully and obediently live your religion and be true to the baptismal and temple covenants, always treasuring up the good things of life. Hold on to the eternal perspective, remembering that the things of the kingdom are eternal and the things of the world are temporal or temporary. Remember to give dedicated service throughout your life and always care for the needy who may require your love and other support.[64]

Plans and Strategies: We Make our Tactical Plans and Strategies. He continued and said, "Making these goals is not enough; we must make a plan to carry them out."[65] Goals are the destination, where we want to be, and our plans are the process by which we will get from where we are now to where we want to be. We need to be detailed in our plans to accomplish our goals and hence our vision.

Constraints: We Determine our Constraints. Whereas goals are the clear objectives for what you want to accomplish, and your plans are how you will accomplish those goals, then your constraints are given conditions or circumstances that your solution must satisfy. These are things that must be taken into account as these constraints can have a major impact on your ability to accomplish your goals and vision.

Accountability: We Share our Vision with Accountability Partners Who Can Help. Accountability is the process by which we make known our vision, goals and plans to others. This could be for three reasons.

- It may be because we need their moral or personal help to accomplish our goals and vision. Sharing your goals with your spouse and children is a good way to get help in accomplishing your goals. Having others help you be accountable for your goals is a great motivator.

- It also may be because they are part of our creative process and necessary to help us accomplish our goals. Mentors and friends can help when we fall short and help us know what to do to improve.

- As we share our vision with others, we give others permission to catch their own visions.

Regardless of the reason, accountability is an important part of the creation process.

For example, Heavenly Father's vision is the happiness and exaltation of his children. His goal is to "bring to pass the immortality and eternal life of man."[66] His plan is the Plan of Salvation or the Plan of Happiness. He has no constraints as his plan is for all people, and He communicates his plan with His children through prophets, apostles and scriptures. Just as He has a vision, goal, plan, constraints, and accountability, so we should too.

The manual will share concrete ideas and experiences on how you can apply the creative process to the personal finance area, how you can create your vision of what you want to become, set goals, develop a plan, work on constraints, and then communicate it to help you accomplish your vision. This process is applicable to all areas of your Personal Financial Plan.

Ezra Taft Benson reminded us to "Plan your financial future early, then live your plan."[67] As part of planning your financial future, you will develop your own Personal Financial Plan (PFP). Your PFP includes 16 different Plans, including your:

- Plan for Life (Vision, Goals, and Plans)
- Saving, Income and Expense Plan (Budget)
- Tax Plan
- Cash Management Plan
- Credit Plan
- Consumer Loans and Debt Plan

- Insurance Plan
- Family Financial Plan
- Investment Plan
- Retirement Plan
- Advance Plan
- Mission Plan
- Education Plan
- Housing Plan
- Auto/Toy Plan
- Individual/family Giving Plan

Our Conduct on the Journey is as Important as our Destination

As Anne and Bryan Sudweeks were driving home from our service in Nauvoo this year, they were listening to the book "Revelations in Context" and the section on D&C 136. Brigham Young was with the vanguard company in Winter Quarters, Iowa, and was praying for inspiration to get the Saints to the west. This section was guidance by the Lord on how to organize the Saints for their trip from Nauvoo to the Great Salt Lake.

As they thought about this inspired document, they wondered if there was more to this section than a standard organizational chart. Did it have a greater meaning that extended beyond the lessons for 1847? Chad M. Orton wrote:

> Some have assumed that the revelation is a simple how-to guide for organizing pioneer companies and have underestimated the role it played in refocusing Brigham Young and the Church. By helping the Saints remember that their conduct on the journey was as important as their destination, the revelation helped transform the westward migration from an unfortunate necessity into an important shared spiritual experience.[68]

Could the Lord be not only letting us know what Brigham needed to do, but also giving us a pattern that we can use in our financial lives as well?

Some have said, "The end justifies the means," meaning that "a desired result is so good or important that any method, even a morally bad one, may be used to achieve it."[69] Here in D&C 136 the Lord is saying that the means is as important as the end.

Brigham Young's vision and goal was simple, namely the largest single migration of an entire people, institutions, and culture in the history of the United States. To do this, the Lord inspired Brigham to organize the Saints "into companies, with a covenant and promise to keep all the commandments and statues of the Lord" (v. 2). Organization into companies was not new and had been discussed by the prophet Joseph. However, that combined with the covenant of righteousness was an inspired addition. Orton continued, "Brigham came to understand that

rather than simply blazing a trail that others would follow, the 1847 vanguard company was establishing a covenant path."[70] He knew that thousands would be following their path and direction, so inspiration was crucial. As the Saints kept their covenants and walked in the ordinances of the Lord, they had the help of heaven as they worked toward their destination.

Likewise, how we conduct ourselves on a day-to-day basis in our finances is as important as the final destination of financial self-reliance or saving money. The important thing is what we learn and become from our experiences with our finances, not just the amount saved, and the inspiration of heaven is critical. Our challenges may not be as daunting as Brigham's, but they are important. As we work toward our vision and goals of greater financial self-reliance, we should likewise be organized and prepared, as well as make that same covenant that we will "keep all the commandments and statues of the Lord" (v. 2) and "walk in all the ordinances of the Lord" (v. 4). As we do these things, we too can have heaven's help as we go along our journey to our financial and other goals.

What should our conduct entail? Thankfully, the Lord shared three important points.

Follow the prophets and stay on the covenant path. As soon as Brigham received this revelation, he and the other apostles worked to ensure that the Saints knew what the Lord expected of them. The results were instructive and impressive. Hosea Stout observed that following the revelation would bring needed calm and unity in the face of unexpected trials; it would "put to silence the wild bickering" that had complicated the journey across Iowa.[71] Richard E. Bennett noted that as they followed the prophet, the exodus became "the most carefully orchestrated, deliberately planned, and abundantly organized hegira [migration] in all of American history."[72]

As the pioneers kept all the commandments and statutes of the Lord (v. 2), followed the prophets (v. 3), and walked in all the ordinances of the Lord (v. 4), the Lord blessed them that they would be able to get to their destination. Likewise, as we keep the commandments and statues, listen to the prophets and stay on the covenant path, we too will get to our destinations, whether it is budgeting, investing, retirement planning, or other activities.

Be wise stewards over all the Lord has freely given you. The Lord reminded the saints that they were His agents and the blessings they had received were from Him and should be used to prepare for what and who were coming later (v. 7, 9). They were to use their intellect, resources and property to help others (v. 10), be honest in their dealings, not covet (v. 20), return things borrowed (v. 25), return what they find to their rightful owners (v. 26), and be diligent in preserving what they have (v. 27). They were counseled against contention, pride (v. 19), taking the name of the Lord in vain (v. 21), speaking evil one with another (v. 23), drunkenness, and unedifying conversations (v. 24). As they did these things with pure hearts, they were promised "Ye shall be blessed; you shall be blessed in your flocks, and in your herds, and in your fields, and in your houses, and in your families" (v. 11). Likewise, as we are wise stewards over our financial resources and work to avoid contention, we too will be blessed in the things we are striving to achieve.

Remember the poor and needy on your journey. While the Saints were to be wise stewards, they also had a covenant responsibility to share an equal proportion for taking care of the poor, widows, and fatherless (v. 8). Likewise, as we work toward our financial goals, we also must remember our covenant responsibility to remember the poor and the needy along our way and to bear our "equal proportion" through our fast and other offerings and helping and serving others.

Because of both organization and righteous conduct, the pioneers were able to make the journey to the west. They established not only a physical but a covenant path as well, a path we can follow today. The Lord reminded the Saints that their conduct on the journey was as important their destination. Likewise, how we do the things we need to do as we work toward our financial goals is as important as what we do.

The Lord then shared what that conduct should include. They must follow the prophets and stay on the covenant path, be wise stewards over all the Lord has freely given, and remember the poor and needy on their journey. As the Saints followed this inspired guidance and improved their conduct, they made progress toward their ultimate goal in the west. Likewise, that guidance has relevance to us today. As we remember the importance of our conduct and these same three areas of concern, the Lord will likewise help us in our financial vision, goals and destinations.

By emphasizing the importance of what we do, our conduct, and what we have, our blessings, we tie everything, including our finances, back to the gospel of Jesus Christ. Moreover, we transform our finances from an unfortunate necessity to an important shared spiritual experience as we work together with our spouse and families to accomplish our financial vision and goals.

Understand the Implications of this Learning Framework

This learning framework is important for six specific reasons.

1. This framework helps us ask the important questions about our lives and our finances, such as "What doctrines and principles, if understood, would help me:

- "Change my attitudes and behaviors toward my finances to become better at them?"
- "Teach my children the place of money in our lives, instead of just the world's ways?"
- "Better live the commandments to live on a budget, spend less than I earn, and be more exact in my record keeping?"

Understanding doctrines and principles can help us ask important questions that can be used to enhance our learning as we ask and seek deeper answers to the difficult questions of life.

2. This framework reminds us where the answers really are. Bednar reminds us, "Appropriate applications are necessary but can never stand alone. What is needed is a balance among doctrines, principles and application. . . The answers always are in the doctrines and principles. And the doctrines and principles need to be in us."[73]

3. This framework allows us to lift our perspective and vision, which can help us gain greater motivation. By finding our higher purpose (or doctrines) in what we are doing, we gain greater motivation to do the things that we need to do. Ted Callister reminds us "With increased vision comes increased motivation."[74]

4. This framework encourages us to take a long-term eternal perspective rather than a checklist approach. Paul declared "In the dispensation of the fullness of times [God] might gather together in one all things in Christ."[75] How do we gather together in one all things and how does this framework help?

David A. Bednar wrote, "The principle of gathering together in one can aid us in changing the conventional checklist [of family finance] into a unified, integrated, and complete whole in receiving the transforming power of the gospel of Jesus Christ in our lives."[76] For most of us our lives revolve around the checklist of things necessary for us to do including living on a budget, getting out of debt, saving for long-term goals, etc. These things are often considered separately, rather than in relation to each other and in relation to our overall lives. As we gather together in one, we put all these things together and see that these things, including our finances, are simply part of the gospel of Jesus Christ and hence we know what is necessary for us to do. We must "obey the commandments."[77] "bridle all our passions,"[78] "perform every word of command with exactness,"[79] "strip ourselves of all pride,"[80] "offer [our] whole souls as an offering unto Him,"[81] and "endure to the end."[82]

5. This framework reminds us of the importance of Christ and our daily conduct. It is not enough to know these things and even to have a testimony of their truthfulness, we must do them every day. It is crucial that we daily stay on the covenant path daily and we will achieve our destination.

6. Finally, this framework helps change our thinking. While principles and application keep us on the right track, understanding the doctrines and principles allows us to transform those hourly and daily mundane acts of obedience we must do in our finances into the majestic purposes that our Heavenly Father has planned for us. It magnifies, as Dieter F. Uchtdorf says, "our small acts of obedience into holy acts of consecration" to our Savior Jesus Christ.[83] Louise Y. Robison reminds us, "If we only half do our work we will have no pleasure, if we do it from a sense of duty we will have no joy, but if we feel . . . that our Father in Heaven has felt us to be worthy . . . and that we can carry this work when it is here to do, then we will have joy.[84]

Summary

We must strive to bring Jesus Christ more into our lives and finances. To do that, we must seek to learn and love the Savior and His atonement more, strive to change daily and become more like Him, learn to apply His words and create our lives more closely with Him, and always remember Him. Our learning framework supports each of those activities.

Perspective is important in studying personal finance. Our perspective is that personal finance is simply living the gospel of Jesus Christ; it is putting Christ first in our lives. Our view of the Savior, the way we look at life, at others and ourselves will have an important impact on how we utilize the blessings we have been given by God. It is critical that we have a correct perspective with our lives and finances, as perspective influences our choices.

We shared our important learning framework of doctrine, principles and application. Doctrines are revealed truth. The first critical question was "why should we learn and become better at family finance? Four key concepts constitute the doctrines, each related to a different perspective.

1. Spiritual- To bring us to Christ
2. Temporal- To help us become wiser stewards.
3. Family- To help us return with our families back to Heavenly Father's presence.
4. Individual- To help us accomplish our divine missions.

Principles are guidelines for the proper use of agency. The second question was "what are the principles on which how we learn and become better at personal finance are based? Four key concepts constitute the principles or "what's" on which this perspective is based. They are:

1. Ownership- None of what we have is ours.
2. Stewardship- We are stewards over all God has blessed us with.
3. Agency- The gift of choice is one of God's most precious gifts.
4. Accountability- We will be accountable for all our choices, including our financial choices.

Application is how we accomplish what we need. The third question was "how do we learn about and become better at personal or family finance? This application or the creative process is critical to our accomplishing all we need to in life. The five key concepts are:

1. Vision- Our vision is what we want to become or how we want to live our lives. It is our ultimate destination and what we want to be like.
2. Goals- Goals constitute our destination or where we want to get to become our vision.
3. Plans- Plans are our tactical strategies or plans that will allow us to accomplish our goals.
4. Constraints- These are the conditions or circumstances that are critical for us to accomplish our goals.
5. Accountability- Finally, accountability is how we let others know what we are trying to accomplish and how we enlist their help in our process.

In summary, our learning framework was designed to help us bring Christ into our finances.

- We must seek to learn and love the Savior and His atonement more. As we do, we realize the personal finance is simply part of the gospel of Jesus Christ.

- We strive to change daily and become more like Him. We know that doctrines and principles, confirmed by the Spirit, change behavior.

- We learn to apply His words and create our lives more closely with Him. For we know that application is an invitation to learn and create.

- We always remember Him. As we do, we remember our conduct on our journey is as important as out destination.

It is our responsibility to be financially wise and use the resources we have been blessed with in blessing the lives of our families and others. We do that best when we daily bring Christ more into our lives and finances. The purpose of this manual and accompanying website, PowerPoints and learning tools is to help you accomplish that purpose.

Assignments

Financial Plan Assignments

Think about the things we have discussed regarding the doctrines ("why's"), principles ("what's"), and application ("how's") of personal finance. Why is this learning framework different? What things will this framework help us understand? These are the reasons we should be learning this material and we have a process on how to do it. With this framework we can change, as Dieter F. Uchtdorf states, "our small acts of obedience into holy acts of consecration."[85] With this understanding, we can avoid the problems that come with the world's different perspectives on wealth – generally incorrect ones. To become truly wealthy, we must first have a correct perspective and understand the key doctrines and principles for using wealth wisely. The scriptures state, "For God so loved the world, that he gave his only begotten Son, that whosoever believeth in him should not perish, but have everlasting life."[86] This is the true kind of wealth. Think about what is necessary to have this correct perspective on wealth.

Read and discuss the following three important chapters that help us with perspective on wealth and our understanding of its key principles: 1 Timothy 6, Jacob 2, and Doctrine and Covenants 6. These chapters are available online at http://scriptures.ChurchofJesusChrist.org/.

As you begin your PFP, start by filling our your PFP Introduction Template (LT01-01). What will happen if you don't prepare carefully this PFP? What will happen if you do? Think through the benefits of putting together a thoughtful Plan.

Learning Tools

The following Learning Tool will also be helpful as you prepare your Personal Financial Plan:

Personal Financial Plan (PFP) Table of Contents (LT01)

This is a recommended table of contents for your Personal Financial Plan. It includes the 16 separate plans which make up your PFP.

Review Materials

Terminology Review

Accountability. This is a principle is that states we are accountable for every choice we make. We do not make choices with no consequences or accountability; rather, we will be held accountable for the decisions and choices we make.

Agency. This principle is that we have choice in our lives. We are agents of will, who can make choices consistent with our beliefs and values. Moreover, the gift of "choice" is man's most precious inheritance, and we should protect it carefully.

Application. Application is the "how' of how we do things. It is how we apply the doctrines and principles in our lives.

Constraints. Constraints are given conditions or circumstances that must be satisfied in order to enable us to accomplish our goals.

Accountability. Accountability is the process of letting others know what your vision, goals, plans, and constraints are to enlist your help in the creative process. It can also be enlisting others in helping accomplish your goals as you need their help for certain specific parts of your plans and strategies.

Creative Process. It is the way we get from an idea or vision to its eventual accomplishment. It has five critical areas: vision, goals, plans, constraints, and accountability.

Doctrines. Doctrines are the reasons behind why we do things. They answer the "why" questions of our lives, which are generally the most difficult questions to answer.

Goals. Goals are tools to help us keep our vision in focus. They are intermediate stepping stones that will take us to our eventual vision of what we are trying to accomplish.

Ownership. This is the principle that everything we have is the Lord's, and we do not own the things we have and are. It is based on scripture and helps us to see our blessings as gifts on loan from a loving Father in Heaven.

Perspective. Perspective is how we look at things. It is important because it influences choice. We can take many different perspectives in our view of different aspects of our lives, with the best perspective being the perspective that last the longest—an eternal perspective.

Plans. Tactical plans are the roadmaps by which we will accomplish our goals. It is how we will get from where we are now to where we want to be to accomplish our goals.

Principles. These are doctrinally based guidelines for how we should live our lives. Whereas doctrines answer the 'why" questions, the principles are the "what" questions, i.e., what are the things and guideline we should be following and doing.

Stewardship. This is the principle that we are stewards over all that the Lord has, is, or will share with us. This view helps us realize the things we have are a gift and we should take care of them.

Vision. This is the act or power of seeing or imagination, where we come to solidify in

our minds who we are and what we can accomplish. It is a creative work through which the power of thought, imagination, and effort combine to help us thoughtfully consider possible future events that may come to pass.

Review Questions

1. Why is it important to "decide to decide" now? What problems can it help us avoid?
2. Why does God want us to learn wise money management?
3. What is our perspective and why is it important?
4. What are the four key principles on which that perspective is based? Why are they important? What can we do to incorporate these principles into our lives now?
5. Some have asked, "If wealth is so bad, should we seek for riches?" What did Jacob say about this question in Jacob 2:18–19? What should we seek for first?
6. What are the benefits of this doctrines, principles and application learning framework?

Case Studies

Case Study 1

Data

Brenda came from a family that had few worldly goods, but there was a lot of love in the home. She has come to talk with you about her finances because she respects you for the wonderful example you have set at work.

Application

She asks you, "What is the purpose of wealth in our lives?"

Case Study 1 Answers

You have lots of good ideas, but you share the following: Jacob shared with us one view of the purpose of wealth in our lives. He counseled us that if we seek wealth, we should do it for the right reasons, and it is OK to do so only *after* we seek the kingdom of God. The purpose of wealth is not to build ourselves up, and its possession does not allow us to think we are better than other people. Rather, it is to help us bless our families, serve our fellow men, and build the kingdom of God.

Case Study 2

Data

Brenda continues to ask you questions regarding your perspective and principles for using wealth wisely. She asks if there are principles that you know and have lived that have made a difference in your life.

Application

Share the four key principles for using wealth wisely discussed in this chapter. Why is each principle important? What can we do now to incorporate each principle into our lives now?

Case Study 2 Answers

There are several good answers for these questions. You might respond with:
Our perspective is that personal finance is simply living the gospel of Jesus Christ. That perspective is based on four key principles:

1. Ownership: Everything we have or are is a gift from God.
   - It is important because the things we have are not ours but are on loan from a loving Father in Heaven.
   - We can incorporate this principle into our lives by learning that when we share with others, we are only giving back to God what was His in the first place.
2. Stewardship: We are stewards over the things the Lord has blessed us with.
   - It is important because we must learn to be better stewards over our blessings because we will be held accountable for what we do with these blessings.
   - We can incorporate this into our lives by learning as much as we can about the things we need to do so we can become the best stewards we can over the blessings our Heavenly Father shares with us.
3. Agency: The gift of "choice" is man's most precious inheritance.
   - It is important because we need to use this gift wisely so we can return and live with God eternally.
   - We can incorporate this into our lives by studying all areas of our decisions and decision-making processes so we can have the information needed to make the best decisions possible.
4. Accountability: We are accountable for our choices, including our financial choices.
   - We are the final decision-makers in life.
   - It is important because we must learn to choose wisely.
   - We can incorporate this into our lives by setting good goals and then by making wise choices to help us attain those goals—goals that our Heavenly Father would have us seek.

Case Study 3

Data

Brenda was concerned as one of her friends was blessed with material riches, and made poor choices which caused him to lose his testimony. She asks: "If wealth is so bad, should we seek for riches?"

Application

What did the prophet Jacob in Jacob 2:18-19 say about this question? What should we seek for first?

Case Study 3 Answers

The prophet Jacob said seeking for riches is OK "if" we first seek the Kingdom of God, and if we seek riches for the right intent--for righteous purposes.
But before ye seek for riches, seek ye for the kingdom of God. "And after ye have obtained a hope in Christ ye shall obtain riches, if ye seek them; and ye will seek them for the intent to do good-to clothe the naked, and to feed the hungry, and to liberate the captive, and administer relief to the sick and the afflicted (Jacob 2:18-19).

First, we should seek for the Kingdom of God and doing His will. Then we can seek for riches—but with the intent to do good. Gordon B. Hinckley said: "The Lord will love us, I think, to the degree to which we lift and bless those in distress. I believe that with all my heart, mind, and soul. The accumulation of means is not a bad endeavor when those means are used to bless the needy of the earth."[87]

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2. Retirement 1: Understanding Retirement Basics

Introduction

People are living longer in modern times than they did in the past. Experts project that as life spans continue to increase, the average individual will spend between 20 and 30 years in retirement. With fewer traditional pension plans available and smaller payouts from traditional government and private plans, retirement planning is an increasingly important part of personal investment planning.

Most people want to be financially secure during retirement. This chapter on retirement planning is divided into four parts that will help you achieve financial security during retirement: (1) retirement basics, (2) Social Security, (3) employer-sponsored retirement plans, and (4) individual and small-business retirement plans. The sooner you begin planning and saving for retirement, the more likely it is that you will be financially secure during retirement.

Ezra Taft Benson gave the following counsel, "*Plan for your financial future.* As you move through life toward retirement and the decades which follow, we invite all . . . to plan frugally for the years following full-time employment."[1]

Retirement planning includes answering three important questions:

1. How much money do I need to have available at retirement to allow me to reach my retirement goals?
2. How do I tell if I am on track to reach my retirement goals?
3. What are the major retirement vehicles available to me, and how can I use them to reach my retirement goals?

This first chapter gives general guidelines on answering the first two questions. The remaining chapters discuss the major retirement vehicles available to you. We have put together a document on the 30 Key Decisions for Retirement that ties in what you have learned thus far with your Retirement Plan.

The purpose of this chapter is to help you lay the foundation for a successful retirement plan and encourage you to follow your plan. This chapter reviews and builds upon concepts discussed in earlier chapters. You should read this chapter before reading the succeeding chapters in this course.

Objectives

When you have completed this chapter, you should be able to do the following:

A. Understand why retirement planning is critical and the principles of successful retirement planning
B. Understand the steps, stages and payout options at retirement
C. Understand one method of monitoring your retirement-planning progress
D. Understand and create your Retirement Plan.

Understanding the basics of retirement planning is important to planning, constructing, and managing a portfolio to achieve your retirement-planning goals.

Understand Why Retirement Planning is critical and the Principles of Retirement Planning

You have the responsibility to take care of yourself and your family. No one will assume that responsibility for you. Building an adequate retirement fund will ensure that you will be able to fulfill this responsibility even after you stop working. By planning ahead, you will help to ensure a better future for you and your family.

Life Expectancy

The following are some interesting statistics on aging from *Kiplinger Magazine* (Feb. 2001):

- There are an estimated 67,000 Americans who are at least 100 years old. This is a 130 percent increase from 1990.
- The number of people over the age of 100 is expected to rise to 834,000 by 2050.
- Of these people over the age of 100, 82 percent are likely to be women.
- In 1900, the life expectancy at birth for men and women was 46 and 48, respectively. In 1997, the life expectancy at birth for men and women was 74 and 80, respectively, and rising

We do not know how long each of us will live. We can gain information from the lives of our parents and family. We can also get estimates from others. We recommend you get a few estimates from the below websites which may indicate how long, based on their algorithms, you may be expected to live.

- Social Security estimates you will live this long based only on date of birth and gender, see Social Security Life Expectancy Calculator
- Northwestern Mutual Life Insurance provides a Longevity Quiz.
- Blueprint Income has their How Long Will You Live.
- Bankrate.com gives a Life Expectancy Calculators

As the average life expectancy rises, the need to save for longer periods of retirement becomes more important. As we discussed earlier in the chapters on the time value of money, the sooner

you invest your money and the more time your money has to compound, the larger your nest egg will be when you retire.

Getting Started

You should begin planning for retirement today. Retirement may seem to be a long way off, but it isn't! You may think your employer or the government will provide the funds to help you through retirement, but this is typically not the case anymore. Employer-sponsored retirement benefits are changing, being reduced, or being eliminated altogether, and the future of government programs, particularly Social Security, is uncertain. Even if Social Security is still available when you retire, it will probably not provide enough money for you to live on exclusively. You need to be aware of these changes in employer-sponsored retirement benefits and government programs and plan accordingly.

Principles of Retirement Planning

There are generally six key principles to successful retirement planning:

1. Know Yourself, Your Vision, Goals and Plans. It is critical that you know yourself. You must have our vision of what your retirement will be like, and then develop your personal and family goals and your plans to achieve them. If you have not written your goals down, you should do so now. Know what you want out of life. Understand what kind of retirement you want. And most importantly, be willing to work toward the kind of retirement you want.

2. Seek, receive and act on the Spirit's guidance. This includes seeking diligently through study and prayer, living worthy of the Spirit's guidance, and then acting on it once it is received.

3. Understand the Retirement-Planning Vehicles Available to You. The government offers a number of retirement vehicles that have specific tax advantages to help you as you save for retirement. Understand them carefully and utilize them to your best advantage.

Understand the government retirement plan, which is Social Security. Social Security promises specific retirement benefits. It is up to you to understand what you are entitled to and the steps you must take to receive those benefits.

Understand the numerous employer-qualified retirement plans, including 401(k), Roth 401(k), 403(b), Roth 403(b), or 457 retirement plans for the employee. Understand these plans and use them to your best interest.

Understand individual and small-business retirement accounts. These include traditional IRAs, Roth IRAs, Keoghs, and SEPs and SIMPLEs for the self-employed.

Finally, once you understand these vehicles, use the highest priority money first, which will help you achieve your financial goals the fastest.

4. Choose Financial Assets Wisely. To help you reach your goals, choose the financial assets that will earn the highest after-tax returns. Follow the principles of successful investing discussed earlier and invest wisely.

5. Follow the Retirement Planning Steps. Follow the steps to successful retirement planning, which will be discussed next. Plan your retirement and live your plan.

6. Develop a Good Retirement Plan and Follow It Closely. Develop a good retirement plan and write it down. Follow it closely, and include ways to check your progress toward your goals. Check yourself regularly to make sure you are on track to meet your goals. Monitor your performance, and re-balance and re-evaluate as needed.

7. Start Now. The longer you wait to start, the more money you will need to invest for retirement. Start investing early so your money will be earning money to help you reach your retirement goals.

Finding Balance

As you work on creating your Retirement Plan, finding balance among doctrines, principles and application is important. We have shared some ideas for principles, and below are a few ideas for doctrines on which the principles are based. As you strive to increase your ability and effectiveness in preparing for retirement, I recommend you study and ponder the doctrines and principles supporting this.

Principles	Doctrines
Know yourself, your vision, goals and plans	Identity
Seek, receive and act on the Spirit's guidance	Obedience
Understand retirement vehicles	Stewardship
Choose assets wisely	Accountability
Know the steps for retirement planning	Agency
Develop and follow your plan	Agency
Start today	Stewardship

From Obedience to Consecration

From the principles and doctrines, we can see that we are not just preparing for retirement, which is an application. From a higher perspective, or with increased vision,

> We are children of God (identity), living worthy of the Spirit (obedience), learning about key areas, steps and strategies of retirement (stewardship) so we can make wise decisions

about our future (agency) which will allow us to save and invest appropriately (accountability) to accomplish our personal and family vision and goals.

Understand the Steps, Stages and Payout Options at Retirement

There are a number of factors that determine how much you will need to save for retirement, including your anticipated retirement age, your desired retirement income (be realistic), your other sources of retirement income (for example, Social Security, investment accounts, real estate, your home), and your tax rate before and during retirement. Other factors include the expected rate of inflation both before and during retirement and the expected return on your retirement savings accounts both before and during retirement. Each of these factors will help you decide how much you must save in order to have sufficient financial resources during retirement. There are seven steps to successful retirement planning:

1. Catch your vision and set retirement goals and estimate how much money you will need at retirement.
2. Estimate how much income you will receive annually during retirement based on your current investments.
3. Estimate your total retirement needs after accounting for inflation.
4. Determine how much you have already saved for retirement.
5. Estimate the value of your home.
6. Determine how much money you still need to save at an expected rate of return to meet your total retirement needs.
7. Determine your optimal investment vehicles and begin saving.

Each of these steps is described in detail below. This process of successful retirement planning mirrors Retirement Planning Needs Spreadsheet (LT06) in the Learning Tools section of the website.

Before you begin the retirement process, you must make five critical estimates.

1. Estimate how many years you have left until you want to retire. While many people retire at age 65, others retire earlier or later. A possible key to successful retirement planning is to achieve your personal financial goals so you can retire with no change in lifestyle.

2. Estimate how long you will be in retirement. Although it is challenging to estimate how long you will live, take the challenge seriously. This estimate has a major bearing on how much money you will need for retirement. You may be able to call your life insurance broker and ask him or her what the actuarial tables predict your lifespan will be.

3. Estimate the average rate of return you will receive on your investment portfolio before retirement and the rate of return you will receive on your investment portfolio

during retirement. Be conservative in making these estimates. As you enter retirement, you will most likely reduce the amount of risk in your portfolio, phasing out higher-risk, higher-return financial assets for lower-risk, lower-return financial assets. These estimates should come from Section 1 of your Investment Plan developed in the investments chapters. I strongly recommend you use conservative estimates (which are generally significantly less than 8 percent).

4. Estimate what the rate of inflation will be both before you retire and while you are in retirement. Inflation will have a major impact on the amount you will need to save for your retirement needs, especially if you have many years left until you retire. See Expected Return Simulation and Benchmarks (LT27) for 1-, 5-, 10-, 25-, 50-, 75-, and 85-year inflation data.

5. Estimate the average tax rate you will likely pay during retirement. While some retirement assets are tax-eliminated (you pay taxes on the asset before you invest) and you eliminate all future taxes on earnings and principal, most individuals have a large percentage of their assets in tax-deferred accounts; these individuals must pay taxes on the funds when they are withdrawn for retirement. When making this estimate, assume that most of your retirement assets are tax-deferred assets rather than tax-eliminated assets.

Step 1: Catch Your Vision and Set Retirement Goals for What you Want

The most important question you must ask yourself is how you want to live when you retire. Will you need more or less money than you are earning now? Be realistic in answering this question. Examine your own situation, estimate how much retirement income you will need, and then work toward achieving that goal.

To make your estimation, start with the amount of money you currently earn on an after-tax basis. Then multiply this amount by the percentage of your income you expect to need for basic living expenses annually during retirement; these are your mandatory costs in retirement and include housing, food, health-care, transportation, etc. This amount is usually between 70 and 90 percent of your current income. Some of your retirement goals may require you to save an annual amount in addition to this base amount—these goals may include visiting your grandchildren, going on vacations, and so on. Add this additional amount to your base amount to estimate your after-tax annual living expense.

Next, use the estimation of what your tax rate will be during retirement to calculate your before-tax annual living expense. For most of the funds in your retirement accounts, you will need to pay taxes when you make withdrawals. Estimate conservatively. To calculate the amount you will need for your before-tax annual living expenses during retirement, divide your annual living expense estimate by the result of one minus your estimated tax rate. This calculation will give you an estimate of your before-tax annual living expense in today's dollars. From the Tax Planning section of your Personal Financial Plan, you know your current average tax rate. This is

a good starting point for estimating your tax rate in the future.

Finally, adjust this before-tax estimation to account for inflation both before retirement and during retirement. Using a financial calculator, solve for the amount you will need to save after inflation has been accounted for. Set the present value equal to the amount of before-tax annual income you will need during retirement, set N equal to the number of years before you retire, and set I equal to the estimated inflation rate. Then solve for the future value; the result will be the amount of money (in future dollars) you will need in the first year of retirement.

Step 2: Estimate Your Current Annual Income Available at Retirement

Once you know how much money you will need for retirement, you should decide which sources of retirement income are already available to you. Start with government resources (in most cases, Social Security). The amount of your Social Security benefit is determined mainly by two factors: (1) your average salary during the years you work and (2) when you begin receiving benefits. Most individuals become eligible to receive Social Security at age 67; however, if you defer receiving benefits until age 70, the amount of your monthly benefit will increase. Estimate how much money you will receive from Social Security each month and multiply that amount by 12. I recommend that you go to www.socialsecurity.gov and request information regarding your Social Security benefits.

Next, work with your company's benefits coordinator to determine how much you can expect to receive from any defined-benefit pension plans, which will be covered later. Estimate a payout amount based on your current age and earnings. Be conservative in this estimate.

Finally, using a financial calculator or spreadsheet program, solve for how much your retirement assets will be worth at retirement. This estimate will likely be different from your estimate of growth on your personal investments because you do not have control over your retirement assets. Set your present value equal to the current value of these assets, set N equal to the number of years before you retire, and set the interest rate equal to the estimated growth rate of these assets. Then solve for the future value. This calculation will reveal the amount of retirement money (in future dollars) that is available to you from your retirement assets.

Step 3: Estimate Your Total Retirement Needs after Inflation

Next, determine the inflation-adjusted shortfall, or how much additional money you will need for retirement after the effects of inflation have been accounted for. To calculate the annual inflation-adjusted shortfall, subtract the amount you expect to receive from Social Security, qualified retirement plans, individual retirement plans, and small-business retirement plans from the total annual amount you will need for retirement. Once you know your inflation-adjusted shortfall, the next step is to figure out how much money you will need to fund that shortfall each year.

You are now ready to calculate the total amount you will need to have invested by retirement in

order to receive your desired annual payment.

Use a financial calculator or spreadsheet to solve this problem. Set your payment (PMT) equal to your desired annual payment, set N equal to the number of years you will be in retirement, and set the interest rate equal to your real return rate. Then solve for the present value. The result of this equation will be the amount of money (in today's dollars) you will need to have invested by the time you retire in order to receive your needed annual payments. Once you retire, you will either live off the returns generated by your investments or use the money you have invested to purchase an annuity from a financial institution to receive your needed monthly amount.

Step 4: Determine How Much You Have Already Saved on a before-tax Basis

Now that you know how much money you will need to fund your retirement, you must determine how much you have already saved for this purpose. First, list the current value of all of your retirement accounts and taxable accounts. This list should include the value of 401(k) plans, IRAs, Keogh plans, and any other savings and retirement vehicles you own. Your next challenge is to determine how much these assets will be worth when you retire, assuming you do not make any withdrawals from these accounts.

Using your estimate of the number of years until you retire, your estimate of the average rate of return you will receive on your investment portfolio before you retire, and your estimate of the rate of inflation before you retire, calculate the real return on your investments. Now, solve for the future value of your investments using a financial calculator. Set the present value equal to the current value of your investments, set N equal to the number of years until you retire, and set the interest rate equal to your real rate of return. Then solve for the future value; the result will be an estimation of the future value of your current investments.

Step 5: Estimate the Contribution or Reduction to your Retirement Plans from Your Home

Your home may or may not be an important part of your retirement plan. In this step, you must decide whether your home will be an expense or an asset during retirement. If your home is not paid off when you retire, you will still need funds to pay the mortgage, and you will need an increased amount of income to pay off your loan. If your home is paid off, and it is larger than your needs require when your kids are gone, you may want to sell your home and downsize when you retire.

There are two ways you can sell your home. You can simply sell your home for cash (usually to another family), or you can sell your home through a reverse mortgage. With a reverse mortgage, the buyer (usually a bank or investor) pays for the home, and you, the owner, can stay in the home until your death.

If you want your home to be a part of your retirement plan, begin by determining the current value of the home. Current appraisals are good starting points. Next, estimate how much your home's value will increase by the time you retire. Again, be conservative in making your

forecast. For example, I usually forecast housing growth rates at below forecasted inflation rates. Finally, determine how much you will owe on the home when you retire. Many people have a goal to have their mortgages paid off before retirement. However, if you expect to still have a mortgage when you retire, allow for mortgage payments when calculating your retirement expenses. Some people plan to buy another home after they retire; this is an additional expense to consider.

To calculate how much money your home will contribute to your retirement plan, subtract the amount you still owe on your mortgage as well as the cost of a new home from the estimated value of your home at retirement.

Step 6: Determine How Much You Still Need to Save at an Expected Rate of Return to Meet Your Total Retirement Needs

This step brings all the calculations together. Begin with the total investment needed (see Step 3). Subtract the future value of your current investments (see Step 4) from the total investment needed. Then subtract the amount your home will contribute to your retirement plan (see Step 5). This will give you the final amount (in future dollars) you must invest, or the total investment shortfall.

Since you have already accounted for the impact of inflation both before retirement and during retirement, you can use a financial calculator to find out how much you will need to save each month. Set the future value equal to the total investment shortfall, set N equal to the number of years until you retire, and set the interest rate equal to the amount of your expected portfolio return before you retire. Then solve for the payment (PMT). This calculation will give you the amount of money you must save every month or year to achieve your retirement goals.

Step 7: Determine Your Preferred Investment Vehicles and Begin Saving Today

Finally, using the priorities of money and the investment hourglass, determine which investment vehicles and financial assets will help you achieve your retirement goals most efficiently. Then begin saving!

Stages and Strategies of Retirement Planning

There are three general stages in retirement planning: accumulation, retirement/annuitization, and distribution. It is important to develop goals and plans in each of these areas as you prepare for retirement.

Stage 1: Accumulation: This is your plan for how you will save money for your retirement before you retire. An example of accumulation might include saving 20 percent of every dollar you make after college. Of that 20 percent, 10 percent will go into your company 401(k) for retirement, 3 percent into a taxable account for missions, 2 percent into education funds for your children's education, and 5 percent into a taxable savings account to pay off your home early or

for other long-term family goals. Another strategy might be to convert funds from tax-deferred accounts into Roth accounts with minimum tax impact if doing so makes financial sense.

Accumulation strategies could include:

- Live on a budget and save 20%, always get the company match
- Save 20% of every dollar, 15% into your Roth 401k, 3% for other goals, and 2% for children's mission and education
- Save 15% of every dollar, with 10% into the Roth IRA for both you and your spouse, 3% for education and 2% mission
- Invest in Roth accounts while young and when rates are low. Use these to target your tax rate in retirement (to a low level)
- Even though you don't know tax rates, maximize investments in Roth vehicles as you are actually saving more for retirement
- Plan to have your house paid off before retirement. Do not go into retirement with a house payment
- Plan, if desired, to not take social security until 3 years past full retirement age to maximize benefits
- Have your house paid off, and live like a retiree before you retire.

Stage 2: Retirement/Annuitization: This is your plan for how your assets will be distributed at retirement (i.e., immediate annuity versus lump sum distribution that you invest) so you will have sufficient assets for your lifetime. An example might include the expectation of receiving $25,000 each year between Social Security and a defined benefit plan and the realization that you will need $40,000 each year to meet your minimum acceptable level of retirement income. When you retire, you will plan to purchase an immediate annuity to provide that $15,000 each year to bring you up to that minimum acceptable level of retirement income.

Retirement strategies might include:

- Calculate a minimum level of retirement income, and annuitize that amount (if you have sufficient assets). The process is:
    - Calculate your amounts from Social Security and any defined benefit plan(s)
    - Determine your minimum amount needed to live comfortably, and
    - Take a percentage of your assets at retirement (if sufficient) to purchase an immediate annuity to give you the minimum amount needed (b-a) to receive your minimum acceptable level of income
- If you can, retire at 3 years beyond Full Retirement Age to get the maximum you can from Social Security
- Have your house and all debts paid off before you retire
- Have both Roth and traditional retirement assets so you can target your tax rates in retirement

Stage 3: Distribution/Disposition/Decumulation: This is your plan for how best to take distributions from your remaining retirement and taxable accounts to minimize taxes and maximize the availability of your assets after you retire. An example might include taking a maximum distribution of 3.6 percent of your total retirement assets based on the asset value as of the previous December, or to only take out earnings from investments for the previous year.

Distribution strategies might include:

- Set up a framework where you will not outlive your assets. Recommendations include:
- Take out a max distribution of 3.6% of assets each year
- Take out earnings from investments of previous year
- Have taxable (tax now), Roth (rarely taxed) and traditional (taxes later) vehicles to target your tax rate in retirement
- Set a target tax rate, then pull traditional assets up to that specific amount, then Roth assets afterwards to reduce taxes
- Make sure to pay your Required Minimum Distributions
- During your later years which your income is less, i.e., during missions, transfer money from your tax-deferred to tax-eliminated accounts
- Use this time to move assets into Roth accounts with as little tax consequences as possible

Realize that these are general but important stages to think about in retirement planning. It is important to develop plans and strategies for each of these areas.

Payout Options Available at Retirement

Before deciding on the manner in which you want to receive your retirement payouts, make sure you understand the tax consequences of your decision. Look at all of your investment payouts and retirement payouts together. Consider the pros and cons of an annuity versus a lump-sum payout. Plan your payouts to minimize your taxes.

Types of Retirement Payouts

There are several types of retirement payouts available to you when you retire. A single life annuity provides equal payments for as long as you live.

A life annuity with certain period provides payments as long as you live; however, with this option, when you die, your heirs receive payments until the end of the specified or guaranteed period.

A joint and survivor annuity means that payments will continue as long as you or your spouse is alive. In some cases, the benefits may be reduced when you die, so review your options carefully.

A lump-sum payout is a single payment of all principal and accumulated interest that is paid to you when you retire.

Deciding how you want to receive your payout is critical, and once the decision is made it usually cannot be changed. Do not make the decision until you have done as much research as possible. When making this decision, you should account for your goals, budget, family situation, and current health.

Tax Treatment of Payouts

Different types of payouts are taxed differently. Annuity payments are taxed as normal income—annuity payments are the most expensive payout option. A lump-sum payout is normally taxed as ordinary income; however, the payout is taxed as if you had received the money over a 10-year span, which reduces taxes slightly. You are still liable for all taxes on a lump-sum payout immediately. One advantage of a lump-sum payout is that it can be rolled over into a traditional IRA if you want to avoid immediate taxes and continue tax-deferred growth. You can then pull the money out of the IRA as needed and pay taxes on these withdrawals. It is important that you understand the tax implications of whatever payout choice you make.

Understand One Method of Monitoring Your Retirement-Planning Progress

Retirement planning is not easy, but it is an important and worthwhile objective. There are a few key points you should remember when planning for retirement. First, remember to plan for inflation. Changes in inflation can have a drastic effect on the amount of money you need to save for retirement. Watch inflation carefully and plan accordingly.

Second, recognize that once you retire, you may still live for a long time. Plan accordingly, and be prudent in your estimation of how long you will live after you retire.

Third, do not neglect your insurance coverage. Health-care costs can quickly reduce a good retirement plan to nothing if you do not have sufficient insurance.

Fourth, monitor the progress you are making toward your goals, and make changes to your plans and goals as necessary. Review and evaluate performance annually.

Monitoring Progress

Evaluating how well you are doing in preparing for retirement is a major challenge. One method of monitoring your progress is to review your progress every year using Retirement Planning Needs Spreadsheet (LT06)**.** This method is useful, but keep in mind that it does not account for large-ticket expenses, such as a home, nor does it allow you to see where you should be in the retirement-planning process based on your age. In addition to these disadvantages, this Learning Tool does not allow you to see the impact changes in interest rates can have on your available savings at retirement.

An article by Jonathan Clements entitled "Ugly Math: How Soaring Housing Costs Are Jeopardizing Retirement Savings"[2] proposes an interesting idea. Using guidelines put together by Charles Farrell, Clements proposes that individuals and families can determine how close they are to achieving their retirement goals by looking at three specific factors: (1) the amount saved in their taxable and retirement vehicles, (2) the amount of their overall debt, and (3) the amount of their annual earnings. By looking at the ratios of year-end savings-to-annual income and year-end debt-to-annual income, you can see whether or not you are on track to achieve your retirement goals based on a table shown in Clements's article (see Table 1).

These guidelines are a reality check in today's spending frenzy because they show the relationship between savings and debt—you must manage both variables, not just one. The article also encourages you to reduce debt while at the same time increasing savings. Clements' article has three main assumptions:

1. Investors will earn 5 percent more than inflation. While I think this assumption is reasonable, 5 percent might be on the high side for older investors who are primarily invested in fixed-income assets.

2. Investors ages 30 to 65 will save about 12 percent of their pre-tax income every year. Currently, the average individual in the United States is saving significantly less than this amount—between 0 and 8 percent (some are even negative). Individuals need to increase the amount they save.

3. Investors will withdraw 5 percent of their portfolio's value each year in retirement. This is probably an acceptable assumption.

While these assumptions are fairly reasonable, the targets proposed in Table 1 are likely too soft. Both Clements and Farrell state that these targets should probably be made more stringent. Overall, this is a great article and a good resource to help you understand where you are and where you want to be in terms of retirement planning.

Table 1. Key Ratios

Age	Savings-to-Income	Debt-to-Income
30	0.1	1.70
35	0.9	1.50
40	1.8	1.25
45	3.0	1.00
50	4.5	0.75
55	6.5	0.50
60	8.9	0.20
65	12.0	0.00

Are there tools that can help you figure out where you are now and where you want to be as you work toward retirement? One suggestion is). In this spreadsheet, I took the framework proposed by Jonathan Clements and Charles Farrell and developed a chart to help you plan and chart your progress. This chart Retirement Planning Ratio Forecasts (LT25) assumes basic information that can be changed depending on your current situation and age. It can help reveal weaknesses in your current plan and help you monitor your progress. The major disadvantage of this spreadsheet is that it assumes earnings and other factors increase each year at a specific rate, and it is only as accurate as the respective inputs. I make five assumptions in this spreadsheet:

1. Housing payments are expenses, and investors can handle housing payments in amounts up to the "back-end ratio" used by many banks: 36 percent of gross salary. Inputs include not only the interest rate and the number of years left on the loan but also annual property costs and insurance costs. If your housing costs are greater than 36 percent, you will get an error message telling you to reduce the cost of the mortgage.

2. Additional payments for housing expenses, such as pre-payments, come out of money earmarked for savings. If you decide to pre-pay your housing loan, the money you have put in savings is diverted to pay off your mortgage. There is a relationship between mortgage payments and savings. The more you pay in mortgage payments, the less you will be able save for your other goals.

3. Individual inputs are consistent and achievable. Any program is only as good as an individual's forecasts. I encourage you to be conservative with your forecasts.

4. Tax savings on interest payments are considered part of expenses. While this spreadsheet accounts for tax rates in retirement, it does not account for a tax shield on interest payments before retirement.

5. The amount of retirement savings desired is a multiple of income. I have included an input for your estimated market interest rate at retirement. You may decide to use your savings to purchase an annuity when you retire. This spreadsheet will estimate the amount of the annual payment you will receive during retirement based on that estimated market rate.

If used correctly, this spreadsheet can help you represent your current situation.

Example

Suppose you are 26 years old and have an annual income of $50,000. You expect to retire at age 65, and you forecast market interest rates to be 4 percent at that time. You estimate you will be in retirement for 30 years, you will save 5 percent of your salary every year until retirement, you will earn 8 percent on your investments, and inflation will be 3 percent each year. You do not anticipate any real growth in income. You estimate that you will buy a home in 4 years, and you will pay $270,000 for the home with a $20,000 down payment. You will finance $250,000 of the home at 7 percent for 30 years, and you will pay $250 per month in property taxes and insurance.

You will pay off the home in 30 years, and the home's value will grow at 3 percent, consistent with inflation.

Age at beginning of employment	26
Starting income	$50,000
Average annual increase in income	3.0%
Age at retirement	65
Estimated market rates at retirement	4%
Years in retirement	30
Annual percent of salary saved	10.0%
Return on investment	8.0%
Assumed inflation rate	3.0%
Age when you will purchase a home	30
Cost of the home	$270,000
Down payment	$20,000
Mortgage amount	$250,000
Taxes and insurance ($250 per month)	$3,000
Mortgage interest rate	7.0%
Mortgage term	30
Years to pay off loan	30
Assumed growth in home prices	3.0%

Based on the above information, the Learning Tool gives the following information: the first column shows your age, the second and third columns show the savings and debt ratios (.59 = 59 percent) recommended by this Learning Tool, and columns four and five show the savings and debt ratios recommended by the *Wall Street Journal* article.

	Estimated Savings and Debt-to-Income Ratios		**Article-Recommended Ratios**	
Age	Savings-to-income	Debt-to-income	Savings-to-income	Debt-to-income
30	0.59		0.10	1.70
35	1.34	3.79	0.90	1.50
40	2.29	3.06	1.80	1.25
45	3.50	2.37	3.00	1.00
50	5.03	1.73	4.50	0.75
55	6.97	1.11	6.50	0.50
60	9.43	0.50	8.90	0.20
65	12.54		12.00	

	Retirement	Annuity Payment	5% Payout
Total savings	$1,985,902	$114,845	$99,295
Savings to income / % of salary	12.5%	73%	63%
Total inflation adjusted savings	$959,082	$37,005	$47,954
Savings to income / % of salary	6.06%	76%	99%

The benefit of this spreadsheet is that it gives you an idea of where you are in your retirement-planning process. If you had input the information in the previous chart and noticed that the 5 percent payout was only 64 percent of your desired annual income stream, you might have decided you needed a higher percentage. By changing the amount saved, you can see how increasing your savings will lead to an increase in the annual amount available for retirement. For example, by increasing your savings from 10 percent to 15 percent, the 5 percent payout amount increases from 64 percent of your income at retirement to 94 percent of your income at retirement. If you want to receive a payout of 100 percent of income, you can adjust the savings percentage to give you 100 percent of salary at retirement by increasing your savings percentage to 16 percent.

Monitoring your progress toward retirement is an important but challenging responsibility. Nevertheless, this responsibility must be assumed if you are to achieve your financial goals and retire in a manner you desire.

Understand and Create Your Retirement Plan

It is not easy to come up with a retirement vision. It is very difficult because we all have different visions, goals, and plans. While it is difficult to develop, it is something that we should think about to give us motivation to prepare for retirement. Following are a few ideas that may be helpful.

Vision

- From your Plan for Life. It may also include:
    - As children of God, our time on earth is limited. As such, retirement will be a good time for my wife and I to give back.
        - We will serve 5 missions, the first at age 65.
        - We will visit the grandkids every year and will serve where needed.
    - We will likely stay where we are, and eventually downsizing our home (no new debt).
    - With our goal to save, we will have a sufficient retirement portfolio to meet our needs for the rest of our lives and will not be a burden on our children.
    - I will plan well so my spouse has sufficient to live on if I pass first.

Goals

- Upon retirement, we will take a portion of our taxable assets and purchase an immediate annuity, which with Social Security and our defined benefit plan will be sufficient to give us a minimum level of income each year.
- That portfolio will include Social Security, a defined benefit plan, and additional investment vehicles including traditional, Roth, and taxable accounts.
- I will take social Security at 3 years beyond full retirement age, and my spouse at full retirement age.

- Our defined benefit payments will be for joint and survivor 75%, so that when I die my spouse will still have sufficient.
- Our home is paid for and we will have no debt as we will pay cash for all vehicles and keep them 10 years.
- Our retirement portfolios will be 40% tax-deferred, 30% Roth, and 30% in taxable accounts to allow us to target our tax rates in retirement.

Plans and Strategies:
Accumulation Stage: Age 23-65

- We will continue to live on a budget and save and invest 20% of all earnings, with 15% going into retirement consistent with our risk tolerance and according to our Investment Plan.
- We will invest in Roth accounts when we are young and tax rates are low.
- We will try to maximize investments in Roth accounts as we are saving more for retirement (we are paying the taxes outside the retirement vehicles)
- 2% will go into our children's education and mission accounts consistent with our Mission and Education Plans.
- The final 3% we will use to pay down the mortgage on our home with a goal is to have it paid off by the time I turn 45.
- We will pay all tithes and offerings and rebalance our investment portfolio to asset allocation targets with appreciated securities.
- We plan to have our house paid off before retirement. We will not go into retirement with debt.

Retirement Stage Age 65 – 70.

- We will strive to live like a retiree before we retire, so we have fewer fixed expenses
- Upon retirement, we will take a portion of our assets and purchase an immediate annuity, which with Social Security and defined benefit payments, be sufficient to give our minimum required level of retirement income each year.
- I will take Social Security at 3 years beyond Full Retirement Age (FRA), and my spouse at FRA.
- We will strive to save 5% during this period, although overall resources will be diminished due to helping to pay for our children's education and missions.
- We will go on our first mission at age 65, and will use this as a time to convert traditional retirement accounts into Roth accounts.
- We will likely come back to teaching until age 70, then go on four other missions, subject to our health.
- We will not have mortgage debt when we retire so we have fewer fixed assets
- We will have a balance among taxable, tax-deferred and tax-eliminated accounts to target our taxes during retirement.

Distribution Stage: Age 70 - 97

- I will take social Security at 3 years beyond full retirement age, and my wife at full retirement age.
- Our work defined benefit payments will start at age 70, and will be for joint and survivor 75%.
- Our home is paid for and we will have no debt as we will pay cash for all vehicles and keep them a minimum of 10 years.
- We will continue to pay tithes and offerings with appreciated securities and will enjoy life to the fullest.
- We will set up a framework to not outlive our assets. We will take a maximum of 3.6% of our total assets each year for retirement
- We will use our tax-deferred accounts and pay our tithes and offerings with appreciated securities, which will also account for our Required Minimum Distributions (RMDs)

Constraints

- The following are the key risks to our retirement plans:
  - Budget. We will continue to live on a budget and save for our individual and family vision and goals
  - Saving. We will continue to save 20% of gross income per year, with 15% going into retirement vehicles
  - Health. We will always have sufficient health coverage, through both government and private coverage
  - Sin. We will guard against loss of the Spirit, testimony and eternal lives. We will continue serving in the church, reading our scriptures, attending the temple each week, spending time with our extended family and friends, and doing our home and visiting teaching, all to help us become more like the Savior

Accountability

- We will share our vision with these partners:
  - Heavenly Father. We will share with Heavenly Father our plans daily and weekly in our weekly companionship stewardship prayer
  - Spouse. We have worked together to put our vision, goals, and plans together and have completed our spiritual creation. Our goal is now the physical creations, to see this retirement plan come to pass
  - Children. We will let our children know our retirement plans. We will help them with missions and education as planned. They know we will not sacrifice our retirement to help our children financially. They will know that our first priority is to my spouse and then children

Summary

You have the responsibility to take care of yourself and your family. No one will assume that responsibility for you. Building an adequate retirement fund will ensure that you will be able to

fulfill this responsibility even after you stop working. By planning for the future, you will ensure a better future.

Before you plan for retirement, you should know your budget, your personal goals, and your needs. You must also ask yourself two questions: What kind of retirement are you planning for? How much money will you need each year?

You should be aware of which investment vehicles are available to you; they may include Social Security, employer-sponsored plans, small-business plans, and individual plans. Once you know which investment vehicles are available to you, you must decide which financial assets should be included in these investment vehicles to most effectively help you achieve your goals. As you make your retirement plan, select the investment vehicles and financial assets that will give you the highest after-tax returns and therefore allow you to reach your personal and retirement goals.

There are seven steps of successful retirement planning:

1. Set retirement goals and estimate how much money you will need at retirement.
2. Estimate how much income you will have annually at retirement based on your current investments.
3. Estimate your total retirement needs after accounting for inflation.
4. Determine how much you have already saved for retirement.
5. Estimate the value of your home.
6. Determine how much money you still need to save at an expected rate of return to meet your total retirement needs.
7. Determine your optimal investment vehicles and begin saving.

Before deciding on the manner in which you want to receive your retirement payouts, make sure you understand the tax consequences of your decision. Look at all of your investment payouts and retirement payouts together. Consider the pros and cons of an annuity versus a lump-sum payout. Plan your payouts to minimize your taxes.

Retirement planning is not easy, but it is an important and worthwhile objective. Finally, we gave an examples of a Retirement Plan.

Assignments

Financial Plan Assignments

One of the most challenging aspects of retirement planning is deciding what kind of retirement you would like. This is where your vision of your retirement comes in. What would you like your retirement to be? What are you spending this year for basic needs? How much money will you need each year in retirement to maintain your lifestyle? Is this amount more or less than what you are currently spending? These are not easy questions, but they are important questions.

Your assignment is to make a first pass at answering these questions. Using Retirement Planning Needs Spreadsheet (LT06), determine how much you must save each month to achieve your specific lifestyle at retirement based on your estimates of years until retirement, expected return, inflation, and tax rates.

To see the impact of inflation on the amount you must save, increase your forecast for inflation by just one percent both before and during retirement and see how much this affects the amount you must save each month. Likewise, decrease your forecast for inflation by one percent both before and during retirement and see how much this affects the amount you must save each month.

Learning Tools

The following Learning Tools may be helpful for this chapter:

Retirement Planning Needs Spreadsheet (LT06)
This Excel spreadsheet helps you determine how much you must save each month to achieve a specific lifestyle at retirement based on your estimates of years until retirement, expected return, inflation, and tax rates.

Retirement Planning Ratio Forecasts (LT25)
This spreadsheet is an Excel template that will help you determine where you are in your progress toward achieving your retirement goals. By inputting the relevant information, you can estimate whether you are on track for reaching your retirement goals, based on your age and income.

Expected Return Simulation and Benchmarks (LT27)
This spreadsheet helps you see the impact of various investment strategies as well as the volatility of different asset classes including inflation. It also shows you the historical impact of different asset-allocation decisions.

Review Materials

Terminology Review

Accumulation Stage (of retirement). This first stage of retirement begins when you first begin to work and is the time where you accumulate assets which you will later use for retirement needs.
Accumulation strategies. These are possible strategies to use while you are in the accumulation stage of retirement.
Annuities. These are financial products developed and sold by insurance companies designed to accept and grow funds, and then, upon annuitization, pay out a stream of payments for a specified length of time.
Annuitization. The process of determining what percent of retirement assets should be annuitized to ensure sufficient funds for the recipients life.
Annuity types. These are the different types of annuities.

- Deferred. Payments are deferred until the specified time the investor elects to begin receiving the payments.
- Fixed. Payments are a fixed amount, and are made to the investor until the end of the contract, usually till the investor dies.
- Immediate. Payments begin immediately upon receiving the funds.
- Life. Payments are fixed and are made each period until the end of the investor's life.
- Period Certain. Payments are made for a specific period, regardless of the investor's life span
- Variable. Payments are variable based on a specific asset's performance as specified in the contract. Variable payments are made to the investor until the end of the contract.

Distribution Options. This is the decision as to how a distribution or payout is to be received. Make sure you understand the tax consequences of any payout or distribution option chosen.
Distribution/disposition/decumulation Stage (of retirement). This stage begins after you have retired. This is your plan as to how best take distributions from your remaining retirement and taxable accounts to minimize taxes and maximize the availability of your assets.
Distribution/disposition/decumulation strategies. These strategies help you set up a framework where you will not outlive your assets.
Retirement/Annuitization Stage (of retirement). This stage begins when you retire. It is your plan on how your assets will be distributed at retirement. Your goal should be to have sufficient assets for your lifetime to enable you and your spouse to live like you want in retirement.
Retirement/Annuitization strategies. These are strategies to use while you are in the retirement stage.
Retirement vehicles. These are a specific type of investment vehicles which are related to retirement. These include qualified retirement plans such as both traditional and Roth 401k, 403b, and 457 plans; Individual retirement plans such as Roth and traditional IRAs; and small business plans such as SEPs, Simple, and Keogh plans.
Shortfall. This is the difference between what you have now saved for retirement and what you think you need for retirement.
Retirement Payout Options. These are the types of annuity distribution payouts available at retirement. Investors and spouses jointly determine the types of payments at retirement.

- Joint and Survivor. You receive payments for as long as both you and your spouse live. Benefits may be reduced for your spouse when you die, depending on the contract specifics.
- Life with "certain period". You receive payments for as long as you live; however, if you die before the certain period, payments continue until the end of the certain period.
- Lump-sum. You receive a single payment of all principal and interest at retirement that you are responsible to manage.
- Single life. You receive payments for the rest of your life only—not including your spouse's life.

Shortfall. This is the difference between what you have and what you need for retirement.
Social Security. Social security is a government funded investment plan where individuals pay into the system for a specific number of years and then are promised benefits according to a specific formula set by the government.

Review Questions

1. Before you begin the retirement-planning process, what are the five critical estimates you must make?
2. What is the first of seven steps to retirement planning as mentioned in this chapter?
3. Why is it important to include inflation when calculating how much money you will need to save for retirement?
4. What are the two ways in which you can sell your home in retirement?
5. What is your investment shortfall?

Case Studies

Case Study 1

Data

Clint and Abby, both age 30, recently reviewed their future retirement income and expense projection. They hope to retire in 35 years at age 65. They determined they would have a retirement income of $15,000 each year in today's dollars before tax ($10,000 from Social Security and $5,000 from their savings), but they would actually need $60,000 before tax in retirement income to retire comfortably.

Calculations

How much must Clint and Abby save annually for 30 years of retirement if they wish to meet their income projection, assuming a 2 percent inflation rate both before and after retirement, a 7 percent return on investments before retirement and 6 percent during retirement?

Case Study 1 Answers

First, draw the diagram discussed earlier in the chapter.

1. Calculate the shortfall.
2. Inflation-adjust the shortfall.
3. Calculate the real return and the annuity.
4. Calculate the period payment.

Time	35 years	30 years
Now	Retirement	Death
	Return 7%	Return 6%
	Inflation 2%	Inflation 2%

1. Calculate the shortfall (all on a before-tax basis as stated):
   The shortfall is $60,000 – $15,000 = ?
   Clint and Abby's shortfall is $45,000 before-tax.
2. Calculate the inflation-adjusted shortfall (end mode):
   The adjustment is PV = $45,000, I = 2%, N = 35, FV = ?
   Clint and Abby need $89,995 each year (you can round to the closest dollar).
3. Calculate the real return and annuity in retirement:
   The real return is (1 + nominal return) / (1 + inflation) – 1, or (1.06)/(1.02) – 1= ?
   The real return is 3.92%.

To calculate an annuity (remember you will want the payments at the beginning of the period, use the begin mode on your calculator)
To get an annuity of $89,995 for 30 years at a 3.92% return, set PMT = $89,995, N = 30, I = 3.92%, and solve for PV.
Clint and Abby need $1,632,737 to be available in 35 years to give them the annuity for 30 years.

4. Calculate the period payment (use end mode):
To get this future amount, set the FV = $1,632,737, N = 35, I = 7%, and calculate the PMT = ?
Clint and Abby need to save $11,811 each year ($907 per month) to meet their retirement goal.

From Retirement Needs Worksheet (LT06)

Determining Your Retirement Needs Worksheet (LT06)
Before Tax Analysis
Personal Finance: Another Perspective

Directions: Fill the green cells with your data. Be careful not to modify the blue cells. Percentages must be converted to decimal form. Be careful with before- and after-tax amounts.

Key Data:

Amount Needed and Expected Annually	
a. Desired before-tax Amount of Money Needed at Retirement	60,000
b. Before-tax Money expected at retirement (SS, DBP, earnings)	15,000
Before Retirement	
c. Number of Years Till Retirement that Investments Will Grow	35
d. Estimated Average Growth Rate of Investments Until Retirement	7.0%
e. Estimated Average Annual Rate of Inflation Until Retirement	2.0%
Retirement	
f. Number of Years In Retirement	30
g. Estimate Growth Rate of Investments During Retirement	6.0%
h. Estimated Annual Rate of Inflation During Retirement	2.0%
i. Estimated tax rate in retirement	20.0%

Step 1: Calculate Your Shortfall

A. Desired before-tax Amount of Money Needed at Retirement	60,000
B. Before-tax money expected at retirement (includes Social Security, D	15,000
C. Calculate your Shortfall in today's dollars	45,000

Step 2: Inflation Adjust Your Shortfall

A. Number of Years Till Retirement	35
B. Inflation Rate until retirement	2.00%
C. The Inflation Adjusted shortfall?	89,995

The calculation is PV = $45,000 I = 2.00%, N = 35, Solve for FV

Step 3: Calculate Your Real Return and Annuity

A. Nominal return during retirement	6.0%
B. Inflation during retirement	2.00%
C. Real return [(1 + nominal return)/(1 + inflation)] - 1	3.92%
D. Amount needed each year in retirement	$89,995
E. Number of Years In Retirement	30
F. Annuity needed to provide this benefit?	$ 1,632,737

The calculation is PMT = $89,995., I = 3.92%, N = 30 (begin mode), Solve for FV

Step 4: Calculate your Amount Needed to Save Each Month

A. Target amount needed at retirement	$ 1,632,737
B. Number of Years Until Retirement	35
C. Estimate Growth Rate of Investments Before Retirement	7.0%
D. Total Investment Amount needed each month in today's dollars	$907

The calculation is FV = $1,632,737, N = 35*12, I = 7.00%/12, Solve for PMT

E. Total Investment Amount needed annually in today's dollars	$11,811

The calculation is FV = $1,632,737, N = 35, I = 7.00%, Solve for PMT

Step 5. Start saving now!!!!!!!!

Case Study 2

Data

Kevin and Whitney, both age 35, recently reviewed their future retirement income and expense projection. They hope to retire in 25 years. They determined they would have a retirement income of $25,000 each year in today's dollars before tax ($10,000 from Social Security and $15,000 from their savings), but they would actually need $67,500 before tax in retirement income to retire comfortably.

Calculations

How much must Kevin and Whitney save annually for 30 years of retirement if they wish to meet their income projection, assuming a two percent inflation rate both before and after retirement, and an 6.5 percent return on investments before retirement and 5.5 percent during retirement?

Case Study 1 Answers

First, draw the diagram discussed earlier in the chapter.

1. Calculate the shortfall.
2. Inflation-adjust the shortfall.
3. Calculate the real return and the annuity.
4. Calculate the period payment.

Time	25 years	30 years
Now	Retirement	Death
	Return 6.5%	Return 5.5%
	Inflation 2%	Inflation 2%

1. Calculate the shortfall (all on a before-tax basis as stated):

   The shortfall is $67,500 – $25,000 = ?

   Kevin and Whitney's shortfall is $42,500 before-tax.

2. Calculate the inflation-adjusted shortfall (end mode):

   The adjustment is PV = $42,500, I = 2%, N = 25, FV = ?

   Kevin and Whitney need $69,726 each year (you can round to the closest dollar).

3. Calculate the real return and annuity:

   The real return is (1+nominal return) / (1 + inflation) – 1, or (1.055)/(1.02) – 1= ?

   The real return is 3.43%.

   To calculate an annuity (remember you will want the payments at the beginning of the period, use the begin mode on your calculator)

   To get an annuity of $69,726 for 30 years at a 3.43% return, set PMT = $69,726, N = 30, I = 3.43%, and solve for PV.

   Kevin and Whitney need $1,337,882 to be available in 25 years to give them the annuity for 30 years.

4. Calculate the period payment (use end mode):

   To get this future amount, set the FV = 1,337,882, N = 25, I = 6.5%, and calculate the PMT = ?

   Kevin and Whitney need to save $22,719 each year ($1,787 per month) to meet their retirement goal.

From Retirement Needs Worksheet (LT06)

Determining Your Retirement Needs Worksheet (LT06)
Before Tax Analysis
Personal Finance: Another Perspective

Directions: Fill the green cells with your data. Be careful not to modify the blue cells. Percentages must be converted to decimal form. Be careful with before- and after-tax amounts.

Key Data:

Amount Needed and Expected Annually

a. Desired before-tax Amount of Money Needed at Retirement	67,500
b. Before-tax Money expected at retirement (SS, DBP, earnings)	25,000

Before Retirement

c. Number of Years Till Retirement that Investments Will Grow	25
d. Estimated Average Growth Rate of Investments Until Retirement	6.5%
e. Estimated Average Annual Rate of Inflation Until Retirement	2.0%

Retirement

f. Number of Years In Retirement	30
g. Estimate Growth Rate of Investments During Retirement	5.5%
h. Estimated Annual Rate of Inflation During Retirement	2.0%
i. Estimated tax rate in retirement	20.0%

Step 1: Calculate Your Shortfall

A. Desired before-tax Amount of Money Needed at Retirement	67,500
B. Before-tax money expected at retirement (includes Social Security	25,000
C. Calculate your Shortfall in today's dollars	42,500

Step 2: Inflation Adjust Your Shortfall

A. Number of Years Till Retirement	25
B. Inflation Rate until retirement	2.00%
C. The Inflation Adjusted shortfall?	69,726

The calculation is PV = $42,500 I = 2.00%, N = 25, Solve for FV

Step 3: Calculate Your Real Return and Annuity

A. Nominal return during retirement	5.5%
B. Inflation during retirement	2.00%
C. Real return [(1 + nominal return)/(1 + inflation)] - 1	3.43%
D. Amount needed each year in retirement	$69,726
E. Number of Years In Retirement	30
F. Annuity needed to provide this benefit?	$ 1,337,882

The calculation is PMT = $69,726., I = 3.43%, N = 30 (begin mode), Solve for FV

Step 4: Calculate your Amount Needed to Save Each Month

A. Target amount needed at retirement	$ 1,337,882
B. Number of Years Until Retirement	25
C. Estimate Growth Rate of Investments Before Retirement	6.5%
D. Total Investment Amount needed each month in today's dollars	$1,787

The calculation is FV = $1,337,882, N = 25*12, I = 6.50%/12, Solve for PMT

E. Total Investment Amount needed annually in today's dollars	$22,719

The calculation is FV = $1,337,882, N = 25, I = 6.50%, Solve for PMT

Step 5. Start saving now!!!!!!!!

AGE	SAVINGS-TO-INCOME	DEBT-TO-INCOME
30	0.1	1.70
35	0.9	1.50
40	1.8	1.25
45	3.0	1.00
50	4.5	0.75
55	6.5	0.50
60	8.9	0.20
65	12.0	0.00

Source: Dorman Farrell LLC

Case Study 3

Data

Kevin and Whitney are now 45 years old and have six kids. They are 20 years into their retirement plan and are making $82,000 per year. They have $115,000 in savings, and their remaining balance on their home mortgage and credit card debt is $150,000. They have saved only five percent per year and have earned seven percent on their savings, which they felt was sufficient.

Calculations

A. Are they on track for retirement or not?

B. Calculate their income/debt ratios based on the information in the *Wall Street Journal* article (this chart is from Doman Farrell, LLC as quoted in: Jonathan Clements, "Ugly Math: How Soaring Housing Costs are Jeopardizing Retirement Savings," Wall Street Journal, 23 March 2005, p. D1.

Application

How are they doing, and what more should they be doing?

Case Study 3 Answers

Calculations

Are they on track? You can't tell until you calculate their ratios.

Current	Salary		Savings	Debt
Age 45	$82,000		$115,000	$150,000
Ratios	Current	Recommended		
Savings Ratio	1.40	($115/82)	> 3.0	
Debt Ratio	1.83	($150/82)	< 1.0	

They are way behind on their savings and debt goals for retirement. They need to increase their savings to a minimum of 20 percent.

Application

They have too little savings and too much debt.
They need to save an even bigger percentage of their salary (20 percent).
They need to work harder if retirement is really a goal.
They may need to sell assets to reduce debt.
They may need to downsize.

Retirement Planning Forecasts Ratio (LT25) may be a useful tool for different financial situations and goals.

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[1] "To the Elderly in the Church," *Ensign*, Nov. 1989, 4
[2] March 25, 2005 issue of the *Wall Street Journal*, D1

3. Retirement 2: Understanding Social Security

Introduction

For many of the 40 million Americans who are 65 and older, Social Security is the primary source of retirement income. Social Security is the first resource most Americans turn to when saving for retirement; however, most younger Americans, who will not face retirement for many years, might not have access to the benefits of the Social Security program, at least not in its present form. The Social Security Administration has given the following forecast:

> Social Security is a compact between generations. For decades, America has kept the promise of security for its workers and their families. Now, however, the Social Security System is facing serious financial problems, and action is needed soon to make sure the system will be sound when today's younger workers are ready for retirement.
>
> Without changes, by 2033 the Social Security Trust Fund will be able to pay only about 77 cents for each dollar of scheduled benefits. We need to resolve these issues soon to make sure Social Security continues to provide a foundation for future generations.[1]

It is important for you to understand Social Security, its history, its processes, and its current form. Likewise, it is important for you to understand the challenges related to Social Security. The purpose of this chapter is to help you understand these topics.

Social Security is not an investment. Social Security is a social insurance program that provides not only retirement income but survivors insurance for children and spouses, disability insurance for people who are unable to work, and Medicare insurance for the elderly.

You are eligible to receive Social Security benefits if you have paid money into the Social Security program through your employment. Most experts expect Social Security to replace only about 42 percent of your current average earnings; therefore, although Social Security may be the first resource you turn to for retirement income, it should definitely not be your only source of retirement income.

Objectives

When you have completed this chapter, you should be able to do the following:

A. Describe how the Social Security program works and the benefits of the Social Security program
B. Answer frequently asked questions about Social Security and the future of Social Security

C. Understand plans and strategies for Social Security.

Describe How the Social Security Program Works and the Benefits of Social Security

Prior to 1935, retirement assistance was solely the responsibility of the individual, and the government did not provide financial help to retired workers. However, when the stock market crashed in 1929 and the gross domestic product (GDP) of the United States fell 48 percent in five years (from $105 billion to $55 billion), many individuals and families were left economically devastated. Millions of Americans were laid off, over 9,000 banks failed, and depositors lost over $7 billion in assets. In an attempt to ensure that this type of depression did not happen again, Franklin D. Roosevelt signed the Social Security Act in 1935 to aid individuals who were displaced and unemployed.

The Social Security Program

The Social Security program was designed to be a pass-through account. This means that the taxes you pay for Social Security (through the Federal Insurance Contribution Act, or FICA) are used to pay benefits to those who are currently retired, disabled, widowed, or orphaned. Because there are currently more people paying into Social Security than there are people receiving Social Security benefits, the tax reserves are maintained in interest-earning government bonds held by the Social Security Trust Fund. There was no investment or savings component to Social Security when it was originally set up because the government assumed that there would always be enough people in the working generation to pay for the retired generation's benefits. In 1935, there were 17 workers for each retiree who received benefits. Today, it is estimated that there are only 3.4 workers for each retiree who receives benefits.

Financing for Social Security is roughly split evenly between the employee and employer. All employees pay at least 7.65 percent of their wages in FICA taxes, which are used to pay for Social Security and Medicare. This FICA tax comprises a Social Security tax of 6.20 percent and a Medicare tax of 1.45 percent. If your adjusted gross income (AGI) is larger than $250,000 (Married Filing Jointly), then the taxpayer is required to pay an additional 0.9 percent in Medicare tax. Also any investment income is taxed an additional 3.8 percent. Since 1937, the government has made major changes in the Social Security tax rate. Table 1 shows how the Social Security tax rate has changed from 1937 to 1990.

Table 1. Social Security Tax Rate Changes

Year	Amount
1937	1.0%
1954	2.0%
1960	3.0%
1971	4.7%
1984	5.8%
1990	6.2%

There is a limit on the amount of wages that are subject to Social Security taxes; this limit changes each year. In 2018, the maximum amount of wages subject to the Social Security tax was $127,200. There is no limit, however, on the amount of earnings that is subject to the Medicare tax. In other words, in 2018, any earnings in excess of $128,400 are exempt from the Social Security tax but not from the Medicare tax. Table 2 shows a historical perspective on changes to this limit.

Table 2. Maximum Wage Amount Subject to Social Security Taxes

Year	Limit
2014	$117,000
2015	$118,500
2016	$118,500
2017	$127,200
2018	$128,400
2019	$132,900

Employers must provide a dollar-for-dollar match to the funds employees pay in Social Security and Medicare taxes. Self-employed individuals are required to pay both the employee's part of the FICA tax and the employer's part of the FICA tax. This means that self-employed individuals pay 12.4 percent on the first $128,400 of their net earnings for Social Security and 2.9 percent on all taxable earnings for Medicare (3.8 percent if AGI is higher than $250,000). However, self-employed individuals may deduct up to half of their Social Security taxes as an adjustment to taxable income on their federal income tax returns.

OASDI-HI, which is the official name of Social Security, stands for "Old Age, Survivors, and Disability Insurance and Hospital Insurance." Individuals must pay Social Security taxes only on taxable wages. Taxable wages include salaries; bonuses; commissions; the value of employer-provided meals and lodging; sick pay during the first six months of illness; employer-paid group life insurance premiums in excess of $50,000; salary reductions from 401(k), 403(b), and 457 plans; nonqualified deferred compensation that is no longer at risk; nonqualified stock options; vacation pay; and severance pay. Nontaxable wages include sick pay after six months, payments made by an employer for medical or hospital expenses, and employer contributions to qualified retirement plans.

Key Terms

In order to understand Social Security, you should understand a number of key terms:

Average indexed monthly earnings (AIME) is calculated using your top 35 highest earning years. It entails adjusting each year's earnings total for inflation to reflect its value in the year in which eligibility is requested.

Primary insurance amount (PIA): Your primary insurance amount is the basic unit used to express the amount of a worker's benefit at their full retirement age (FRA). The calculation of a

worker's PIA is based on the average indexed monthly earnings (AIME), which is split into three segments and multiplied by specific percentages for each segment and summing the parts. Calculating your PIA from your AIME is divided into three separate calculations (the numbers are for 2018). These numbers are called "bend points" (see Table 3).

1. 90% of the amount for the first $926
2. 32% of earnings from $926 - $5,583, and
3. 15% of earnings above $5,583 subject to a maximum.

If your AIME was $5,000 per month, the amount is:

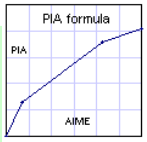
- 90% of the first $926 – ($926*.90) $833.40
- 32% of $5,583 - $926 ($4,074*.32) $1,303.68
- 15% of amount over $5,000 ($0*.15) $0.00

Your total PIA would be $2,137.08

Table 3: PIA Benefit Formula Bend Points[2]

PIA Benefit Formula Bend Points

	$ in PIA Formula		$ in Max Family Benefits		
Year	First	Second	First	Second	Third
2011	749	4,517	957	1,382	1,803
2012	767	4,624	980	1,415	1,845
2013	791	4,768	1,011	1,459	1,903
2014	816	4,917	1,042	1,505	1,962
2015	826	4,980	1,056	1,524	1,987
2016	856	5,157	1,093	1,578	2,058
2017	885	5,336	1,131	1,633	2,130
2018	895	5,397	1,144	1,651	2,154
2019	926	5,583	1,184	1,708	2,228



Full retirement age (FRA) is the age at which retirees will receive 100 percent of the benefits (PIA) to which they are entitled. If individuals choose to receive benefits prior to reaching the FRA, they will receive a reduced amount. Individuals can begin receiving benefits as early as age 62, even though they are not yet at full retirement age. If individuals choose to delay receiving benefits until after they reach the FRA, they will receive an increased amount of benefits. The full retirement age can be calculated using Table 4.

Fully Insured: A worker is only entitled to receive benefits if that worker is fully insured. In 2019, workers are only considered fully insured if they have worked at least 40 quarters of work (a quarter is three months) and earned at least $1,360 per quarter (see Table 5).

Currently Insured: To have currently insured status, workers must have worked a minimum of 6 quarters in the previous 13 quarters.

There are four main types of Social Security benefits: retirement, disability, survivors', and

Medicare benefits. These four main types are discussed in detail in the following paragraphs.

1. Retirement Benefits

Retirement benefits are available to four classes of people: workers, spouses, children, and single parents who have a child under the age of 16.

Table 4. Full Retirement Age:

Birth Year	Year at Age 62	Full Retirement Age
1937	1999	65
1938	2000	65 + 2 mo.
1939	2001	65 + 4 mo.
1940	2002	65 + 6 mo.
1941	2003	65 + 8 mo.
1942	2004	65 + 10 mo.
1943–1954	2005–2016	66
1955	2017	66 + 2 mo.
1956	2018	66 + 4 mo.
1957	2019	66 + 6 mo.
1958	2020	66 + 8 mo.
1959	2021	66 + 10 mo.
1960	2022	67
1961 +	2023 +	67

Table 5. Quarters of Coverage

Year	Amount
2014	$1,200
2015	$1,220
2016	$1,260
2017	$1,300
2018	$1,320
2019	$1,360

Worker's benefit: Workers may receive retirement benefits beginning at any month between the time they turn age 62 and the time they reach full retirement age. Benefits received up to 36 months before FRA will be reduced by 5/9 of 1 percent per month for each month you began receiving benefits before your FRA, for a maximum reduction of 20 percent. Additional reductions of 5 percent per year will be effective when the full retirement age exceeds age 65. Note that once you begin receiving benefits, this reduction will remain through the rest of your life.

For example, if your full retirement age is 66, and you begin retirement at age 62, your benefits will be reduced by 20 percent for the first three years and 5 percent for the fourth year; your benefits will be reduced by 25 percent total.

Delaying payment beyond full retirement age results in a benefit increase for each year of delay. You may delay benefits after age 67 up to age 70 and receive credits amounting to a specific percentage increase for each year of delay (see Table 6). For example, if your FRA is 67 and you begin receiving benefits at age 70, your PIA will be increased by 24 percent (three years multiplied by 8 percent).

Table 6. Percentage Increase per Year for Delaying Benefits

Year Born	Percentage Increase
1935-36	6.0%
1937-38	6.5%
1939-40	7.0%
1941-42	7.5%
1943 or later	8.0%

You may work while you are receiving benefits. Earnings you receive during or after the month in which you reach full retirement age will not reduce your Social Security benefits. However, if you choose to continue working while receiving benefits before your full retirement age, your benefits will be reduced. In 2018, earnings you receive in the year you reach your FRA will be reduced by $1 in benefits for every $3 you earn above the annual limit of $45,360; your earnings will only be reduced until the month you reach full retirement age. In the years before you reach full retirement age, your earnings will be reduced by $1 in benefits for each $2 you earn above the limit ($17,640 in 2019). Note that these limits change each year (see Table 7).

Spouse's benefit: The spouse of a fully insured worker is eligible to receive a retirement benefit of 50 percent of the worker's PIA, subject to the family maximum. This benefit is reduced by up to 25 percent for three years if it is received while the spouse has not reached his or her FRA. Once the spouse has reached age 65, a reduction of 5/12 of 1 percent per month, or 5 percent per year, is imposed for each of the remaining months the spouse is below the FRA. Any reductions to the worker's benefit resulting from early retirement will not affect the amount of the spouse's retirement benefit. If a spouse is entitled to benefits from his or her own employment, that spouse will receive 100 percent of his or her own PIA or 50 percent of his or her spouse's PIA, whichever is larger.

Child's benefit: Any child who is under 18 (19, if the child is still in high school), is eligible to receive a benefit of 50 percent of the retired worker's PIA (this amount is subject to a family maximum).

Mother's or father's benefit: The spouse of a fully or currently insured worker is eligible to receive a benefit of 75 percent of the worker's PIA if the spouse is caring for a child under age 16 or a child who was disabled before age 22.

2. Disability Benefits

Worker's Benefits: Workers who qualify for disability benefits are entitled to receive 100 percent

of their PIA until one of the following situations occurs: the disability ends (benefits are terminated in the second month after the end of the disability); the worker dies (benefits are terminated in the month after the worker dies); or the worker attains full retirement age (disability benefits convert to retirement benefits). Note that it is very challenging to qualify for disability benefits.

Table 7. Benefits Withheld for Earnings

Before You Reach Full Retirement Age: One dollar in benefits will be withheld for every $2 in earnings above the limit:

Year	Benefit Amount
2015	$15,720
2016	$15,720
2017	$16,920
2018	$17,040
2019	$17,640

Year You Reach Full Retirement Age: One dollar in benefits will be withheld for every $3 in earnings above the limit:

Year	Benefit Amount
2015	$41,880
2016	$41,880
2017	$44,880
2018	$45,360
2019	$46,920

There is no limit on earnings made during the month when an individual reaches FRA.

Spouse's Benefit: The spouse's disability benefit is either 50 percent of the worker's benefit or the spouse's own Social Security benefit, whichever is larger. Retirement or disability benefits paid to a spouse who is 62 years old will be reduced by a maximum of 25 percent each year. If the worker's benefit is decreased, the benefit paid to the worker's spouse is also decreased.

Child's Benefit: Any child who is under 18 (19 if the child is still in high school), is eligible to receive a benefit of 50 percent of the disabled worker's PIA.

Mother's or Father's Benefit: The surviving spouse of a fully or currently insured worker is eligible to receive a benefit of 75 percent of the worker's PIA if he or she is caring for a child under age 16 or a child who was disabled before age 22.

Maximum family benefit: When more than one family member is eligible to receive benefits (e.g. the worker, his or her spouse, and children), a family maximum applies. This maximum applies to all benefits paid to the family. For disability benefits, the family maximum is either 150 percent of the worker's disability benefit or 85 percent of the AIME used to calculate the worker's benefit, whichever is smaller. This maximum will not be less than the benefit paid to

the worker.

3. Survivor Benefits

Lump-sum benefit: If the deceased worker was fully insured (40 quarters of credits) or currently insured (6 quarters of credits), a lump-sum survivor benefit will be paid to eligible survivors. A monthly lump sum is available to the surviving resident spouse, nonresident spouse, or eligible children.

Widow(er)'s benefits: A benefit of up to 100 percent of the fully insured, deceased spouse's PIA will be paid to the surviving spouse who is at least age 60 and who was married to the deceased spouse for at least nine months. The surviving spouse is generally eligible if he or she is not remarried and is not entitled to retirement benefits (for his or her covered employment) in at least the amount of the deceased spouse's PIA. If the worker dies before receiving retirement benefits, the surviving spouse of full retirement age is entitled to a benefit of 100 percent of the deceased worker's PIA.

A surviving spouse between the ages of 60 and 65 (below the FRA) would receive reduced benefits of 19 to 40 percent per month each month until the spouse turned 65. If a worker dies after Social Security benefits have begun, the surviving spouse's benefit cannot exceed the amount being paid at the time of death. A widow(er)'s benefit terminates at death or at eligibility for an equal or greater retirement benefit.

Child's benefits: Child's benefits terminate at age 18, at marriage, or at death. The dependent child of a fully or currently insured worker will receive a benefit of 75 percent of the worker's PIA (this amount is subject to the family maximum) under at least one of the following circumstances: if the child is under age 18 (or age 19 if the child is a full-time high school student) and not married, or if the child is over age 18 and has been disabled since before age 22.

Mother's or father's benefit: The surviving spouse of a fully or currently insured worker is eligible to receive a benefit of 75 percent of the worker's PIA if that surviving spouse is caring for a child who is under age 16 or a child who was disabled before age 22 (the benefit amount is subject to the family maximum). The benefit is paid until the youngest child reaches 16 or marries or until the surviving spouse dies or remarries.

4. Medicare Benefits

The Medicare hospital insurance (HI) portion of Medicare, also known as Part A, is largely funded by the 2.9 percent HI tax on earnings. Part A is compulsory insurance. Part B of the Medicare program, supplemental medical insurance (SMI), is financed by premiums paid by participants and by federal government funding.

Individuals who are at least age 65 and who are eligible for Social Security retirement benefits on their own behalf are entitled to coverage under Medicare Part A. If the individual has applied

for Social Security retirement benefits, no separate application is required. If the individual continues to work after age 65 and is not receiving Social Security benefits, an application must be filed in order for the individual to receive Medicare Part A coverage. Recipients of disability benefits are eligible for Part A coverage after they have been eligible for disability benefits for 24 months.

Survivors and dependents of individuals who are entitled to Part A coverage must be at least 65 years old to be eligible for Part A coverage. U.S. citizens who are not eligible for Part A coverage but who are enrolled in Part B may pay a monthly premium to enroll in Part A. Individuals are automatically enrolled for Part B coverage when they become eligible for Part A coverage. Part B coverage can be waived by completing the necessary forms. Any individual may enroll in Part B coverage if he or she is at least age 65 and has been a citizen or resident for five years.

Answer Frequently Asked Questions about Social Security

There is a great deal of important information about Social Security that may be of interest to you. The following are a few of the more frequently asked questions and their answers.

If I have a full-time job and I have a small business on the side, how much do I pay for Social Security? If you have both a full-time job and you have a small business on the side, no more than $132,900 of your combined earnings is subject to the FICA tax in 2019. However, any additional wages are subject to the Medicare tax.

How does Social Security account for the increasing cost of living expenses? Benefits are increased annually on January 1 to reflect increases in the cost of living.

Do unearned income and asset ownership affect how much one pays in Social Security? Unearned income, such as interest earned on investments and assets, has no effect on eligibility for Social Security benefits.

How does earned income affect Social Security before age 65? Earned income has an effect on retirement benefits and survivor benefits paid to individuals who are under age 65 if such earnings exceed their earnings limitations. When individuals begin to take advantage of retirement benefits, the earnings limit is applied as a monthly amount in the months preceding the 65th birthday.

How do I qualify for benefits? To qualify for full benefits, you must meet the quarters-of-coverage requirement, which means you must earn at least the required minimum during each calendar quarter (every three months). For 2019, the quarters-of-coverage minimum was $1,360. You need to meet this minimum for at least 40 quarters to qualify for full benefits; this is equivalent to 10 years of work. Earning beyond 40 quarters will not increase your benefits.

What is an annual Social Security statement, and when will I receive it? An annual Social

Security statement shows your quarters-of-coverage credit, the amount you have paid in Social Security taxes, and the amount of your estimated benefit. You must be at least 18 years old to receive a statement. The statement is sent to you each year three months before your birthday, or may be reviewed online at www.ssa.gov.

How can I apply to receive benefits? You can complete the application process at a Social Security office, over the telephone, or via the Internet. When you apply, you may need to show verification of your age by providing your birth certificate or your Social Security card.

When will I receive my retirement benefits? Benefits are paid once a month on either the second, third, or fourth Wednesday of the month, depending on your birth date. You can choose to receive your payment as a check or through direct deposit.

Do I have to pay federal income taxes on my retirement benefits? About 20 percent of those who receive Social Security benefits must pay some federal taxes on the benefit, when they earn substantial income (including pension and wages) in addition to the Social Security benefit. See an accountant to discuss your personal situation.

Describe the Future of Social Security

The Social Security program is currently collecting more money than it is paying out. In 2012, the program collected $840.2 bn (versus $784.9 bn in 2007) and paid out $785.8 bn in benefits ($495.7bn in 2007) to 56.8 mn people (54.7mn).[3]). Note that income is growing 1.4% per year over this period and expenses are growing 9.7% over the same period.

Today, it is estimated that there are 2.8 workers per recipient of Social Security (see Chart 1). However, by the year 2075, it is estimated that there will be only 2.0 workers per recipient of Social Security. Clearly, the program must undergo some changes to accommodate this major shift in demographics.

According to government projections, Social Security benefits can be paid solely from tax revenues until 2015. From 2016 to 2025, Social Security benefits will likely have to be paid with the interest from government bonds. From 2026 to 2033, the Social Security Trust Fund may have to redeem its bonds to pay Social Security benefits. Current projections estimate that Social Security funds will be exhausted in 2033.

Plans and Strategies for Social Security

Following are a few ideas of plans and strategies for Social Security, part of your Retirement Plan. We have developed Social Security Spreadsheet (LT36) to help as you calculate your Primary Insurance Amount, Family Maximums, Spouse's benefits, Children's benefits, as well as determine your breakeven years for taking different benefit options (see Breakeven tab).

As a starting point, you should have a rough idea of how long are you expecting to live. I recommend you take some life expectancy quizzes to help you in this area. With this information, you would take benefits earlier than later if:

- You do not expect to live to the Social Security determined life expectancy
- You are no longer working and can't make ends meet without benefits
- You are in poor health, and don't expect to live to an average life expectancy
- You are the lower earning spouse and the higher-earning can wait to file for higher benefit.

You would take benefits later than sooner if:

- You are in good health and expect to live longer than the normal social security determined life expectancy
- You are still working and make enough to impact the taxability of benefits (at least wait till FRA so your benefits are not further reduced)
- You are the higher earning spouse and want to be sure your surviving spouse received the highest possible benefit.

Using Social Security Spreadsheet (LT36), you can determine your breakeven age, the point where if would be more beneficial for you to wait to take benefits, based on your age, full retirement age, and your NPV assumptions including cost of living adjustments and interest rates. Again, this is an approximation only.

Following are Social Security plans and strategies for the accumulation, retirement and distribution stages.

Plans and Strategies

Accumulation

- If health is poor, life expectancy low, or needs are great, begin taking benefits as soon as possible
- Continue to work and contribute to the SS system as benefits are based on top 35 earning years
- If possible, don't take benefits before full retirement age as there is a tax penalty on benefits if your earnings are above a specific amount before FRA
- If needed, you can take benefits up to 5 years before FRA; however, once you start taking benefits you cannot change that choice!

Retirement

- The higher-earning spouse should take retirement as late as possible. This would increase benefit and would maximize the amount the lower-earning spouse would have after the higher-earning spouse passes. Once the higher-earning spouse passes, the remaining spouse receives the higher of their amount or the higher-earning spouses amount

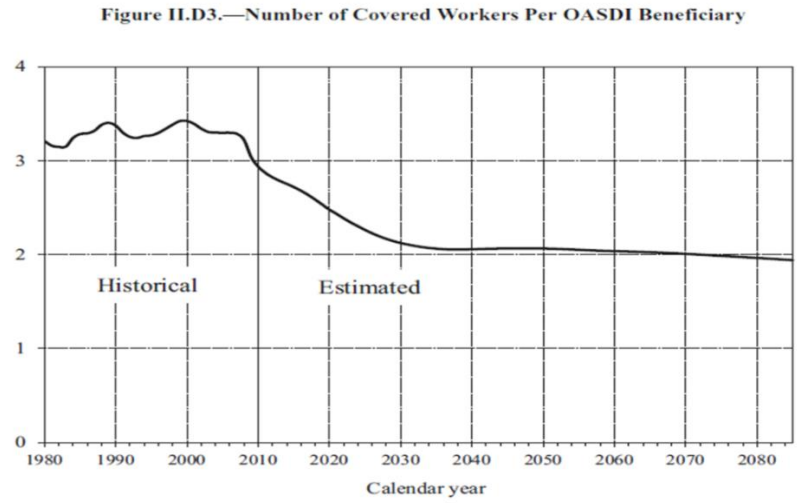
- If possible, don't take benefits before full retirement age as there is a tax penalty on benefits if your earnings are above a specific amount before FRA

Distribution

- Try to defer taking benefits as long as possible, especially if you expect to live longer than the SS system determined average.
- The longer you delay taking benefits, the greater your monthly benefit (up to 3 years beyond FRA)
- If you have extra money left over, roll over excess amounts into a Roth IRA to use later.

Summary

Chart 1: Number of Workers per OASDI Beneficiary[4]



Source: 2011 Social Security Trust Fund Reports, http://www.ssa.gov/oact/tr/2011/tr2011.pdf

For many of the 40 million Americans who are 65 and older, Social Security is the primary source of retirement income. However, most young Americans, who will not face retirement for many years, might not have access to the benefits of the Social Security program, at least not in its present form.

The Social Security program was designed to be a pass-through account; this means that the taxes you pay for Social Security (through the Federal Insurance Contribution Act, or FICA) are used to pay benefits to those who are currently retired, disabled, widowed, or orphaned. Because there are currently more people paying into Social Security than there are people receiving Social Security benefits, the tax reserves are maintained in interest-earning government bonds held by the Social Security Trust Fund. There was no investment or savings component to Social

Security when it was originally set up because the government assumed there would always be enough people in the working generation to pay for the retired generation's benefits.

Social Security should be the first component of your retirement plan, but it should not be the only one. To fully understand how Social Security can benefit you, you must understand what Social Security is, what Social Security does, and how your benefits will be calculated. You must also realize that the program is in transition and that you should include other retirement resources in your retirement plan accordingly.

Assignments

Financial Plan Assignments

Your assignment is to learn about the benefits you will receive from Social Security. Get a copy of your Social Security statement benefits by going to www.ssa.gov. Click on *Get a Copy of your Social Security Statement Online* near the middle left of the page, and then click on *Sign in or Create an Account*. Fill out your name, middle initial, last name, social security number, birthday, and other information that is requested. Follow the on screen instructions, and they will send you a copy of your Social Security statement. Use this statement as you work to determine how much you will need for retirement.

Learning Tools

The following learning tools may also be helpful as you prepare your Personal Financial Plan:

Retirement Planning Needs Spreadsheet (LT06)
: This Excel spreadsheet helps you determine how much you must save each month to achieve a specific lifestyle at retirement based on the following estimates: years until retirement, expected return, inflation, and tax rates.

Retirement Planning Ratio Forecasts (LT25)
: This Excel spreadsheet helps you determine where you are in your progress towards achieving your retirement goals. By inputting the relevant information, you can determine whether you are on track for reaching your retirement goals based on your age and your income.

Social Security Spreadsheet (LT36)
: This spreadsheet helps you calculate your Primary Insurance Amount and Maximum Family benefit from your Average Indexed Monthly Earnings, and how much you will receive at various ages. It also shows how the bend points have changed over time.

Review Materials

Terminology Review

Average Indexed Monthly Earnings (AIME). The average lifetime earnings indexed for inflation is your top 35 highest earning years. It entails adjusting each year's earnings total to reflect its value in the year in which eligibility is requested.

Bend Points. Calculating your PIA from AIME is divided into three calculations called "bend points" because the formula, when graphed, appears as a series of line segments joined at these amounts. These bend points change year to year.

Child's Benefit. Any child who is under 18 (19 if still in high school), is eligible for a benefit of 50% of the retired workers PIA, subject to a family maximum. Child's benefits terminate at age 18, marriage, or death. The dependent child of a fully or currently insured worker will receive a benefit of 75% of the worker's PIA (subject to family maximum) if the child is under age 18 (or age 19 is a full-time high school student), or is over age 18 and has been disabled since before age 22, and is not married.

Currently Insured Status. To be "currently insured", you must have at least 6 quarters of coverage in the previous 13 quarter period. Currently insured is adequate for eligibility for survivor benefits paid to children and for a surviving spouse caring for a qualifying child. Eligibility for other benefits generally requires fully insured status or 40 quarters of coverage

Delayed Retirement Credit. Delaying payment beyond full retirement age results in a benefit increase for each year of delay. With a delay the worker's PIA is not increased and the benefits to family members is not increased.

Disability Benefits. Workers who qualify for disability benefits are entitled to 100% of PIA until the earliest of the following: disability ends: benefits are terminated in the second month after the end of disability, or the workers dies: benefits are terminated in the month prior to the month the worker dies. If the worker attains full retirement age: disability benefits convert to retirement benefits.

Disabled Child. The disable child of a retired or disable worked is entitled to benefits past age 22 if the disability began before age 22.

Full Retirement Age (FRA). This is the age at which a retiree will receive 100% of their entitled benefits. Receiving benefits prior to FRA will result in a reduction in benefits. Receiving benefits after FRA will result in an increase of benefits.

Insured Worker. A worker is only entitled to receive benefits if that worker is fully insured. Workers are considered fully insured if they have worked forty quarters of work (a quarter is three months) and earned a specific amount of money per quarter.

Low Income Filer. This is a single filer with provisional income below $25,000 or married filing jointly (MFJ) with income below $34,000. None of the benefits are taxable.

Lump Sum Benefit. A lump sum of $255 is available to the surviving spouse, nonresident spouse, or to children eligible for the monthly benefits (for 2018).

Maximum Family Benefit. When benefits are payable to more than one family member, a family maximum applies. This includes all benefits paid to the family. For disability, the family maximum is the lesser of 150% of the workers disability benefit or 85% of the AIME used to calculate the benefit, but is not less than the benefit paid to the worker. When the worker is living, and benefits exceed the family maximum, the worker's benefit is not adjusted; rather, the reduction is made in other beneficiaries' payments.

Medicare Benefits. Medicate hospital insurance (HI) portion of Medicare, also known as Part A, is largely funded by the 2.9% HI tax on earnings. Part A is compulsory. Individuals at least age 65 and eligible for Social Security retirement benefits on their own behalf are entitled to coverage under Medicare Part A. If the individual has applied for Social Security (SS) retirement benefits,

no separate application is required.

Middle Income Filer. This is a single with income from $25,000 to $34,000 and MFJ with income from $32,000 to $44,000. Up to 50% of social security benefits are taxable.

Mother's or Father's Benefit. The surviving spouse of a fully or currently insured worker is eligible to receive a benefit of 75% of the worker's PIA if they are caring for a child who is under age 16 or who was disabled before age 22 (subject to family maximum).

OASDI – HI (Old Age, Survivors, and Disability Insurance and Hospital Insurance). This is payment for Social Security and Medicare taxes. The employee and employer each pay (assuming your Adjusted Gross Income (AGI) is less than $250,000: Social security tax (OASDI) of 6.20%, Medicare tax (HI) of 1.45%, for a total of 7.65% each. Self-employed individuals pay the whole 15.30%. OASDI-HI taxes are on taxable wages including wages, salaries, bonuses, commissions, value of employer provided meals/lodging, sick pay during first 6 months, employer paid group life insurance premiums in excess of $50,000, salary reduction from 401k, 403b, 457 plans, non-qualified deferred compensation no longer at risk, non-qualified stock options, vacation pay, and severance pay.

Primary Insurance Amount (PIA). Your PIA is the basic unit used to express the amount of a worker's benefit if they received benefits at their full retirement age (FRA). The calculation of PIA is based on the workers AIME, which is split into three segments and multiplied by specific percentages for each segment and summing the parts.

Retirement Benefits. Retirement benefits can either be reduced or increased depending on your PIA, your FRA and the date when benefits begin. You can begin receiving benefits as early as age 62. Benefits that begin 3 years before FRA will be reduced by a maximum of 20% (or 5/9% of 1% per month for each month benefits begin before FRA or 6.67% per year). Additional reductions of 5% per year are effective when FRA exceeds age 65.

Social Security. Social security is a government provided retirement, survivor, and disability benefits. Franklin D Roosevelt signed the Social Security Act in 1935 to Aid the displaced and out of work. Social Security is a pass-through account, which means that FICA taxes being paid by current workers provided the money for benefit payments to current retirees.

Spouses benefit. A fully insured worker's spouse age 65 (FRA) is eligible to receive a retirement benefit of 50% of the worker's PIA subject to the family maximum. This benefit is reduced by 25/36% of 1% for each of the first 36 months that the spouse is under FRA (25% for 3 years). Once the FRA > 65, a reduction of 5/12 of 1% is imposed for each month beyond 36 months the spouse is under the FRA. The reduction of benefit from early retirement will not affect the amount of the spouses benefit. Disability benefits for spouses are 50% of the worker's PIA, reduced if the spouse is under FRA, subject to a family maximum amount.

Supplemental medical insurance. The SMI portion of the Medicare program (Part B) is financed by premiums paid by participants and by federal government funding. Participation in Part B is voluntary.

Survivor Benefits. Deceased worker must had had fully insured status; other survivor benefit (mother's or fathers' child's lump sum) will be paid to eligible survivors of a fully or currently insured worker

Upper Income Filer. These are singles with income above $34,000 and MFJ with income above $44,000. 85% of Social Security benefits are taxable.

Widow(er)'s Benefits. A benefit of up to 100% of the deceased, fully insured PIA will be paid to the surviving spouse who is at least age 60 and who was married to the worker for 9 months. The surviving spouse is generally eligible if he or she is not remarried and is not entitled to retirement benefits (due to his or her covered employment) of at least the amount of the deceased workers

PIA. A widowers benefit terminates at death or at eligibility for an equal or greater retirement benefit.

Review Questions

1. What is the primary source of income for adults 65 and older? Is this a reliable source for the future?
2. What two people/entities finance Social Security and Medicare? What percentage does each pay?
3. What does it take to be fully insured in the Social Security program?
4. To which four classes of people are retirement benefits available?
5. Why is it advantageous to wait until you are 70 before withdrawing money from your social security account?

Case Studies

Case Study 1

Data

Bill was born in 1940. He plans to retire and begin receiving Social Security benefits at age 68 and 6 months. His AIME is $2,072, his PIA is $1,200 and he knows that his PIA will be increased by 7% for each year beyond FRA he takes retirement. His FRA is 65 and 6 months.

Calculations

What is his retirement benefit at 3 years beyond FRA?

Case Study 1 Answers

Since Bill was born in 1940, his full retirement age is 65 years and 6 months. At 68 years and 6 months, he would be three years beyond his FRA. He would have a benefit of 7.0 percent per year for waiting beyond his FRA to retire.

His retirement benefit is 3 * 7.0% = (21% + 1) * $1,200 = ?

He would receive $1,452 per month for a retirement benefit.

LT36

Tax Year	2019	FRA	65 + 6 mo.
Birth Year:	1940	Additional %	7.0%
Calc. Spouse's Benefit (50% of workers PIA)			No

Average Indexed Monthly Earnings (AIME)			$ 2,071.6
Weights:	SS Limits	Difference	Amounts
90%	926	926	833.40
32%	5,583	1,146	366.60
15%		-	-
Worker's Primary Insur. Amt. (PIA)			$ 1,200.00

Worker Period:	Age Begin SS Benefits	Monthly Payments
FRA - 5	60 + 6 mo.	840
FRA - 4	61 + 6 mo.	900
FRA - 3	62 + 6 mo.	960
FRA - 2	63 + 6 mo.	1,040
FRA - 1	64 + 6 mo.	1,120
FRA	65 + 6 mo.	1,200
FRA + 1	66 + 6 mo.	1,284
FRA + 2	67 + 6 mo.	1,368
FRA + 3	68 + 6 mo.	1,452

Case Study 2

Data:

Steve was born in 1960 and is thinking about perhaps retiring at age 62. He knows that his full retirement age is 67. He also knows that if he begins retirement 3 years before his FRA his AIME will be reduced by 20% and for each year before that, it will be reduced by 5%.

Calculations:

A. How much in percentage terms would his PIA be reduced if he was to begin receiving Social Security benefits at age 62?

B. If his AIME was $2,072 and his PIA was $1,200, how much would he receive each month if he retired at age 62?

Case Study 2 Answers

Bill's benefits would be reduced by 5/9 percent per month for the first 36 months prior to age 67 (20 percent for three years) and 5/12 percent for each month after those three years (5 percent per year for each year after that).

A. Calculate the benefit Bill would receive if he was to retire at age 62:

5/9 percent x 36 months =	20%
5/12 percent x 24 months =	10%
Total reduction in payments =	30%

B. Bill would receive 1,200 x .7 (1 – 30%) or $840 each month.

LT36

Tax Year	2019	FRA	65 + 6 mo.
Birth Year:	1940	Additional %	7.0%
Calc. Spouse's Benefit (50% of workers PIA)			No

Average Indexed Monthly Earnings (AIME)			$ 2,071.6
Weights:	SS Limits	Difference	Amounts
90%	926	926	833.40
32%	5,583	1,146	366.60
15%		-	-
Worker's Primary Insur. Amt. (PIA)			$ 1,200.00

Worker Period:	Age Begin SS Benefits	Monthly Payments
FRA - 5	60 + 6 mo.	840
FRA - 4	61 + 6 mo.	900
FRA - 3	62 + 6 mo.	960
FRA - 2	63 + 6 mo.	1,040
FRA - 1	64 + 6 mo.	1,120
FRA	65 + 6 mo.	1,200
FRA + 1	66 + 6 mo.	1,284
FRA + 2	67 + 6 mo.	1,368
FRA + 3	68 + 6 mo.	1,452

Case Study 3

Data

Sam was born in 1955 (FRA is 66 and 2 months), and his wife Ann was born in 1958 (FRA is 66 and 8 months). They plan to both begin receiving Social Security benefits when Ann reaches full retirement age (Sam will be three years beyond FRA; the percentage increase is 8 percent per year beyond FRA).

Calculations

A. Assuming Sam's PIA is $1,500, and Ann's PIA, because she has worked in the home, is only $600, how much would each receive at retirement?

B. What would is the combined amount they would receive each month?

Case Study 3 Answers

A. Since Sam was born in 1955, his full retirement age is 66 years and 2 months. At Ann's FRA of 66 and 8 months, Sam would be three years beyond his FRA. He would have a benefit of 8 percent per year of for waiting beyond his FRA for retirement.
His retirement benefit is 3 * 8.0% = (24% + 1) * $1,500 = ? or $1,860 per month.
His wife would receive the higher of half her spouse's PIA (before the increase) of $1,500 / 2 or $600, whichever was higher, subject to the family maximum. In this case she would take the $750.

B. Their combined benefit would be $1,860 + $750, or $2,610, per month.

<u>Case Study 4</u>

Data

Jenny and Steve were married for 15 years when Steve passed away. They have four children, all under age 12. Steve was a currently insured worker and had an AIME of $2,072 and a PIA of $1,200 when he passed away. The family maximum amount was $1,820.

Calculations

A. How much would Jenny receive from Social Security survivor benefits to help her raise her children after Steve's death?

B. How much would the children receive?

Case Study 4 Answers

A. Since Steve was a currently insured worker, Jenny would receive 75 percent of his PIA regardless of her age as there are children in the home under age 18. Jenny's survivor benefit would be 75 percent of Steve's PIA of $1,200, or $900 per month.

B. The children's benefit would also be 75 percent of Steve's PIA.
However, because Jenny had already received $900, the four children would only receive together the difference up to the family maximum of $968 ($1,868 family maximum less the $900 for Jenny), rather than 75 percent per child.

LT36

Tax Year	2019	FRA	65 + 6 mo.
Birth Year:	1940	Additional %	7.0%
Calc. Spouse's Benefit (50% of workers PIA)			No

Average Indexed Monthly Earnings (AIME)			$ 2,071.6
Weights:	SS Limits	Difference	Amounts
90%	926	926	833.40
32%	5,583	1,146	366.60
15%		-	-
Worker's Primary Insur. Amt. (PIA)			$ 1,200.00

Worker Period:	Age Begin SS Benefits	Monthly Payments
FRA - 5	60 + 6 mo.	840
FRA - 4	61 + 6 mo.	900
FRA - 3	62 + 6 mo.	960
FRA - 2	63 + 6 mo.	1,040
FRA - 1	64 + 6 mo.	1,120
FRA	65 + 6 mo.	1,200
FRA + 1	66 + 6 mo.	1,284
FRA + 2	67 + 6 mo.	1,368
FRA + 3	68 + 6 mo.	1,452

Calculating Family Maximum from your PIA - Survivor Benefits
Using Bend Points for 2019

Primary Insurance Amount (PIA)			$ 1,200.00
Weights:	SS Limits	Difference	Amounts
150%	1,184	1,184	1,776.00
272%	1,708	16	43.52
134%	2,228	-	-
175%	-	-	-
Maximum Family Benefit			$ 1,819.52

Survivor Benefits:

- Spouse: 75% of PIA with kids < 18
- Children: 75% of PIA, subj. to max

Calculations:

Spouse's Benefit (75% PI	$ 900
Child #1 Benefit (75% PI	900
Other Children's Benefit (	20

Case Study 5

Data

Jenny and Steve are both beyond FRA and received $11,000 in social Security benefits in 2019. Their AGI (taxable pensions, wages, interest and dividends) was $22,500. They had $1,500 in tax-exempt interest income from a mutual fund. (Remember provisional Income (PI) is your AGI (before Social Security) + tax-exempt interest + 50% of your Social Security benefits)

Calculations:

- A. Calculate their provisional income (Married Filing Jointly)
- B. How much of that $11,000 is taxable?

Case study 5 Answers

Low Income: Benefits not taxable

Single filer with PI < $25,000 ($32,000 MFJ)

Middle Income: Up to 50% of benefits taxable

Single filer with PI from $25,000 to $34,000 ($32,000 to $44,000 MFJ)

Upper Income: 85% of benefits taxable

Single filer with PI > $34,000 ($44,000 MFJ)

Their provisional income is $22,500 + $1,500 + ($11,000/2) = $29,500

Since they are married filing jointly, the $29,500 is less than the $34,000 base amount. Therefore, none of the benefits are taxable.

Case Study 6

Data:

Bob has an AIME of $5,500 per month.

Calculations

a. Based on 2019 bend points of $926 and $5,583, what would Bob's PIA be (his PIA is calculated from his AIME)? Remember the weights are 90% of the first bend point, 32% of the second and 15% of the remainder.

Case Study 6 Answers

a. Calculating Bob's PIA from his AIME in 2019 is divided into three calculations called "bend points"

1. 90% of the amount for the first $926
2. 32% of earnings from $926 - $5,583, and
3. 15% of earnings above $5,583

Since Bob's AIME was $5,500 per month, the amount is:

90% of $926 or	$833.40
32% of $5,583 - $926 ($4,574) or	$1,463.68
15% of $5,500 - $5,583 ($0) or	$0.00
Bob's total PIA would be	$2,297.08

This is the sum of each of the bend calculations

This is the sum of each of the bend calculations

LT36

Tax Year	2019	FRA	67
Birth Year:	1960	Additional %	8.0%
Calc. Spouse's Benefit (50% of workers PIA)			No

Average Indexed Monthly Earnings (AIME)			$ 5,500.0
Weights:	SS Limits	Difference	Amounts
90%	926	926	833.40
32%	5,583	4,574	1,463.68
15%		-	-
Worker's Primary Insur. Amt. (PIA)			$ 2,297.08

Worker Period:	Age Begin SS Benefits	Monthly Payments
FRA - 5	62	1,608
FRA - 4	63	1,723
FRA - 3	64	1,838
FRA - 2	65	1,991
FRA - 1	66	2,144
FRA	67	2,297
FRA + 1	68	2,481
FRA + 2	69	2,665
FRA + 3	70	2,848

Case Study 7

Data:

Bob, born in 1972, has an AIME of $5,397 and a PIA of $2,246 per month.

Calculations

a. Based on 2019 family bend points, what would his family maximum be (the family maximum is calculated based on his PIA)? (For calculating family maximums, the weights are 150% of the first bend point, 272% of the second, 134% of the third, and 175% over the third bend point using the PIA).

Case Study 7 Answers

a. Calculating Bob's family maximum benefits in 2019 from his PIA is divided into four calculations

1. 150% of the amount for the first $1,184
2. 272% of earnings from $1,708 - $1,184
3. 134% of earnings from $2,154 - $1,708, and
4. 175% of earnings over $2,154

Since Bob's PIA was $2,246, the family maximum would be:

150% of $1,184 or	$1,776.00

272% of $1,708 - 1,184 ($524) or $1,425.28
134% of $2,154 - $1,708 ($520) or $696.80
175% of $2,246 - $2,154 ($36) $63.21
His family maximum amount would be $3,961.29

Calculating Family Maximum from your PIA - Survivor Benefits
Using Bend Points for 2019

Primary Insurance Amount (PIA)			$ 2,264.12
Weights:	SS Limits	Difference	Amounts
150%	1,184	1,184	1,776.00
272%	1,708	524	1,425.28
134%	2,228	520	696.80
175%	2,264	36	63.21

Maximum Family Benefit	$ 3,961.29

Survivor Benefits:

- Spouse: 75% of PIA with kids < 18
- Children: 75% of PIA, subj. to max

Calculations:

Spouse's Benefit (75% PI	$ 1,698
Child #1 Benefit (75% PI	1,698
Other Children's Benefit (	565

Case Study 8

Data:

Bob was born in 1960, has an AIME of $5,397 and a PIA of $2,264 per month. Assuming no time value of money (no interest rate) and no cost of living adjustment (COLA), after what breakeven age would it be more beneficial for Bob to wait for FRA+3 than to retire at his full retirement age.

Hint: Use Social Security Spreadsheet (LT36)

Social Security Benefits (LT36.2)
Breakeven Point for When to Take Benefits
Note: This does not take into account taxes on benefits

Graph Inputs:	
Tax Year	2019
Birth Year	1960
Primary Insurance Amount (PIA)	2,264
Interest Rate	0.0%
Cost of Living Adjustment (COLA)	0.0%

Retirement Age:		
Full Retirement Age (FRA)		67
Additional % beyond FRA		8.0%
Chosen Periods:		**Age:**
Chart #1 (Blue)	FRA-5	62
Chart #2 (Orange)	FRA+3	70
Breakeven Age		80

[1] Carolyn Davis, Acting Commissioner, as printed in individual Social Security Statements, January 2, 2014 from http://www.ssa.gov/myaccount/materials/pdfs/SSA-7005-OL.pdf
[2] http://www.ssa.gov/oact/COLA/bendpoints.html, August 14, 2014.
[3] 2011 Social Security Trust Fund Report of the Social Security Administration, 2011.
[4] Source: 2011 Social Security Trust Fund Reports, http://www.ssa.gov/oact/tr/2011/tr2011.pdf.

4. Retirement 3: Understanding Employer-Qualified Plans

Introduction

Employer-qualified retirement plans, also called employer-sponsored retirement plans, are the second source of income you should consider when planning for retirement. You can think of the payouts from these plans as a series of delayed payments you will receive during retirement for work you performed prior to retirement. There are many varieties of employer-qualified retirement plans; these plans can be an important part of your overall retirement plan.

A qualified retirement plan is a retirement plan that allows a company to make tax-deductible contributions to employees through either a defined-benefit plan or a defined-contribution plan. Some of these plans require no employee contributions, and some require employee contributions that are employer matched. Employer-qualified retirement plans provide free money, which should be the highest priority for your retirement and investment funds.

Objectives

When you have completed this chapter, you should be able to do the following:

A. Understand employer-qualified retirement plans
B. Understand defined-benefit plans
C. Understand defined-contribution plans
D. Understand plans and strategies for employer qualified plans.

Understand Employer-Qualified Retirement Plans

There are many reasons why companies offer qualified retirement plans, including a desire to be competitive. Since most companies offer a qualified retirement plan, a company that does not is at a disadvantage. Most companies must offer benefits to attract and retain qualified personnel.

Money set aside in qualified plans has specific tax advantages. These tax advantages make retirement plans especially attractive to companies. Companies may be motivated to offer qualified retirement plans because the company owner may wish to use them to save money for retirement in a tax-efficient manner. These funds offer tax advantages to the company and may be tax-deferred for the employee as well.

Concern for employees may also be a reason that companies offer qualified retirement plans. Companies may reason that the better prepared for retirement employees are, the better the employees will perform their work.

There are two main types of employer-qualified retirement plans: defined-benefit plans and defined-contribution plans. Defined-benefit plans provide a predetermined payout based on specific employee data, such as years of employment and annual salary. With defined-benefit plans, the company bears most of the risk associated with funding a specific amount each year. Defined-contribution plans are investment plans in which both the employee and the employer contribute funds to the plan; the amount contributed by the employer is generally fixed. With defined-contribution plans, the employee bears most of the risk involved in funding the plan. Table 1 lists the major types of defined-benefit and defined-contribution plans.

Table 1. Retirement Plan Characteristics

Characteristic	Defined-Benefit	Defined-Contribution
Employer's contribution	Actuarially determined	Specified by formula
Benefit amount	Certain	Uncertain
IRC limit applicable	Maximum	Contributions
Types of benefits funded	Defined-benefit Cash balance	Profit sharing ESOP Stock bonus Target benefit Money purchase Employee contribution

Because of the tax advantages, there are limits to the amounts of money that may be contributed to defined-benefit and defined-contribution plans. These limits are set forth in Code 415 of the Internal Revenue Code. See Table 2 for the Code 415 contribution limits for 2018.

Table 2. Internal Revenue Code Limits in 2019

Plan Type	Participant Limit	Employer Limit
Defined-contribution:	100% or $56,000 (indexed) if less	25% of participant's total compensation
Defined-benefit:	100% or $225,000 (indexed) if less	Amount necessary to fund compensation
Profit-sharing:	100% or $56,000 (indexed) if less	25% of participant's total compensation

There are also limits to the types of retirement plans that can be used by different types of business entities. For a list of types, see Chart 1.

In recent years, there has been a significant shift away from defined-benefit plans and toward defined-contribution plans. Even companies that continue to offer defined-benefit plans have

tried to reduce their risk by reducing benefits. This change suggests that companies are shifting the responsibility of retirement planning onto individual employees. Because of this change, it is critical that you understand qualified retirement plans and make retirement planning an important part of your personal investment plan.

Chart 1. Business Forms and Retirement Plans

	Defined Benefit Plans		Defined Contribution Plans								
			Discretionary Contribution			Fixed Contribution		Employee Contribution			
Entity	Defined Benefit	Cash Balance	Profit Sharing	Stock Bonus ESOP	Money Purchase	Targt Benefit	Thrift Savings	Section 401k Provisions	TSA 403B	457 Plan	SIMPLE and SEP-IRA
C Corp.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
S Corp.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No	Yes
Prof. Corp.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
Partnership	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	No	No	Yes
Sole Prop.	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	No	No	Yes
Tax-exempt	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Public School	Yes	Yes	Yes	No	Yes	Yes	Yes	No	Yes	Yes	Yes
S/L Govt.	Yes	Yes	Yes	No	Yes	Yes	Yes	No	No	Yes	Yes

Explain Defined-Benefit Plans

A defined-benefit plan (DBP), also called a pension plan, is a retirement plan funded entirely by an employer; the employee does not contribute to this type of plan. At retirement, the employee is promised a specific payout amount that is calculated using a formula set by the company.

Advantages and Disadvantages

One advantage of defined-benefit plans is that they often pay out a large percentage of an employee's final salary—as much as 30 to 50 percent—thereby making a significant contribution to that employee's retirement plan. Since you as the employee do not contribute to the plan, you bear no investment risk. Sometimes the benefits of these plans can even be extended to a spouse, depending on the type of retirement payout you choose.

There are also disadvantages of defined-benefit plans. One disadvantage is that the payout benefits are considered taxable income, and taxes can significantly diminish your net benefit. Another disadvantage is that your company can change its plan policies over time—even after you retire—so there is no guarantee your benefits will remain constant. Moreover, most plans require you to stay with the company for a specific length of time to become fully vested, or in other words, fully eligible for benefits. If you quit or lose your job before retirement, you may

lose your benefits.

It is important for you to remember that 9 out of 10 defined-benefit plans do not provide for a cost of living adjustment (COLA). This means that inflation could significantly reduce your purchasing power during retirement. You should also be aware that some plans are unfunded, which means the company does not put aside the money to pay retirement benefits but instead pays retirement benefits out of the company's current profits. If the company does not make the necessary profits, you may not get your retirement benefits. Finally, if you die before retirement, your surviving spouse will likely receive a reduced benefit.

Payout Formulas

With a defined-benefit plan, the company uses a payout formula to determine how much you will receive at retirement. This formula usually includes variables such as retirement age, average salary, and years of employment.

The following example shows a payout formula used by XYZ Corporation. Assume XYZ Corporation uses the following steps to calculate an employee's annual retirement payout:

1. Averages the employee's five highest annual salaries within the last 10 years
2. Determines the employee's total years of employment
3. Multiplies the average salary by 1.5 percent and by the total years of employment—a maximum of 33 years

Bill Smith has worked for XYZ Corporation for 25 years. The average of his five highest salaries over the last 10 years is $60,000. Using this information, XYZ Corporation calculates his retirement benefit as follows: $60,000 * 0.015 * 25 = $22,500.

When Bill retires at the end of next month, he will begin receiving $22,500 each year for as long as he lives. This means that Bill will receive 37.5 percent of his average salary each year throughout his retirement.

Time and Salary

One reason a company might provide a defined-benefit plan is to encourage employees to stay with the company over the long term. In most cases, it is easier to retain a good employee than to hire and train a new employee. Providing a good retirement program is an important means by which companies retain good employees. Table 3 shows the payouts of a pension plan based on the amount of time an employee has stayed with a company; the payout is shown for two different salary levels.

Cash-Balance Plans

A cash-balance plan is a type of defined-benefit plan that credits your retirement account based on a certain percentage of your salary each year (usually between 4 and 7 percent) plus a predetermined rate of interest. Employees have no control over the way this money is invested. The difference between cash-balance plans and plans based on a formula is that cash-balance plans grow at a predetermined rate regardless of how much money is in the account.

Table 3. Payouts Based on Time and Salary

Years of Employment	Average Salary	Payout
10 years	$55,000	$8,250
	$72,000	$10,800
20 years	$55,000	$16,500
	$72,000	$21,600
30 years	$55,000	$24,750
	$72,000	$32,400

There are several advantages of cash-balance plans. First, like basic defined-benefit plans, these plans are noncontributory, which means that, as the employee, you do not contribute funds to this plan. Funds contributed to a cash-balance plan are free money. Second, the rate of return on a cash-balance plan is constant and guaranteed. Third, your retirement benefits are much easier to calculate because you know all of the variables and the guaranteed rate of return. Fourth, cash-balance plans are portable. If you are fully vested, you can take your principal and earnings with you when you move to another company. Fifth, cash-balance plans are much cheaper for the company because the percentage of your salary and the guaranteed rate of return are generally low; funding these plans is not as much of a financial burden or risk to the company. One major disadvantage to employees is that the actual payouts are generally lower than the payouts of basic defined-benefit plans.

Payout Options

When you retire, you must choose from among several options of how you would like to receive your distributions. These options determine how long you will receive payments, how long your spouse or beneficiary will receive payments after you die (not all options allow this), and how much you will receive each month or year. Table 4 shows several payout options that may be offered by your company. Since different options insure more people and have guaranteed payments, the conversion factor relates the present value of the estimated payments compared to the standard benefit. For example, if you chose the Joint and Survivor 100-percent annuity (10-year certain), you would receive 88 percent of the standard payment but would have the guarantee that both you and your spouse would receive payments for the rest of your lives, with a minimum 10 years guaranteed even if you both died within 10 years.

The standard benefit gives you equal monthly payments for as long as you live. If you die within 10 years of the date you retire, payments will continue to your beneficiary until the 10 years are up. If you choose the 20-year certain and life option, payments are guaranteed for 20 years. A life annuity guarantees payments only for as long as you live.

If you are married when you retire, federal law requires that, at a minimum, your benefit be paid according to the qualified joint and survivor annuity payment option. This option provides equal payments for as long as you live, and 50 percent payments to your spouse for as long as he or she lives. A surviving spouse may also be eligible to receive a 10-year certain or a 75 or 100 percent annuity, but, if you die before retirement, your spouse will usually be restricted to the qualified joint and survivor annuity option.

Table 4. Payout Options and Conversion Factors

Payout Option	Conversion Factor
Standard benefit (10-year certain and life)	1.00
20-year certain and life	0.92
Life annuity	1.02
Qualified joint and survivor annuity (50 percent and no-term certain)	0.95
Joint and survivor 50 percent annuity (10-year certain)	0.95
Joint and survivor 75 percent annuity (10-year certain)	0.91
Joint and survivor 100 percent annuity (10-year certain)	0.88

Learning about Your Company's Plan

You should ask a number of questions when investigating your company's retirement plan or when considering new employment. You should also get it in writing, as benefits may change over time. The following are questions you should ask about your company's plan:

1. Does the company provide a defined-benefit plan?
2. Is the payout based on your average salary, your final annual salary, or some other amount?
3. How long is the vesting period?
4. What formula does the company use to calculate benefits?
5. What is the normal retirement age?
6. What happens to your payout amount if you retire earlier than the normal retirement age?
7. Is there any advantage to working past age 65?
8. Will the payout include a cost of living adjustment (COLA)?

Defined-benefit plans can be an important part of your retirement plan. However, you must understand the plan—its benefits, drawbacks, and requirements—so that you can receive the maximum amount at retirement.

Explain Defined-Contribution Plans

With a defined-contribution plan (DCP), your employer contributes a specific amount to your retirement plan while you are working; when you retire, your employer is absolved of any further responsibilities. In a defined-contribution plan, both you and your employer generally contribute to the fund. Your pension is determined by how much both you and your employer invest each year, how fast the investment grows, and how many years your investment is able to grow.

Advantages and Disadvantages

For employees, the advantages of defined-contribution plans include that they have strong growth potential, they are portable, and they provide you with greater control. These plans are also tax-advantaged in the sense that the contributions and earnings are tax-deferred money. The main disadvantage of these plans is that there is no guarantee as to the actual amount of money you will receive at retirement; in other words, defined-contribution plans shift the risk from your employer to you.

For employers, defined-contribution plans are advantageous because they are easier to manage, they have fewer government regulations, they provide a greater number of investment choices, and they come in many different types. The disadvantage to employers is that these plans take time and resources to manage.

Types of Defined-Contribution Plans

There are three types of defined-contribution plans: discretionary (or optional) contribution plans, fixed contribution plans, and salary-reduction plans. In discretionary contribution plans, contributions are made at the discretion of the employer. In fixed contribution plans, contributions are fixed by the employer. And in salary-reduction plans, employees' contributions are made on a before-tax basis. Contributions to a salary reduction plan reduce the amount of the employees' taxable income and remain tax-deferred until retirement. In salary-reduction plans, you can direct your funds into various investment options, including fixed-income securities, equities, money market funds, and guaranteed investment contracts (GICs).

There are three main types of discretionary contribution plans:

> In a **Profit Sharing Plan**, the employer's contribution varies from year to year depending on the firm's profitability. There may be no contributions made if the company has an unprofitable year.
>
> **Stock Bonus Plans** are a type of profit-sharing plan in which employer contributions are made in the form of employer-owned shares of stock. Employee stock-ownership plans (ESOPs) and leveraged ESOPs (LESOPs) are the most common types of stock-bonus plans. In an employee stock-options plan, retirement funds are invested in company

stock. This is a very risky and non-diversified plan because both your retirement and your job are dependent on the same company. Since you are already an employee of the company, if the company does well, you will also likely do well, i.e., keep your job. If the company does poorly, you may lose your job, and the value of your company stock is likely to decline as well.

In a **Money Purchase Plan**, the employer contributes a percentage of the employee's salary each year.

There are two main types of fixed contribution plans:

In a **Thrift and Savings Plan**, the employer matches a percentage of the employee's contributions. These contributions are free money.

A **Target Benefit Plan** is a defined-contribution plan that has a required contribution level so that the employee will be able to meet a target level of benefits. Employers set this target level when an employee is hired, and the employer contributes to the plan each year to help the employee reach that level.

There are several types of salary-reduction plans. These plans are categorized according to the type of company that installs the plan and whether the plan uses before-tax or after-tax dollars for funding. The main types of salary reduction plans are 401(k) plans, Roth 401(k) plans, 403(b) plans, Roth 403(b) plans, and 457 plans.

401(k) plans are set up by a private company. In a 401(k), you contribute a percentage of your salary up to a specified amount ($19,000 in 2019 or $25,000 if you are over age 50, see Table 6), and the money grows in a tax-deferred account until you retire. Your employer may or may not contribute a matching amount (free money). Because this money is tax-deferred, you do not have to pay taxes on the money until you withdraw it after you reach age 59½.

In **Roth 401(k) plans**, you contribute a percentage of your salary. The maximum contribution amount is the same as for 401(k) plans (see Table 6). Roth 401(k) plans are unique in that you contribute to the fund using after-tax dollars, or money on which you have already paid taxes. These plans are beneficial because the money grows until you retire, and you never need to pay taxes on the earnings and capital gains again if you withdraw it after age 59½.

403(b) plans are basically the same as a 401(k) plan; however, 403(b) plans are specifically designed for employees of nonprofit, tax-exempt companies and institutions (for example, schools). The maximum contribution amount is the same as for 401(k) plans (see Table 6).

Roth 403(b) plans are basically the same as a Roth 401(k) plan; however, they are specifically designed for employees of nonprofit, tax-exempt companies and institutions. Contributions are made with after-tax dollars, and individuals are not required to pay taxes on withdrawals after individuals reach age 55. The maximum contribution amount is the same as for 401(k) plans (see Table 6).

457 Plans are basically the same as a 401(k) plan, but they are specifically designed for state and municipal workers. The maximum contribution amount is the same as for 401(k) plans (see Table 6).

Matching Plans

In a matching plan, the employer matches all or a percentage of the contributions you make to your retirement fund. Less than 80 percent of all 401(k) plans include a matching component. Note that with a Roth 401(k) or Roth 403(b) plan, the employer contribution is made on a before-tax basis and not an after-tax basis. Funds the employer provides as a match are held in a separate tax-deferred account; taxes must still be paid on the matched amount at retirement. Always get the match!

Vesting Requirements

Vesting is the process through which your employer's contributions to your retirement fund become your property. You will typically become fully vested, or gain full ownership of the contributions, after you have worked for the company for a certain number of years. For example, you may own 60 percent of the employer's contribution after two years, 80 percent after three years, and 100 percent after four years. Vesting schedules vary depending on the company. Matching contributions must be vested according to the cliff schedule, which means that after a specific number of years, you are immediately vested, or to the graded schedule, which means you are partially vested after a specific number of years, and the vesting increases each year (see Table 6).

Contribution Limits

An annual contribution limit is the maximum amount you can invest in a particular retirement vehicle each year. In a 401(k) plan, you cannot contribute more than 25 percent of your before-tax income, and this amount cannot exceed the annual limits in Table 7. Employer contributions may exceed this limit. Annual contribution limits gradually increase each year. In addition to the limits listed in Table 7, a "catch-up" limit is available for those over age 50. If you are over age 50, your annual contribution limits are the normal contribution limit (i.e., $19,000 in 2019) plus the additional catch up contribution limit of $6,000, which adds up to $25,000.

Tax Implications of Defined-Contribution Plans

If your company offers a defined-contribution plan, there are several tax implications you should be aware of:

- Retirement income is taxed as ordinary income.
- If you make withdrawals from your defined-contribution plan before age 59½, you will be charged a 10 percent penalty to principal and earnings (there are some exceptions).
- There is a 20 percent withholding requirement on withdrawals made before age 59½ from qualified plans. This means that if you withdraw $20,000 before age 59½, you will only receive $16,000. The pension plan will keep the remaining 20 percent to submit to the Internal Revenue Service for tax purposes.
- Certain loan provisions may apply.
- Mandatory annual distributions begin after age 70½.

Table 5. Vesting Schedule for Matching Plans

	401(k) Plans		403(b) Plans	
Year	Cliff	Graded	Cliff	Graded
1	0%	0%	0%	0%
2	0%	20%	0%	0%
3	100%	40%	0%	20%
4	100%	60%	0%	40%
5	100%	80%	100%	60%
6	100%	100%	100%	80%
7	100%	100%	100%	100%

Table 6. Annual Contribution Limits for 401(k) Plans, 403(b) Plans, and 457 Plans**

Year	Contribution Limit	Catch-Up Contribution Limit*
2014	$17,500	$5,500
2015	$18,000	$6,000
2016	$18,000	$6,000
2017	$18,000	$6,000
2018	$18,500	$6,000
2019	$19,000	$6,000

* Catch-up contribution is for those over age 50.

** 457 plan participants also have the option of increasing their deferrals to the lesser of twice the normal limit ($38,000 in 2019) or the normal limit not applied in previous years; this option may be exercised in the final three years before retirement.

Required Minimum Distributions

When saving for retirement, remember that the benefit of deferred taxes is offset by the fact that

you must eventually pay taxes on your principal and earnings. Defined-contribution plans that defer taxes require that minimum distributions must begin by April 1 of the year following age 70½. The distribution amount is calculated by dividing the account balance on December 31 of the previous year by the life expectancy. Note that there is a 50 percent penalty on minimum distributions that are not taken (see Table 7).

Payout Options

Payout options are the ways you can receive your money at retirement. You can receive a lump-sum distribution, an annuity, periodic payments, or you can roll the money into an individual retirement account (IRA).

A **Lump Sum Distribution** gives you full control over future investing and spending. The disadvantage is that taxes are due immediately on the full amount of the distribution. In addition, this type of distribution will not necessarily provide you with income throughout your retirement.

Table 7. Life Expectancy and Age

Age	Life Expectancy
70	27.4
71	26.5
72	25.6
73	24.7
74	23.8
75	22.9
76	22.0
77	21.2
78	20.3

An **Annuity**, which may be purchased either through an investment company or through an outside company, provides fixed payments, usually for life. However, an annuity does not usually provide a cost of living adjustment (COLA), and you must pay taxes on the amount you receive each year.

Periodic Payments provide you with fixed payments at regular intervals. However, this type of distribution does not ensure that you will receive income throughout your retirement because the money may eventually run out if you live longer than your planned periodic payments. Also, if payments are large, your tax rate may be quite high.

Rolling into IRA allows you to continue to defer taxes until you make withdrawals. Once the money is in an IRA, you can direct the investment of the funds even more than when the funds were in a 401(k) plan. The only disadvantage of this option is that you must begin making withdrawals at age 70½ or you will incur a penalty.

Making Use of Your Defined-Contribution Plan

Once you know which investment vehicle is available to you through your employer's defined-contribution plan, the next step is to choose the appropriate financial assets to include in this plan. Most people invest about 75 percent of their retirement assets in equities; in general, mutual funds provide good diversification opportunities. Refer to the unit on investing for help in determining which assets to include in your retirement vehicle. Most company plans offer about 10 investment options, although some plans offer significantly more.

As you make investment decisions, it is important to remember the principles of successful investing, the priorities of money, your investment horizon, your financial goals, and your risk-tolerance level. You should also consider other important issues, such as annual expenses, administration expenses, transfer fees, and reallocation options and costs.

Plans and Strategies for Employer Qualified Plans

As you put your Retirement Plan together, it is important to think through some plans and strategies. Examples include:

Plans and Strategies

Accumulation

- Live on a budget, save 20%, always get the company match
- Save 20% of every dollar, 15% into your Roth 401k, 3% for other goals, and 2% for children's mission and education
- Invest in Roth accounts while young and when rates are low. Use these to target your tax rate in retirement (to a low level)
- Even though you don't know future tax rates, maximize investments in Roths as you are saving more for retirement

Retirement

- Calculate a minimum level of retirement income, and annuitize that amount (if you have sufficient assets). The process is:
    - a. Calculate Social Security and defined benefit plan(s)
    - b. Determine your minimum amount needed to live on
    - c. Take a percentage of EQP assets at retirement to purchase an immediate annuity to give you the minimum amount needed to have your acceptable level of income
- Have both Roth and traditional retirement assets so you can target your tax rates in retirement
- Donate assets from your traditional 401k/403b to pay tithes and offerings to eliminate your capital gains

Distribution

- Have taxable (tax now), Roth (rarely taxed) and traditional (taxes later) vehicles to target your tax rate in retirement
- Set a target tax rate, then pull traditional assets up to that specific amount, then Roth assets afterwards to reduce taxes
- Make sure to pay your Required Minimum Distributions
- During your later years which your income is less, i.e., during missions, transfer money from your tax-deferred to tax-eliminated accounts. Use this time to move assets into Roth accounts with as little tax consequences as possible
- After age 69.5, donate assets from your traditional 401k/403b to pay tithes and offerings, to eliminate your capital gains, and to fulfill your required Minimum Distribution amounts

Summary

There are three main types of employer-qualified retirement plans: defined-benefit plans, defined-contribution plans, and salary-reduction plans. Defined-benefit plans provide a predetermined payout based on specific employee data, such as years of employment and annual salary. Defined-contribution plans are investment plans in which both the employee and the employer contribute funds to the plan; the amount contributed by the employer is generally fixed. In salary-reduction plans, employees contribute a percentage of their salary to retirement vehicles each period.

A defined-benefit plan (DBP), also called a pension plan, is a retirement plan funded entirely by an employer; the employee does not contribute to this type of plan. At retirement, the employee is promised a specific payout amount that is calculated using a formula set by the company.

With a defined-contribution plan (DCP), your employer contributes a specific amount to your retirement plan while you are working; when you retire, your employer is absolved of any further responsibilities. Both you and your employer generally contribute to the fund. Your pension is determined by how much both you and your employer invest each year, how fast the investment grows, and how many years your investment is able to grow. With salary-reduction plans, employees' contributions are made on a before-tax basis. Contributions to a salary reduction plan reduce the amount of the employees' taxable income and remain tax-deferred until retirement. In salary-reduction plans, you can direct your funds into various investment options, including fixed-income securities, equities, money market funds, and guaranteed investment contracts (GICs).

Assignments

Financial Plan Assignment

If you have an employer-qualified plan, talk to your employer. Find out as much information as

you can regarding your plan. What type of plan is it? Is it a defined-benefit plan or a defined-contribution plan, or does your employer offer both?

If your company offers a defined-benefit plan, what are the requirements for the plan? What factors are included in the payout formula (number of years working, average salary, percentage of salary, etc.)? How long must you be with the company to receive benefits? At what age can you begin receiving benefits? Based on today's earnings, how much will you receive each month during retirement?

If your company offers a defined-contribution plan, what type of plan is it? Does it have a company matching option (free money)? Are you getting your full company match each year? How much do you currently have in the plan? Where is that money allocated? Is the allocation consistent with your risk level and the fact that the funds are long term? Have you followed the principles of successful investing in terms of diversification, low costs, low risk, and other key factors? Are you rebalancing back to your target allocations in a timely manner? Become aware of this information because it is important to your retirement planning.

Learning Tools

The following Learning Tools may also be helpful as you prepare your Personal Financial Plan.

Retirement Planning Needs Spreadsheet (LT06)
: This Excel spreadsheet helps you determine how much you must save each month to achieve a specific lifestyle at retirement based on the following estimates: years until retirement, expected return, inflation, and tax rates.

Retirement Planning Ratio Forecasts (LT25)
: This spreadsheet is an Excel template that will help you determine where you are in your progress toward achieving your retirement goals. By inputting the relevant information, you can estimate whether you are on track for reaching your retirement goals, based on your age and income.

Roth versus Traditional: Which Is Better for You (LT28)
: This Excel spreadsheet helps you determine whether the traditional IRA or the Roth IRA is a better investment vehicle for you to use in saving for retirement. Note that this shares the 8 questions you should answer in deciding which to choose (see also Roth versus Traditional Accounts).

Review Materials

Terminology Review

401k Plans or Roth 401k Plans. These are defined contribution plans where employees contribute a percent of salary up to a specified amount. Employers may contribute a matching

amount (free money) to encourage participation.
403b Plans or Roth 403(b) Plans (also called Tax Sheltered Annuities). These are defined contribution plans, and are the same as 401k but for non-profit tax-exempt companies and institutions (i.e., schools).
457 Plans. These are defined contribution plans, the same as 401k plans but for state and municipal workers and tax-exempt organizations.
Average compensation. The average of the years of salary considered in making the defined benefit calculation.
Cash-Balance Plans. A type of DBP in which provides specific annual employer contribution (generally 4-7%) each year, plus a low but guaranteed rate of investment earnings. Accounts grow at a predetermined rate, regardless of how much is in the account. Employees do not make any investment decisions.
Defined Benefit Pension Plans. A Defined Benefit Pension Plan is a DBP where payments are based on a benefit payout formula. The formula is based on your salary, years worked and a company determined factor to calculate how much you will get each year. Employees do not contribute and bear no risk.
Defined Contribution Plan (DCP). A retirement plan where the employer contributes a specific amount to the employee's retirement funds while the employee is working and then has no responsibilities once the employee retires. Employer contributes to a fund, and then has no additional obligation when the employee retires. Employee may also contribute to the fund. Pension is determined by how much is invested by both the employer and employee, and how fast it grows.
Discretionary contribution plans. Retirement plans where contributions are at the employer's discretion. These include profit sharing plans, stock bonus or ESOP plans, and money purchase plans.
Distribution/Payout Options. These are options as to how you will take the benefits over your retirement.

- Life Annuities (guaranteed for the "certain" period). You receive benefits for as long as you live or for a certain guaranteed period, whichever is longer.
- Joint and Survivor Annuities (percent relates to the amount the spouse receives). You receive payment for as long as you live or for a certain guaranteed period, whichever is longer, and your spouse, after you die, receives that percent of your payment for as long as they live.
- Special Joint and Survivor Annuity (if there is a death in the marriage the benefit decreases). You receive payment for as long as you live or for a certain guaranteed period, whichever is longer, and your spouse, after you die, receives a percentage of that payment for as long as they live.

Employee Contribution (or Salary Reduction Plans). These are defined contribution plans where employees contribute before tax dollars reducing their taxable income and earnings accumulate tax deferred. The major plans are Roth or Traditional 401k and 403b plans and 457 plans. Employees direct the funds into different financial asset options provided by the company including mutual funds, index funds, fixed income, equities, money market funds, and GICs (guaranteed investment contracts). Companies have their list of approved investment assets. Employees choose where to invest their assets subject to the company list, and employees are not allowed to invest outside of approved investment assets.
Employer Qualified Retirement Plans. These are retirement plans, established by a company, that have specific tax and other benefits to both the company and the employee. Benefits include

competition, tax shelters, personal retirement for the owners, and personal retirement for the employees. They can be either defined benefit or defined contribution plans.
Fixed contribution plans. These are defined contribution plans where contributions are fixed by the employer. Examples are thrift and savings plans and target benefit plans.
Immediate Annuity Distribution. You can use your defined contribution plan to purchase an immediate annuity, either from your retirement Plan provider or from others outside the Plan.
IRA Rollover distribution (Be careful and don't touch the funds). You can roll over your distribution into an IRA. The benefits are you can defer taxes until you withdraw the funds, you can direct investment to different assets and asset classes, and you can continue to enjoy tax-deferred growth. The risks are that there is no guarantee that funds will last a lifetime and you must begin withdrawals at 70½ or 50% penalty is incurred.
Lump Sum Distribution. This is taking the entire retirement account at retirement. You are responsible to ensure this amount lasts your entire life. The benefits are you can take the money out as you need it, and can invest/gift/use it elsewhere. The risks are that plans only allow distributions every 3 months, taxes are incurred immediately, and if you do not plan well, may not have sufficient money for retirement.
Money Purchase Plans. These are defined contribution plans where the employer contributes a percentage of employee salary each year, not dependent on company profits. Employees do not contribute.
Periodic Payments distribution. With this distribution, you can plan for regular payments at regular intervals, and can ensure that payments are available for a specific period of time. However, there is no assurance of lifetime income, and your tax rate may be high due to the amount of money withdrawn.
Profit Sharing Plans. These are defined contribution plans where employer contributions vary year-to-year depending on firm profitability (it may be zero if the firm is not profitable in that year).
Required minimum distributions. For tax deferred retirement plans, the government requires that a certain percentage of assets must begin by April 1st of the year following age 70½. The distribution is the account balance on Dec. 31 of the previous year (age 69) divided by the life expectancy from the table below. There is a 50% penalty on minimum distributions not taken.
Roth. These are defined contribution plans where distributions of contributions can be made without penalty and without tax after 5 years. Roth plans do not have mandatory distributions (if they are rolled over into Roth IRAs at retirement), and matching employer contributions with Roth plans go into traditional plans (not Roth plans). Roth plans allow you to save more money (as taxes are paid outside the retirement vehicle).
Stock Bonus Plan. These are defined contribution plans where employer contributions are made with employer shares of stock. Employee stock ownership plans (ESOPs) and leveraged ESOPs (LESOPs) are the most common.
Target Benefit Plan. These are defined contribution plans that establish a required contribution level to meet a specific target level of benefits at retirement.
Thrift /Savings Plans (TSP). These are defined contribution plans where the employer matches a percentage of employee contributions to a specific amount (i.e., free money). This program is for employees of federal civil service.
Vesting period. This is the period required before the promised benefits are considered yours.

Review Questions

1. What is a qualified retirement plan?
2. What are the three major types of employer-qualified retirement plans?
3. What is the general trend in regard to qualified retirement plans, or what types of plans are most companies shifting away from, and what types of plans are most companies shifting toward?
4. What are the three types of defined-contribution plans?
5. In relation to an employer's contributions to your retirement fund, what does "vesting" mean? Why is it important to know the vesting requirements of your employer?

Case Studies

Case Study 1

Data

Bill, married with two kids, will be graduating in April with his bachelor's degree and has two similar offers from companies located in San Francisco, California. Both are companies he would be content to stay with for 30 years. Company A has a 401(k) with a 100 percent match up to 4 percent of his salary. Company B has a 401(k) with no match but has a defined-benefit plan with the formula based on average salary, a factor of 1.5 percent, and years of service up to 30 years.

Calculations/Application

A. Assuming the salary is $50,000 for each firm, which has the more attractive retirement package for Bill?

B. Can Bill participate in other retirement plans?

Case Study 1 Answers

A. This is a difficult question to answer and depends on (1) Bill's plans, (2) Bill's forecast for the company, and (3) Bill's view of company policy.

(1) Bill's Plans. How long is he planning to be with either company? Is he going back to graduate school soon? How portable is the defined-benefit plan? The answer to this question is really based on the assumptions Bill has regarding how long he plans to stay with either company. Since a defined-benefit plan generally requires you to stay for an extended period, that benefit will only be valuable if Bill is committed for a long period of time.

(2) Bill's Forecast for the Company. Is the company viable, particularly company B? Will Company B be around for as long as Bill wants it to? Are the products of both companies viable?

(3) Bill's View of Company Policy. Will either company change its retirement policies after Bill retires? Have the companies historically taken good care of their employees? Are the plans consistent with similar companies? What is Company B's defined-benefit formula? If Bill stays until retirement at B, what is the annual benefit? Assuming a reasonable interest rate, what is the present value of the annual benefit to

Bill? What is the value of the company match over the same period?

B. Bill can have other plans, as long as his salary is below specific IRS-determined limits. Based on the information provided, he could also invest in either a Roth or traditional IRA, or if he had a small business, he may be able to invest in a small business plan, such as a SEP IRA.

Case Study 2

Data

Greg is 50 years old and has been working for 10 years with a company that has a defined-benefit plan. The formula is the average of the five highest annual salaries within the last 10 years multiplied by a company-determined factor of 1.5 percent multiplied by years in service (to a maximum of 33). Assume Greg stays with the company until his retirement at age 65 and his highest annual salaries for five years average $60,000.

Calculations

A. How much can Greg expect to receive annually at retirement?

B. What is the percent of his final five-year average salary?

Case Study 2 Answers

A. Greg can expect to receive the following:

$60,000 * .015 * 25 years = $22,500 per year until he dies.

B. This is $22,500 / $60,000, or 37.5 percent, of his final salary.

Case Study 3

Data

Adam is 55 and plans to retire in 10 years. He is working for a company with a tax-sheltered annuity (TSA, or 403(b) Plan).

Calculations

A. How much can he contribute, assuming his salary is below the IRS-determined limits, into his company's Roth 403(b) plan in 2019?

B. If his company has a matching program, what impact will that have on Adam's contribution?

Case Study 3 Answers

A. Contribution limits for the 401(k), Roth 401(k), 403(b), Roth 403(b), and 457 Plan annual contribution limits are:

Year	Contribution Limit	Catch-Up Contr.
2017	18,000	6,000
2018	18,500	6,000
2019	19,000	6,000

Since Adam is over 50 years old, he could contribute $19,000 plus a $6,000 catch-up contribution in 2019, for a total of $25,000.

B. The company match will have no impact on the amount Adam can contribute.

Case Study 4

Data

Adam retired on his 60th birthday and did not use any of his traditional IRA balances. On December 31 of his 69th year, he had $450,000 in his 401(k) plan.

Calculations

A. How much would he be required to take out of his account the next year, the year he turns 70.5?

B. How much would he be required to take out if this was a Roth 401(k)?

Life Expectancy Table

Age	Life Expectancy (LE)
70	27.4
71	26.5
72	25.6

Case Study 4 Answers

A. From the table, his life expectancy at age 70 is 27.4 years. Adam will be required to take a distribution of his 401(k) plan of $450,000 / 27.4, or $16,423, the next year.

B. If this was a Roth 401(k), he would still have to take the required distributions. However, if, once he retired, he rolled his Roth 401(k) over to a Roth IRA, there would be no required distributions.

Case Study 5

Data

Sam graduated last year and has already begun his retirement program. He has invested enough in his company 401(k) plan to get the company match this year and has found out that his company has a Roth 401(k) plan as an option. He is discussing with a friend the benefits of the Roth 401(k) versus the traditional 401(k).

Application

A. Which vehicle, the Roth or traditional 401(k), should Sam select and why?

B. What are the assumptions that would impact Sam's choice of retirement vehicle?

Case Study 5 Answers

A. Which vehicle Sam chooses should be based on his vision, goals, objectives, and assumptions for the future.

B. His assumptions should relate to seven key areas (see Roth versus Traditional: Which Is Better for You (LT28):

1. Sam's projected tax rate in retirement. If Sam expects his tax rate to be higher (or lower) in retirement, the Roth (or traditional) is preferred. Make sure Sam takes into account child tax and other credits when determining his current tax rate.

2. Sam's need for the tax break now. If the reduction in AGI is important for Sam to reduce his current tax bill, he would likely choose the traditional.

3. His cash flow situation. If he has additional money to invest for retirement, he can invest more in the Roth than the traditional, due to taxes.
4. His possible need for principal. If Sam might need some of the money in the account (just in case), with the Roth he can take out principal after five years without penalty or taxes, as principal has already been taxed. He cannot, however, take out earnings and interest without penalty.
5. His desire to have more money saved for retirement. If Sam wants to put more money in for retirement, since he pays taxes outside the retirement vehicle with a Roth vehicle, he is actually saving more for retirement. For example, if he puts both $5,000 into both a Roth and traditional IRA, the Roth will be worth more at retirement after taxes as Sam must pay taxes on the traditional IRA when he takes out the money.
6. Does he want to avoid RMDs or required minimum distributions. If he puts money into a tax-deferred account, he is required by law to take out a required minimum distribution each year after age 69. If he does not take out these RMDs, his penalty is 50% of those RMDs, which is steep.
7. *Does he want to leave money to your heirs without major tax or other problems*. Tax deferred money has yet to be taxed. When these assets are left to heirs, the heir still must pay taxes on these assets. With Roth vehicles, because the taxes are already paid, it is much easier from a tax basis to give them to heirs.
8. *Does he want to be able to target his tax rate in retirement.* If he wants to target his tax rate in retirement, he should have a balance of his assets in tax-now accounts (brokerage, banks, and mutual fund companies), tax-deferred accounts (traditional 401k, 403b and IRA accounts), and tax-never accounts (Roth IRA and Roth 401k accounts). This way he can pull out assets from his tax-now and tax-deferred accounts up to his targeted tax rate, and anything beyond, he takes from his Tax-never accounts.

5. Retirement 4: Understanding Individual and Small-Business Plans

Introduction

Whether you work for a large or a small company or are self-employed, you need to plan for retirement. This chapter will discuss your third priority regarding money when saving for retirement: individual retirement accounts. I will explain how you can plan for retirement if you work for a small company or are self-employed. Even if you already have a qualified retirement plan with your company, you may still be eligible to contribute to an individual retirement plan and save even more for your retirement goals. The key is to understand the retirement vehicles available to you and how you can utilize these vehicles to help you achieve your goals.

Objectives

When you have completed this chapter, you should be able to do the following:

A. Understand individual retirement accounts
B. Explain when it is beneficial to convert a traditional IRA to a Roth IRA
C. Describe retirement plans designed for small businesses and individuals who are self-employed
D. Understand plans and strategies for individual and small business plans.

Understanding individual and small-business retirement plans is an important part of retirement planning.

Describe Individual Retirement Accounts

Because of the Taxpayer Relief Act of 1997, there are now three main types of individual retirement accounts (IRAs): the traditional IRA, the Roth IRA, and the education IRA. In addition to these three main types of IRAs, there are many other types of IRAs you should learn about as you prepare for retirement.

Traditional IRAs

A traditional IRA is a retirement account in which you can contribute up to $6,000 in 2019 if you are under age 50; if you are over age 50, you can contribute $7,000 (see Table 1). This account may or may not be tax-deferred, depending on your income level and whether or not you are a participant in another employer-sponsored retirement plan (ESRP). To contribute to a

traditional IRA, you must be younger than 70½ years, and you or your spouse must have earned income the year you contribute.

Contributions to a traditional IRA are tax-deductible if you meet certain conditions. If you are single and are not an active participant in an ESRP, or if you are married and neither spouse is an active participant in an ESRP, your traditional IRA contributions are tax-deductible regardless of your income level. If you or your spouse is an active participant in an ESRP, you can deduct contributions only if your income is below a certain level (see Table 3). For example, in 2018, if you are below age 50, you can deduct the full $6,000 contribution on your income tax return if you do not have an ESRP. You can also deduct the full $6,000 if you have an ESRP but your modified adjusted gross income (AGI) is $101,000 or less for a joint return or $63,000 or less for a single return (see Table 3).

Table 1. Traditional and Roth IRA Annual Contribution Limits

Year	Contribution Limit	Catch-Up Contributions*
2015	$5,500	$1,000
2016	$5,500	$1,000
2017	$5,500	$1,000
2018	$5,500	$1,000
2019	$6,000	$1,000

* The catch-up contribution is for individuals over age 50.

You can take withdrawals from a traditional IRA after you reach age 59½ and you can use the money for any purpose. Before you reach this age, your withdrawals are subject to federal penalties of 10 percent unless you use the withdrawals to pay for your first home (limit $10,000), death or disability expenses, annuity payments, or medical expenses greater than 7.5 percent of your AGI.

Traditional IRA plans that defer taxes require that you begin taking minimum distributions by April 1 of the year after you turn age 70½. You can always take out more. This required minimum distribution amount is calculated by dividing the total account balances of all tax-deferred IRA retirement plans on December 31 of the previous year by the individual's current life expectancy (see Table 2). Note that there is a 50 percent penalty on minimum distributions that are not taken.

Table 2. Life Expectancy and Age

Age	Life Expectancy (LE)	Age	LE
70	27.4	75	22.9
71	26.5	76	22.0
72	25.6	77	21.2
73	24.7	78	20.3
74	23.8	79	19.5

Roth IRAs

A Roth IRA : is a type of individual retirement plan in which contributions are made with after-tax dollars. Because you make contributions with after-tax dollars, your contributions are not tax-deductible. However, this plan provides a unique benefit that is not available with any other retirement plan: all earnings and capital gains are tax-free when you or your beneficiaries make withdrawals at retirement.

You can contribute to a Roth IRA even if you have an ESRP and even if you are over age 70½. In 2019, each individual can contribute up to $6,000 (see Table 1).

A big advantage of a Roth IRA is that you can withdraw your initial contributions at any time without incurring taxes or penalties (check your state's tax rules for more information); however, this benefit does not apply to earnings. Earnings are tax-free if your Roth IRA has been in place for at least five years and if you are at least 59½ when you make withdrawals. You can contribute to both a traditional IRA and a Roth IRA in a single year, but you cannot exceed the yearly contribution limits for the combined contributions to your traditional and Roth IRAs. With Roth IRAs, you are not required to receive distributions by age 70½.

The disadvantages of a Roth IRA include that there are income limits above which you cannot invest in a Roth IRA (see Table 3), and you must hold your account for at least five years before you can make earnings withdrawals without penalty.

If you make withdrawals before age 59½ and you have had the account for fewer than five years, earnings are subject to ordinary income taxes. Earnings are also subject to an early withdrawal penalty of 10 percent unless you use the money to purchase your first home or to pay for death or disability costs.

If you make withdrawals after age 59½ but you have had the account for fewer than five years, earnings are subject to ordinary income taxes but not to early withdrawal penalties.

If you make withdrawals after age 59½ and you have had the account for five years or more, all contributions and earnings can be withdrawn tax-free. There are no minimum withdrawal requirements.

Education IRAs or Coverdell Education Savings (ESA) Accounts

An education IRA : is an investment tool you can use to prepare for the cost of your children's education. You can set up a separate IRA for each child and make contributions to these accounts until the child reaches age 18. The annual contribution limit for education IRAs in 2018 is $2,000 per child; your total contributions into different ESA accounts can equal no more than $2,000 per child. These contributions and their earnings can be withdrawn tax-free if they are used to pay for qualified educational expenses related to enrollment at eligible elementary, secondary, post-secondary, and higher-education facilities. All savings must be withdrawn by the time the child reaches age 30, but any amount left over after you pay for one child's education can be rolled into another child's account. You also cannot take a Hope education credit on your

tax return the same year in which you withdraw money from your education IRA. One disadvantage of an Education IRA is that there are income limits above which you cannot invest in an education IRA (see Table 3).

Other IRAs

The spousal IRA is funded by a married taxpayer in the name of his or her spouse. Normally, participants in IRAs must have earned income. However, it is not necessary for the spouse to have earned income with the spousal IRA.

In a nondeductible IRA, contributions are made with after-tax dollars, and earnings grow tax-deferred; taxes are paid on the earnings when they are withdrawn at retirement. Even if your modified adjusted gross income (MAGI) is greater than allowable limits, you may still find it useful to look into this type of IRA.

An individual retirement annuity is set up with a life insurance company through the purchase of an annuity contract. This annuity ensures a certain dollar amount of funds will be paid to the owner each period of the contract after retirement.

The employer and employee association trust account IRA is set up by employers, unions, and associations.

The rollover IRA is a traditional IRA that is set up specifically to receive distributions from a qualified retirement plan, such as another 401(k), IRA, or other plan.

An inherited IRA is acquired by the non-spousal beneficiary of a deceased IRA owner.

The simplified employee pension IRA (SEP IRA) is a traditional IRA set up by a small-business owner for the company's employees. This type of IRA will be discussed later in this chapter.

The savings incentive match plan for employees IRA (SIMPLE-IRA) is a traditional IRA set up by a small-business employer for the company's employees. This type of IRA will be discussed later in this chapter.

Deductibility and Contribution Limits

Individuals whose modified adjusted gross income (MAGI) is below the ranges listed in Table 3 can take the full deduction for contributing to a traditional IRAs or make a full contribution to a Roth IRA or education IRA. Your MAGI is calculated by taking your adjusted gross income and adding certain items such as deductions for foreign income, foreign-housing, student-loans, IRA-contributions, and for higher-education costs. If your MAGI is between the ranges indicated, you can take only a partial tax deduction on your contribution or make only a partial contribution to the indicated IRA account.

Which Is Better: The Traditional IRA or the Roth IRA?

The decision of whether you should invest in the traditional IRA or the Roth IRA should be based mainly on these five factors: (1) your need to reduce current taxes through tax deductions, (2) your anticipation of tax rates when you retire, (3) your availability of money to pay the necessary taxes on the money contributed to a Roth IRA, (4) your need for investment flexibility, and (5) your need for estate planning to transfer assets to your heirs.

If you need tax deductions now, the traditional IRA is the best choice. Note, however, that since you are taking a deduction now, you will have to pay taxes on your entire traditional IRA balance (principal and earnings) when you retire. Remember that tax-deferred vehicles have the disadvantage of converting capital gains income (which is taxed at a lower rate, generally 15 percent) into ordinary income (which is taxed at your higher marginal tax rate).

Table 3. IRA Deductibility and Contribution Limits

	Modified Adjusted Gross Income (MAGI) Range	
Traditional IRA- Deductibility Limits		
Year	Single Range	Married Range
2015	$61,000–$71,000	$98,000–$118,000
2016	$61,000–$71,000	$98,000–$118,000
2017	$62,000–$72,000	$99,000–$119,000
2018	$63,000–$73,000	$101,000–$121,000
2019	$64,000–$74,000	$103,000–$123,000
Roth IRA- Contribution Limits		
2015	$116,000–$131,000	$183,000–$193,000
2016	$117,000–$132,000	$184,000–$194,000
2017	$118,000–$133,000	$186,000–$196,000
2018	$120,000–$135,000	$189,000–$199,000
2019	$122,000–$137,000	$193,000–$203,000
Coverdell (Education IRA)- Contribution Limits		
2015	$95,000–$110,000	$190,000–$220,000
2016	$95,000–$110,000	$190,000–$220,000
2017	$95,000–$110,000	$190,000–$220,000
2018	$95,000–$110,000	$190,000–$220,000
2019	$95,000–$110,000	$190,000–$220,000

If you expect your tax rates to be lower in the future, the traditional IRA is usually the best choice. If you expect tax rates to be higher in the future, the Roth IRA is usually the better choice. To see the impact of tax rates on retirement savings, see Roth versus Traditional: Which Is Better for You (LT28).

If you currently have the money available to pay taxes on your retirement plan contributions, your best choice is likely the Roth IRA. If you pay taxes now on the principal, you will never have to pay taxes on any of the earnings again if you withdraw funds after age 59½ and have

held the fund for at least five years. In addition, you can theoretically contribute more to the Roth IRA than to the traditional IRA. Remember that the Roth is an after-tax contribution fund—this means that to make the $6,000 contribution in 2019, you must earn $6,000 plus any taxes you must pay on your income. If your average tax rate is 15 percent, you would, in essence, be contributing $6,471 in earnings ($6,000 / (1 – .15)) before taxes.

If you need investment flexibility, which in this case means that you think you may need to withdraw some of your retirement funds before retirement (and you would like to withdraw funds without a penalty), the Roth IRA is the better choice. Since you have already paid taxes on the principal you contribute to the Roth IRA, you are allowed to withdraw the principal at any time without having to pay any penalties or taxes.

Finally, if you want to leave your retirement money to your heirs, the Roth IRA is usually the better choice. Since taxes are paid up front on the Roth IRA, the money can be left to heirs without the imposition of additional estate or inheritance taxes on distribution. Assets from a traditional IRA require the payment of taxes before distribution to your heirs.

Explain When It Is Beneficial to Convert a Traditional IRA to a Roth IRA

Converting : your traditional IRA into a Roth IRA may be a smart choice under the following circumstances: (1) you think your tax bracket will stay the same or go up after you retire, (2) you plan to wait at least five years before withdrawing money, (3) you have sufficient funds from other savings or investments to pay the taxes on the conversion; (4) you won't move into a higher tax bracket during the year by converting, or (5) you want to avoid a minimum-distribution requirement from your retirement savings at age 70½.

To convert to a Roth IRA, you take the money from your traditional IRA, 401(k), 403(b), or 457 plan and pay the taxes on these accounts before moving the funds to a Roth IRA. For the money to accumulate tax-free in the Roth account, both the 5-year rule and the 59½-year rule still apply.

Transfers are allowed in three ways: (1) by accepting a payment from your traditional IRA and re-depositing it within 60 days, (2) by requesting a trustee-to-trustee direct transfer, or (3) by changing the account designation to a Roth with the account's trustee. The direct transfer is the simplest and safest way to convert. If you use the 60-day rollover option, remember that a 10 percent penalty tax will be withheld at distribution, and you will have to replace the withheld taxes with other funds when the money is deposited into the Roth account. Moreover, the 10 percent early withdrawal penalty applies if you use IRA funds to pay income taxes at conversion. Direct transfer is the simplest and safest way to convert funds from one type of account to another.

Describe Retirement Plans Designed for Small Businesses and Self-Employed

Just as there are: retirement plans available to employees of large businesses, there are also retirement plans available to employees of small businesses and to individuals who are self-

employed. These plans have some of the same tax advantages as the plans available to larger businesses, and some are even more generous. Some of these plans allow you to invest even if you already have another retirement plan through another employer. If you are self-employed (either full- or part-time), or if you work for a small business, you can invest money in a simplified employee pension plan (SEP IRA), a Keogh plan, or a new savings incentive match plan for employees (SIMPLE IRA).

There are two categories of small-business retirement plans. The first category includes plans funded by the small-business employer, for example, SEP IRAs and Keogh plans. The second category includes plans funded by both the small-business employer and the employee: mainly the SIMPLE IRA and SIMPLE 401(k) plans.

Plans Funded by Your Employer

The **SEP IRA** (simplified employee pension individual retirement account) allows a small-business employer to contribute to employees' retirement funds. The employer usually contributes the same percentage of income for each eligible employee. In 2018, employers could contribute a maximum of either 25 percent of an employee's salary or $56,000, whichever was less. The limits on the amount of money that can be contributed to this defined-contribution account are set in Code 415 of the Internal Revenue Code (see Table 4). There are no minimum contribution requirements on the amount the employer can contribute to these plans, and they are generally best for companies with few employees. If you have one of these accounts, you can still have other qualified individual retirement accounts. Contributions are tax-deductible for the employer, earnings grow tax-deferred for the employee, and the individual employees own the plans.

Table 4. Section 415 Funding Limits

Year	$ Amount
2015	53,000
2016	53,000
2017	54,000
2018	55,000
2019	56,000

SEP IRAs are easiest to set up and maintain, and they do not require annual filings. They allow larger contributions than traditional IRAs ($56,000 versus $6,000 in 2019). This is the best type of retirement plan for businesses with no or only a few employees.

The major disadvantages of a SEP IRA include that you cannot borrow against the retirement plan and that early withdrawals (withdrawals made before age 59½) incur a 10 percent penalty in addition to ordinary income taxes.

Keogh Plans (also called HR 10 plans) are set up by a sole proprietor or partnership. These plans allow small businesses to make tax-deductible contributions to employees' retirement plans.

Plans can either be defined-benefit plans or defined-contribution plans, but most Keogh plans are defined-contribution profit-sharing plans or defined-contribution money-purchase plans.

Employers usually contribute the same percentage of income for each eligible employee. As an employee, you can also contribute up to 20 percent of your income (to a maximum of $56,000 in 2019) into your Keogh plan. As with many other retirement plans, Keogh investments grow tax-deferred.

There are three unique options that make Keogh plans flexible: two are defined-contribution plans and one is a defined-benefit plan. These options make Keogh plans somewhat similar to the defined-benefit plans and defined-contribution plans offered by larger companies. (For more complete details on these plans, see Internal Revenue Service, Publication 560: Retirement Plans for Small Businesses: SEP, SIMPLE, and Qualified Plans at http://www.irs.gov/pub/irs-pdf/p560.pdf.)

There are two types of Keogh defined-contribution plans: profit-sharing plans and money-purchase plans. Profit-sharing plans allow employers to share company profits with employees by contributing to employee retirement plans. Contribution limits for profit-sharing plans are more flexible than limits on other plans. Money-purchase plans have a fixed contribution limit that is not based on company profitability. A Keogh defined-benefit plan is any plan that is not a defined-contribution plan.

In a defined-contribution plan, the maximum amount an employer can contribute in 2018 is either 100 percent of an employee's average salary for the past three years or $56,000, whichever is less. In a defined-benefit plan, the maximum amount an employer can contribute in 2018 is either the employee's average salary for the past three years or $225,000, whichever is less. Because of these higher contribution maximums, Keogh plans are especially helpful for those trying to catch up on retirement savings.

Possible disadvantages of Keogh plans include that they require more administrative work than SEP IRAs, they cannot be borrowed against, and they must be established by December 31 of each year.

Plans Funded by Both You and Your Employer

The most popular plans that are funded by both the employer and employee are the SIMPLE plans. SIMPLE plans, or savings incentive match plans for employees, are tax-sheltered retirement plans for small businesses (businesses with fewer than 100 employees) or for individuals that are self-employed. In SIMPLE plans, an employer matches some employee contributions; SIMPLE plans are similar to company-matching 401(k) plans. There are two different types of SIMPLE plans: SIMPLE IRAs and SIMPLE 401(k) plans.

In a SIMPLE IRA, both you and your employer take part in funding your retirement. To be eligible for a SIMPLE IRA, you cannot have another qualified plan at the same time. In 2019,

you can contribute up to 100 percent of your annual income, up to a maximum of $13,000, in tax-deferred funds (see Table 5). Since contributions are tax-deferred, there is a penalty for early withdrawals. Money withdrawn within two years of establishing the account incurs a 25 percent penalty, and money withdrawn before you reach age 59½ incurs a 10 percent penalty and is taxed as ordinary income.

With a SIMPLE IRA, your employer must match your contributions (usually up to two to three percent of your annual income) unless you make non-elective or optional contributions. The employer is required to make a minimum contribution of two percent of your annual income to your SIMPLE IRA each year. Any contributions you or your employer makes to your SIMPLE IRA are tax-deductible. Compared with other small-business plans, SIMPLE IRA plans are easy to set up and administer.

Table 5. SIMPLE IRA/401(k) Plan Contribution Limits

Year	Contribution Limit	Catch-up*
2015	$12,500	$3,000
2016	$12,500	$3,000
2017	$12,500	$3,000
2018	$12,500	$3,000
2019	$13,000	$3,000

* Catch-up contributions are available for those over age 50.

A SIMPLE 401(k) plan is very similar to a SIMPLE IRA and has the same contribution limits and matching requirements. However, a SIMPLE 401(k) plan requires more time and resources to establish. If you are making contributions to a SIMPLE 401(k) plan, your employer must match one to three percent of your elective annual contributions or contribute at least two percent of your annual income as a non-elective contribution.

Understand Plans and Strategies for Small Business and Individual Plans

As you put your Retirement Plan together, it is important to think through some plans and strategies. Examples include:

Plans and Strategies

Accumulation

- Live on a budget, save 20%, always get the company match
- Save 20% of every dollar, 15% into your Roth 401k or Roth IRA for both you and your spouse (if you don't have a Roth 401k), 3% for other goals, and 2% for children's mission and education
- Invest in Roth accounts while young and when rates are low. Use these to target your tax rate in retirement (to a low level)
- Even though you don't know future tax rates, maximize investments in Roth accounts as you are saving more for retirement.

Retirement

- Calculate a minimum level of retirement income, and annuitize that amount (if you have sufficient assets). The process is:
    - a. Calculate Social Security and defined benefit plan(s)
    - b. Determine your minimum amount needed to live on
    - c. Take a percentage of retirement assets (including 401k/403b/Roth and traditional IRAs/SEP/Simple Plans) at retirement to purchase an immediate annuity to give you the minimum amount needed for an acceptable level of income
- Have both Roth and traditional retirement assets so you can target your tax rates in retirement
- Donate assets from your traditional IRA/SEP/Simple plans to pay tithes and offerings to eliminate your capital gains.

Distribution

- Have taxable (tax now), Roth (rarely taxed) and traditional (taxes later) vehicles to target your tax rate in retirement
- Set a target tax rate, then pull traditional assets up to that specific amount, then Roth assets afterwards to reduce taxes
- Make sure to pay your Required Minimum Distributions if over 69.5
- During your later years which your income is less, i.e., during missions, transfer money from your tax-deferred to tax-eliminated accounts. Use this time to move assets into Roth accounts with as little tax consequences as possible
- After age 69.5, donate assets from your traditional IRA/SEP/Simple/401k/403b plans to pay tithes and offerings, to eliminate your capital gains, and to fulfill your required Minimum Distribution amounts.

Summary

It is important to plan for retirement. Because of the Taxpayer Relief Act of 1997, there are now three main types of individual retirement accounts (IRAs): the traditional, the Roth, and the education. There are also many other types of IRAs that you should learn about as you plan for retirement. Individuals who are self-employed or employed by small businesses have access to unique retirement plans that can help them reach their retirement goals. It is important for you to understand and use the investment vehicles available to you.

A traditional IRA is a retirement account in which you can contribute up to $6,000 each year (in 2019) if you are under age 50 or up to $7,000 if you are over age 50 (see Table 1). This account may or may not be tax-deferred, depending on your income level and whether you or your spouse are participating in an employer-sponsored retirement plan (ESRP). To contribute to a traditional IRA, you must be younger than 70½ and you or your spouse must have earned income. Contributions to a traditional IRA are tax-deductible if you meet certain conditions.

A Roth IRA is a type of individual retirement plan in which your contributions are made with after-tax dollars. Your contributions are not tax-deductible, but all earnings and capital gains are tax-free when you or your beneficiaries make withdrawals at retirement.

A Coverdell Education Savings Account, or education IRA, is an investment tool you can use to prepare for the cost of your children's education. You can set up a separate IRA for each child and make contributions into these accounts until the children reach age 18. The annual contribution limit for Education IRAs in 2019 is $2,000 per child. These contributions and their earnings can be withdrawn tax-free if they are used to pay for qualified educational expenses related to enrollment at eligible elementary, secondary, post-secondary, and higher-education facilities.

In addition to the traditional IRA, Roth IRA, and education IRA, there are a number of other IRAs you should learn about. These IRAS include the spousal, nondeductible, individual retirement annuity, employer and employee association trust account, rollover, inherited, simplified employee pension (SEP IRA), and savings incentive match plan for employees IRAs (SIMPLE IRA).

The decision of whether to invest in the traditional IRA or the Roth IRA should be based mainly on five factors: (1) your need to reduce current taxes with tax deductions, (2) your anticipation of tax rates when you retire, (3) your availability of money to pay the necessary taxes on the Roth IRA, (4) your need for investment flexibility, and (5) your need for estate planning to transfer assets to your heirs.

There are special retirement plans available to employees of small businesses and individuals who are self-employed. These plans have some of the same tax advantages as the plans available to larger businesses and may be even more generous. Some of these plans allow you to invest even if you already have another retirement plan through another employer. For example, if you are self-employed, either full- or part-time, or if you work for a small business, you can invest money in a simplified employee pension plan (SEP IRA), a Keogh plan, or a new savings incentive match plan for employees (SIMPLE IRA).

There are two categories of small-business retirement plans. The first category includes plans funded by the small-business employer, such as SEP IRAs and Keogh plans. The second category includes plans funded by both the small-business employer and the employee, mainly the SIMPLE IRA and SIMPLE 401(k) plans.

Assignments

Financial Plan Assignments

Your Retirement Plan has many different sections, including individual and small business plans. How will you utilize individual IRAs in your retirement Plan? Do you have a small-business retirement account or an individual retirement account? If so, who do you have the plan with?

What are your annual fees for the account? Is there a way to minimize those fees?

Where are your assets invested? Are they invested in a manner that is consistent with the asset-allocation targets detailed in your financial plan and the fact that they are longer-term assets? What are your plans and strategies for these accounts?

Learning Tools

The following Learning Tools may be helpful as you prepare your Personal Financial Plan:

Retirement Planning Needs Spreadsheet (LT06)
This Excel spreadsheet helps you determine how much you must save each month to achieve a specific lifestyle at retirement based on the following estimates: years until retirement, expected return, inflation, and tax rates.

Retirement Planning Ratio Forecasts (LT25)
This spreadsheet is an Excel template that will help you determine where you are in your progress toward achieving your retirement goals. By inputting the relevant information, you can estimate whether you are on track for reaching your retirement goals, based on your age and income.

Roth versus Traditional: Which Is Better for You (LT28)
This spreadsheet includes an Excel template to help you determine whether the traditional or the Roth IRA is a better investment vehicle to help you save for retirement. Note that this spreadsheet considers only the factor of future taxes when making this decision.

Review Materials

Terminology Review

Education IRA. An Education IRA, also called a Coverdell ESA, is an investment vehicle for planning for the future cost of a child's education. The plan allows after-tax contributions each year for each child until age 18. Contributions and their subsequent earnings are tax-free when withdrawn to pay for qualified secondary and post-secondary education expenses.
Individual Retirement Accounts. These are retirement account created with the Taxpayer Relief act of 1997. While there are over a dozen different individual retirement accounts, the three major types of Individual Retirement Accounts are Traditional IRA, Roth IRA, and Education IRA, which is also called a Coverdell Education Savings Account (ESA).
Individual Retirement Annuity: An IRA set up with a life insurance company through purchase of annuity contract.
Inherited IRA: An IRA acquired by the non-spousal beneficiary of a deceased IRA owner.
Keogh Plan. This is a small business retirement plan set up by a sole proprietor or partnership (not incorporated) which allows employers to make tax-deductible payments to retirement plans, similar to pension or profit-sharing plans. Plans can be either a defined benefit or defined contribution, but most commonly are DC profit sharing or money purchase plans. Contributions

are tax deductible, earnings grow tax-deferred, and employers may borrow from the Plan
Non-deductible IRA. Individuals may contribute to a non-deductible IRA. The benefits are that money is contributed after-tax, and investment earnings grow tax-deferred. No taxes are paid on the investment earnings until the earning are withdrawn at retirement. Accurate record keeping is required to pro-rate the nondeductible portion of any subsequent distribution.
Non-deductible IRA: An IRA with contributions made after-tax, and earnings grow tax-deferred, with taxes paid when withdrawn at retirement.
Required Minimum Distributions. This is a legal requirement of many tax-deferred retirement vehicles which require savers to distribute a specific amount each year after age 69 of total plan assets. It is calculated by dividing the total amount in accounts by a specified number given.
Rollover IRA: A traditional IRA set up to receive a distribution from a qualified retirement plan.
Roth Conversion. This is the process of converting a traditional individual retirement account to a Roth account.
Roth IRA. This is an individual retirement account which provides no deduction for contributions but provides that all earnings and capital gains are tax free upon withdrawal after retirement. You are actually investing more with a Roth, since your investments are after-tax, and contributions can be withdrawn tax/penalty free. Earnings grow tax-free if the Roth IRA is in place for at least 5 years, and you are 59½ years old.
SEP-IRA. The Simplified Employee Pension (SEP-IRA) is an Individual Retirement Account which allows a small business employer to contribute to the retirement of the employees. Employer contributes the same percentage to all employees, and no required annual contribution. Contributions are tax deductible, earnings grow tax-deferred, and employees own the plans.
SIMPLE 401k. This is a small business qualified retirement plan that provides some matching funds by the employer. Employees can have no other qualified plan, and may contribute up to the specific amount each year. Contributions are tax deferred and grow tax-free, and there is a penalty for early withdrawal. The employer is "required" to either contribute at least 2% or to match employee contributions, usually 1-3%
SIMPLE IRA. This is one of the SIMPLE retirement plans where Employees can participate. Contributions are tax deductible, it is easy to set up and administer (compared with a traditional 401(k)). A small business qualified retirement plan that provides some matching funds by the employer.
SIMPLE Plans. These are Savings Incentive Match Plans (SIMPLE) that provides matching funds by the employer. It can be established as an IRA or as part of a 401k plan. Employees can have no other qualified plan, and can contribute up to 100% of compensation to a maximum limit each year. The employer is "required" to either contribute at least 2% or to match employee contributions, usually 1-3%.
Spousal IRA. A Spousal IRA is an IRA contribution for a non-earning spouse. If one spouse is an active participant, the non-earning spouse can contribute to a Spousal IRA. Limits are the same as the traditional and Roth IRA.
Traditional IRA. An individual retirement account in which an individual can contribute up to a specific amount annually which is tax-deferred. Eligibility and amounts depend on the contributor's income level and whether they have other retirement plans. The contribution is tax deductible and earnings grow tax-deferred.

Review Questions

1. What are the three main types of individual retirement accounts?

2. If your marginal tax rate is low now and you believe it will continue get larger as you grow older, which type of IRA should you most likely make contributions into?
3. What is the 2019 annual contribution limit per individual for a traditional IRA? Roth IRA? Education IRA?
4. If you currently need a tax deduction, which type of IRA is preferable to contribute to?
5. What are two types of small business/self-employment retirement plans that are funded by the employer?

Case Studies

Case Study 1

Data:

Steve is considering a traditional IRA. He is married and he and his wife both have an Employer Sponsored 401k retirement plan at work. His modified adjusted gross income is $115,000 this year.

Application:

a. Can Steve fully contribute to a traditional IRA and get the tax deduction? Why or why not?

b. Can he contribute to any other IRAs?

c. If neither Steve nor his wife have an employer sponsored retirement plan at work, could he still contribute to a traditional IRA and get the tax deduction?

Case Study 1 Answers

a. Can Steve contribute to a traditional IRA?

- Steve cannot contribute to a traditional IRA and get the full tax deduction as his income is beyond the MAGI phase-out limits of $103-123,000 in 2019

b. Can he contribute to other IRAs?

- He could contribute to a Roth or a non-contributory IRA which is a traditional IRA with no initial tax benefits

c. Neither have an employer plan, so what can they do?

- If neither Steve nor his wife are covered by an employer sponsored retirement plan at work, they can both contribute to a traditional IRA regardless of MAGI limits. If only one spouse is covered by a retirement plan at work, the traditional IRA limits are expanded to the limits of the Roth IRA

Case Study 2

Data

Bill has money in a traditional and a rollover IRA. He retired on his 60th birthday and did not use any of his traditional IRA balances. On December 31 of his 69th year, he had $150,000 in his traditional IRA.

Calculations:

How much is he required to take out of his account the next year?

Age	Life Expectancy
70	27.4
71	26.5

Case Study 2 Answer

Bill will be required to take a distribution of $150,000 / 27.4 (from the life expectancy table), or $5,474.45, the next year.

Case Study 3

Data

Steve is considering a traditional IRA. He is married, and his modified adjusted gross income is $121,000 per year.

Application

Can Steve contribute to a traditional IRA? Why or why not?

Can he contribute to any other IRAs?

If neither Steve nor his wife have an employer sponsored retirement plan at work, could he still contribute to a traditional IRA and get the tax deduction?

Case Study 3 Answers

a. Steve will not be able to contribute to a traditional IRA because his income is beyond the MAGI phase-out limits of $101-121,000 in 2019.

b. He could, however, contribute to a Roth IRA as he is below the phase out limits, or a non-contributory IRA which is a traditional IRA with no initial tax benefits.

c. If neither Steve nor his wife are covered by an employer sponsored retirement plan at work, they can both contribute to a traditional IRA regardless of MAGI limits. If only one spouse is covered by a retirement plan at work, the traditional IRA limits are expanded to the limits of the Roth IRA.

Case Study 4

Data

Sam and his wife just turned 60, and they are very concerned about retirement. All their kids are grown, and they have additional money they want to contribute toward retirement in 2018. Their modified adjusted gross income is $120,000 this year, and they feel they can save 30 percent for retirement this year. Their company has a 401(k) plan without a match.

Application

Which vehicles can they use, and how much can they save for retirement?

Case Study 4 Answers

Sam is eligible for not only the 401(k) (limit of $19,000 in 2019), but also the $6,000 catch up contribution.

Both he and his wife are also eligible for the $6,000 Roth IRA contribution, as well as the

$1,000 catch up limit, as they are not beyond the phase-out limits for the Roth IRAs ($14,000 total). They are, however, beyond the limits for the traditional IRA to get the deduction.

Overall, they could invest $25,000 in their 401(k) and $14,000 in their IRAs for a total of $39,000 saved in 2019.

6. Estate Planning: Taking Care of Those You Love

Introduction

Estate planning is the process of planning for the accumulation, conservation, and distribution of estate assets. This process should be used to help you accomplish your personal and family goals. Every estate is eventually planned, either through planning done by an individual for his or her estate or by default through rules established by the state and local governments. The purpose of estate planning is to ensure that you—and not others, such as the government or lawyers—choose who will inherit your wealth. Through proper estate planning, you can take care of those you love even after you die. The Church of Jesus Christ of Latter-day Saint's family guidebook states the following:

> Brigham Young once said, "A fool can earn money; but it takes a wise man to save and dispose of it to his own advantage." . . . Estate planning is the way we manage our major financial resources and properties to "dispose of it to [our] own advantage." . . . This kind of planning, begun early in life, can help provide financial security for a family throughout several generations.[1]

Objectives

When you have completed this chapter, you should be able to do the following:

A. Understand the principles, importance and the process of estate planning
B. Know how trusts can be used to your advantage in estate planning
C. Understand the importance of wills and probate planning
D. Understand how to create your advance plan.

Understand the Importance, Process and Principles of Estate Planning

The purpose of estate planning is to help us achieve our personal and family goals even after we die. Estate planning ensures that your wealth will go to those you want it to go to, so you can achieve your personal goals even after you are gone. Proper estate planning can even significantly reduce the taxes paid to Uncle Sam, thus ensuring that your heirs get a larger inheritance.

There are five main goals of estate planning:

1. Live Life Fully

To live life fully, you must provide for yourself as well as for others for whom you are

responsible. You must account for the possibility that you may die prematurely. One of the main ways of managing the risk of premature death is to buy life insurance, which we discussed earlier. There are two main types of life insurance. Term life insurance provides a simple death benefit with no accumulation of cash value but significantly lower premiums. Cash-value policies offer a death benefit plus a cash-value component that grows, tax-deferred, over time and cannot be canceled.

In order to live life fully, you also need to plan for the possibility that you may become unable to provide for yourself. Medical-advance directives cover this possibility by allowing you to establish a living will and/or designate the special power of attorney for health-care, which gives someone else the power to make medical decisions for you should you become unable to make them for yourself. Exercise caution when establishing powers of attorney, such as durable power of attorney, special power of attorney, or general power of attorney. Someone who has your power of attorney can do anything you can do, including sell your house and your car and enter into agreements. An example of a medical-advance directive is Utah Advance Health Care Directive (LT14).

2. Pass Property at Death According to Your Desires

There are four ways to designate how property should be divided after you die: by will, by law, by contract, or by trust.

Pass on property at death by will: A will is a legal document that specifies your desires at the time of your death and allows your desires to be enforced. Wills permit you to appoint a personal representative to act on your behalf, appoint guardians for your minor children, appoint conservators for the assets of your minor children, and provide for disposition of your property at death. In some states, wills allow you to keep a separate updated list of tangible personal property dispositions, so you do not have to write a new will each time you decide to give something to someone else.

Current wills can revoke or change earlier wills. A will is necessary to disinherit a presumed heir, and a will can create a testamentary trust, a trust that is to be set up when you die. Unfortunately, creating a will does not avoid probate, even if the will creates a testamentary trust.

Some states, including Utah, consider holographic wills to be valid. A holographic will must be made completely in your own handwriting. It must include the date at the top and your signature at the bottom. Within the holographic will, you must name a guardian, alternate guardians, and how you would like your assets divided among your heirs. It is not necessary to have either a notary or witnesses. Be careful if you decide to create a holographic will, however. You should consider consulting an attorney about the language, and you should use a holographic will only if you do not have significant assets or a complicated family situation. Remember that a will does not avoid probate.

Pass on property at death by law: If you fail to write a will, the state will write your will for you upon your death. Through this process, known as intestacy, the state tries to determine what your will would have been had you written a will for yourself.

For example, in Utah, if a deceased person with no will has no children, the surviving spouse is given 100 percent of the deceased's assets. If the deceased has children by a prior relationship, the surviving spouse gets the first $50,000 and half of the remaining assets. If there is no surviving spouse, the assets go to each of the children on a per capita basis at each generation. If there are no children, the assets go to parents, then to the parents' descendants, and so on.

Pass property at death by contract: Third-party contracts and deeds are two examples of contracts to disperse property upon death. Examples of third-party contracts include insurance, pay-on-death accounts, IRAs, and pension plans. Contractual deeds can either be in the form of joint tenancy, which grants rights of survivorship (i.e., the property goes to the surviving tenant), or tenancy-in-common, which grants no such rights of survivorship (i.e., the property goes to whoever is stated in the contract). Although contracts do avoid probate, they do not avoid tax consequences.

Having a contractual deed for joint-tenancy with a non-spouse may not be a good idea because it circumvents will and trust provisions. This contract creates a gift for tax purposes when a non-spouse's name is added. A joint-tenancy contract postpones probate only until the second joint-tenant dies. It also may create problems for the new tenant because of taxes on capital gains income. Additional problems may occur if one joint-tenant becomes incompetent because the asset cannot be sold or disposed of under this contract. Creating a joint-tenancy with a person who is not your spouse causes loss of control.

Pass on property at death by trust: There are many advantages to passing on property by way of trusts. Trusts are legal entities that are allowed, by law, to hold assets. Specific types of trusts may reduce or eliminate estate taxes, allow for privacy, and facilitate advanced planning. Trusts may be used as a means of handling complex family situations.

3. Provide for Guardianship of Minor Children

For most parents, the most important part of estate planning is providing for guardianship of children who are still minors. You must answer the question, if your spouse and you were to die, who would take care of your children and raise them the way you would want them to be raised? In addition, you must ask yourself, who would take care of your children's assets until the children are old enough and wise enough to manage these assets themselves?

4. Avoid Probate If Desired, or Use Probate Strategically

Probate is the legal process by which an asset's title is transferred after an individual's death. One concern many individuals have regarding probate is that the records of the assets, including information about who owns the assets, are open to public view. Anyone who reviews the public

records gains access to the information.

Probate is not necessarily bad, and it is often necessary to pass on an asset's title. However, if it is important that information about ownership not be available to the public, advance planning and the use of various estate-planning tools can be helpful in avoiding probate.

5. Avoid Taxes

The final reason for estate planning is to avoid taxes. There are many legal ways to save substantially on estate and gift taxes. A few ideas will be discussed later.

The Estate-Planning Process

There are four steps in the estate-planning process:

1. Determine how much your estate is worth.
2. Choose your heirs and decide which assets they will receive.
3. Determine the cash needs of the estate and calculate your estate taxes.
4. Select and implement estate-planning techniques to maximize the money going toward your personal and family goals and to minimize taxes.

Estate planning helps you use your assets wisely in order to achieve your personal goals even after your death. If you prepare well before you die, there is a greater chance you will be able to achieve your personal and family goals even after your death. For help in this process, see Estate Planning Tax Spreadsheet (LT40), which helps you understand and calculate estate taxes.

Step 1: Determine What Your Estate Is Worth

The worth of an estate is basically the difference between the value of the estate's assets and the value of the estate's liabilities. However, there are a number of steps for calculating the value of your estate.

First, calculate the gross value of the estate. This is the combined value of all estate assets, including pensions, investments, and any real or personal property. The gross value also includes life insurance proceeds payable to your estate or, if you own the policy, to your heirs; the value of certain annuities payable to your estate or heirs; and the value of certain properties you have transferred within three years of your death. The government counts assets gifted to others in the last three years of your life as part of your estate.

Second, calculate the taxable estate. This is equal to the gross value of the estate minus estimated funeral and administrative expenses, debts, liabilities, taxes, and any marital or charitable deductions.

Third, calculate the gift-adjusted taxable estate. This is equal to your taxable estate plus any taxable lifetime gifts (the cumulative total of all gifts over the annual limit). This will be

discussed later. The adjusted taxable gifts are the total amount of the taxable gifts you made after 1976 that are not included in the gross value of your estate.

Step 2: Choose Your Heirs and Decide What They Will Receive

In making these decisions, remember the long-term goals for you and your family and use your financial resources to help you achieve these personal goals. Make these decisions with much thought and prayer.

Step 3: Determine the Cash Needs of Your Estate and Calculate Your Estate Taxes

Determining the cash needs of the estate is the process of making sure there will be sufficient cash available to pay the necessary debts, bills, and taxes. If the estate is large, there must be sufficient liquid assets available to pay the required estate taxes, which may be high.

Estate taxes are equal to the gift-adjusted taxable estate multiplied by the appropriate tax rate. To determine the net tax owed, calculate the total tax owed and subtract the unified gift-tax and estate-tax credit (this is discussed in more detail later in the chapter). Ensure that you have adequate liquidity available to your heirs. Term or cash-value life insurance may be used as a tool to ensure sufficient liquidity for paying estate taxes.

Step 4: Select and Implement Your Estate-Planning Techniques

If you prepare well before your death, your estate will do well after you have died. Generally, qualified legal help is critical to help you determine and implement the best estate-planning vehicles. Remember that these vehicles are not useful until they are funded.

Table 1. Estate Tax Limits

Year	Exclusion Amounts	Top Tax Rate
2015	$5,430,000	40%
2016	$5,450,000	40%
2017	$5,490,000	40%
2018	$11,180,000	40%
2019	$11,400,000	40%

Table 2. Unified Estate Tax and Gift Tax Rates

If Amount Is Over	But Not Over	Tax on Column A	Rate on Excess Over A
$0	$10,000	$0	18%
$10,000	$20,000	$1,800	20%
$20,000	$40,000	$3,800	22%
$40,000	$60,000	$8,200	24%
$60,000	$80,000	$13,000	26%
$80,000	$100,000	$18,200	28%
$100,000	$150,000	$23,800	30%

$150,000	$250,000	$38,800	32%
$250,000	$500,000	$70,800	34%
$500,000	$750,000	$155,800	37%
$750,000	$1,000,000	$248,300	39%
$1,000,000	$1,250,000	$345,800	41%
$1,250,000	$1,500,000	$448,300	43%
$1,500,000	$2,000,000	$555,800	45%

Table 3. Unified Estate Tax Exclusion Amounts

Amounts Above	Year	Tax on Column A	Rate on Excess
$5,430,000	2015	$2,172,000	40%
$5,450,000	2016	$2,180,000	40%
$5,490,000	2017	$2,196,000	40%
$11,180,000	2018	$4,472,000	40%
$11,400,000	2019	$4,505,000	40%

Table 4. Gift Tax Exclusion Amounts

Year	Maximum Amount
1982–2002	$10,000
2003–2005	$11,000
2006–2008	$12,000
2009–2012	$13,000
2013-2017	$14,000
2019	$15,000

Four Key Taxes on Estates

There are four key taxes on estates:

1. Estate taxes, or inheritance taxes, are taxes that must be paid on an estate that has a value greater than a government-determined exclusion amount. An estate tax return for a U.S. citizen or resident needs to be filed only if the gross estate value exceeds the exclusion amount that has been determined by the government in the year of the citizen or resident's death (see Table 1). For example, if John Smith died in 201 and his estate was valued at less than $11.4 million, John's estate would not be required to pay estate taxes because its value is less than the estate tax exclusion amount for 2019.

2. Gift taxes: Gift taxes apply to the transfer of any property, including money, in the form of a gift. If you sell something at less than its full value, if you make an interest-free or reduced-interest loan, or if you allow the free use of your property or income from your property, you may be giving a gift. Gift taxes are taxes paid on gifts of property or money that exceed the annual exclusion, which is $15,000 per individual (or $30,000 per couple) in 2019. This amount can be divided and given to an unlimited number of people without incurring federal gift taxes. In the future, the $15,000 exclusion amount will be indexed to account for inflation; the

exclusion amount will increase in $1,000 increments. A gift tax must be paid on all transfers to others (other than a spouse) that are in excess of the maximums listed in Table 4.

Tax Implications of Defined-Contribution Plans

If your company offers a defined-contribution plan, there are several tax implications you should be aware of:

Gifts in excess of the annual exclusion limit are subject to taxes and are subtracted from your lifetime gift limit of $11.4 million in 2019. The following are exempt from this limit: gifts less than the exclusion amount in any of the previous years; tuition payments made directly to the school or medical expenses paid directly to the hospital for others; and gifts to spouses, political organizations, or charities. While a gift for one year may be greater than the annual exclusion and requires you to file a gift tax return (Form 409), you may not have to pay a gift tax if you apply the unified credit to your gift tax.

3. Unlimited marital deductions: There is no limit on the value of an estate that can be passed tax-free to a spouse who is a U.S. citizen. However, the unlimited marital deduction does not apply to spouses who are not U.S. citizens. The limit on tax-free gifts that can be made beyond the tax-free transfer threshold per year to non-citizen spouses is $155,000 in 2019 (see Table 6).

Table 6. Tax-Free Gifts to Non-Citizen Spouses

Year	Maximum Amount
2015	$147,000
2016	$148,000
2017	$149,000
2018	$150,000
2019	$155,000

4. Generation-skipping taxes (GSTT): In addition to the regular estate tax, a tax is imposed on any wealth or property transfers made to a person two or more generations younger than the donor. The GSTT is designed to allow tax-free transfers to spouses and children but imposes taxes on transfers going to grandchildren and others who are two or more generations away from the person making the transfer. The tax is 40 percent of the value of the property transferred in 2018 (see Table 7). There are exceptions to this tax. The $15,000 gift-tax exclusion applies, as do the education-tax exclusion and medical-expense gift-tax exclusion. In addition, up to $11.4 million per individual ($22.8 million per couple) may be passed on to grandchildren in 2019 without incurring taxes.

Principles of Estate Planning

The following are a few important principles of estate planning:

1. Understand Yourself, Your Vision, Goals and Plans. What is your vision for estate planning? What would you like to accomplish? What are your personal and family goals? Make sure what you are planning to do is in the best long-term interest of those you love.

What is your budget and balance sheet? Is what you are planning to do reasonable in light of your available resources? Will it still allow you to live in an acceptable manner for the rest of your life?

2. Seek, receive and act on the Spirit's guidance. This includes seeking diligently through study and prayer, living worthy of the Spirit's guidance, and then acting on it once it is received. Realize that inheritance gifts are not always blessings. There may be others ways to accomplish your vision and goals than just giving money.

3. Understand the key areas of Estate-Planning and All Applicable Laws. Once you understand what you want to accomplish, you must next understand the estate-planning process and applicable laws. Make sure what you are doing is legal. Recognize the tax consequences of your actions and plan for adequate liquidity to meet your tax needs.

4. Start Early and Seek Qualified Legal Help. Start estate planning early. Once you are married, write a will to make sure your assets will go to who you want. Once you have children, make sure you articulate who you want to be the guardian of your children and executor of your will. As your assets reach a critical mass, determine how you want to dispose of those assets, and do so in a way that is consistent with your goals and objectives.

Seek qualified legal help in this process. Make sure the legal documents are well written and will accomplish the goals you want to accomplish. Realize that if you have assets in multiple states, you may need legal help in each state.

5. Remember the Key Principles of Finance. Remember the key principles of finance: Ownership: none of what we have is ours. Stewardship: we are stewards over all God has and will bless us with. Agency: the gift of choice is one of God's greatest gifts. And accountability: we will be held accountable for all of our choices, including our financial ones.

Finding Balance

As you work on your Advance Plan, finding balance among doctrines, principles and application is important in helping you prepare for what happens after we pass away. We have shared some ideas for principles. Below are a few ideas for doctrines on which the principles are based.

Principles	Doctrines
Understand yourself and your vision	Identity
Seek, receive and act on the Spirit's guidance	Obedience

Understand needs after retirement	Stewardship
Understand your posterity's needs	Agency
Understand the key areas of estate planning	Stewardship
Get very qualified legal help	Agency

From Obedience to Consecration

From the principles and doctrines, we can see that we are not just working on preparing for life after death; rather, from a higher perspective, or with increased vision,

> We are children of the living God (identity), living worthy of the Spirit's guidance (obedience), using our agency wisely (agency) so we can carefully and with wisdom make long-term decisions (agency) for the disposition of our current and future assets (accountability). As we think through our vision and goals for life, we will develop Plans and Strategies that will help our family (stewardship), with our help, to accomplish our individual and family vision and goals even after we pass away.

Know How Trusts Can Be Used to Your Advantage in the Estate-Planning Process

Trusts give you professional management of your assets and provide for confidentiality. They may allow you to reduce your personal assets by transferring ownership to the trust, thus helping you avoid estate taxes. They may also allow you to avoid probate.

Table 7. Generation Skipping

Year	Generation-Skipping Transfer Tax Exemption	Tax Rate of Amount Over Exemption
2015	$5,430,000	40%
2016	$5,450,000	40%
2017	$5,490,000	40%
2018	$11,180,000	40%
2019	$11,400,000	40%

Other benefits of trusts include that they may allow you to more clearly specify your desires regarding your assets, since they are much more difficult to challenge than wills. They may allow you to specify which assets should go to which children (particularly children from a previous marriage). Finally, trusts can be used to provide for children with special needs or to hold money until a child reaches maturity.

If any of the following conditions apply to you, you should seek professional advice regarding the ways a trust could benefit you:

1. Your total estate is larger than the estate tax-exemption amount, which was $11.4 million in 2019.
2. You want to avoid probate.

3. You have specific desires or goals for the management and disbursement of your assets.
4. You want to leave an inheritance to children from a prior marriage.
5. You have a child with a handicap or a relative who requires specialized care because of a disability.

Trust Assets

Once a trust is established, it is critical to transfer the assets to the trust; a trust is worthless until assets have been transferred into it. Trusts can hold all types of assets, including real property assets, such as a home; real estate assets; land tracts and out-of-state properties; liability and title insurance assets; property taxes; transfer taxes; and rental real estate.

Trusts can also hold credit cards, notes you owe, mortgages, loans, checking accounts, savings accounts, pay-on-death accounts, certificates of deposit, credit union accounts, safe deposit boxes, stocks, bonds, mutual funds, and savings bonds.

Trusts can hold real assets such as boats, automobiles, motorcycles, recreational vehicles, and other vehicles. In addition, they can hold life insurance and other self-provided insurance.

Businesses may be included in trusts if they are sole proprietorships, limited partnerships, closely held corporations, S corporations, limited liability companies, or general partnership interests.

Other assets that may be included in trusts include personal untitled property, copyrights, patents, royalties, oil and gas interests, club memberships, and foreign assets.

Types of Trusts

There are two different types of trusts: living trusts and testamentary trusts. A living trust is a trust in which assets are placed while you are still living. With a testamentary trust, assets are placed in the trust after you die. This trust is created after probate, according to your instructions.

1. Living trusts: There are two different types of living trusts: revocable living trusts and irrevocable living trusts.

A revocable living trust allows for unlimited control by the trust owner because the owner retains the title to all the assets in the trust. The advantage of a living trust is that the assets in the trust do not pass through probate when the owner dies. In addition, a living trust provides greater ease of distribution and greater privacy upon death. The disadvantage to a living trust is that it does not provide any tax advantages. The entire amount of the living trust is considered an asset for estate tax purposes.

An irrevocable living trust cannot be changed by the owner once established because the trust becomes a separate legal entity that owns all the assets it contains and pays taxes on the assets and the gains they produce. The advantage of an irrevocable living trust is that the assets are not subject to estate taxes, since they are not part of the owner’s estate. Additionally, assets in the

trust do not pass through probate. The disadvantage to an irrevocable living trust is that the owner no longer has the title to or use of any of the assets.

2. Testamentary trusts: A testamentary trust is a trust in which assets are placed only after the owner dies. The trust is created after probate, according to the desires of the owner, and the assets are transferred into the trust. There are different types of testamentary trusts, including standard family trusts, qualified terminable interest property trusts (Q-TIP trusts), and sprinkling trusts.

Standard family trusts hold the assets of the first spouse who dies until the second spouse dies. The surviving spouse has access to income from the trust, or the trust principal, if necessary. Standard family trusts reduce the size of the estate for the second spouse, which reduces estate tax liability.

A Q-TIP trust provides a means of passing on income to a surviving spouse without turning over control of the assets. These trusts ensure that assets will be passed on to your children upon the death of your surviving spouse.

A sprinkling trust distributes assets to a designated group of beneficiaries on an as-needed basis rather than in accordance with a preset plan.

Setting Up a Trust

In order to establish a trust, you must understand the following terminology:

Grantor: The person who creates the trust.
Trustee: The person who will manage the trust.
Successor trustee: The person who will succeed the trustee should the trustee be unable to manage the trust.
Beneficiaries: The recipients of the trust's earnings or assets.
Children's trusts: Trusts created for underage children.
Guardian: The person who raises children in lieu of their parents.
Children's trustee: The person who manages children's assets in lieu of their parents.

A qualified estate-planning lawyer or financial planner can help you establish a trust. Be sure to consult with a lawyer or financial planner who is not trying to sell you any products. Insist on seeing identification and a description of your consultant's qualifications, education, and expertise in estate planning. Seeking advice from a good, qualified consultant is important, especially if the size of the trust is significant and if there may be questions as to how assets should be distributed.

Do not allow yourself to be rushed. Ask for time to consider your decision, and report high-pressure tactics, misrepresentations, or fraud immediately to the Better Business Bureau. Always ask for a copy of any documents you sign, and know your cancellation rights. Finally, be wary of

home solicitors who insist on receiving confidential and detailed information. If any concerns arise, call the Better Business Bureau and report the solicitors.

Be aware of the costs of establishing and managing a trust. The costs will vary from lawyer to lawyer, but they should include the costs of reviewing your assets and their present titles, discussing your estate plan, preparing your trust, and supervising the execution of the trust and the transfer of assets.

Understand the Importance of Wills and Probate Planning

A will is a legal document that indicates how the state should distribute your assets upon your death. The legal term for someone who dies without a will is "intestate." When someone dies intestate, or without a will, the state determines, based on specific state laws, which assets will go to which individuals, regardless of the intentions of the deceased. That is why it is so critical to have a will.

Having a will ensures that state law will not dictate the distribution of your assets, the custody of your children, or the care of those under your responsibility who have special needs. A will also allows you to avoid the costs associated with having a court-appointed administrator.

The following are key terms related to wills that you should be familiar with:

> **Will:** A legal document that transfers an estate after death.
> **Beneficiaries:** People who receive the deceased's property and assets.
> **Executor or personal representative:** The person responsible for carrying out the provisions of the will.
> **Guardian:** The person who cares for minor children of the deceased and manages the children's property.

Wills

Wills can be handwritten, computer-generated, or oral. It is safest to have a will drawn up by a lawyer. Most wills (holographic wills being the exception) must be signed, witnessed by two or more people, and notarized.

Wills should be stored in a safe place; however, a safe-deposit box is not always a good place to store a will because it may be sealed upon your death. Always tell someone you trust where your will is so it can be found upon your death.

In order to have a valid will, a person must have mental competence and must not be under undue influence from another person. For a will to be valid, it must also conform to the laws of the state in which it is written.

An amendment to a will (a codicil) institutes minor changes to the original will. To be effective, a codicil must be signed, witnessed, and attached to the original will. However, if the changes are

major, a new will should be drafted.

Probate

Probate is the process of distributing an estate's assets. The probate process includes appointing an executor if one is not named, validating the will, allowing for challenges to the will, overseeing the distribution of assets, filing a report with the court, and closing the estate.

There are numerous costs and fees involved in the probate process, including legal fees, executor fees, and court fees; these fees can be from one percent to eight percent of the estate's value. Additionally, the probate process can be quite slow, especially if there are challenges to the will or tax problems.

Ways to Avoid Probate

You can avoid probate in the following ways:

Have joint ownership: There are several different options for joint ownership of property that help you avoid probate. You can have tenancy by the entirety, joint tenancy with the right of survivorship, tenancy in common (where the will controls distribution of the deceased's share of the property), or community property (where state law and a will control distribution of the property). Each of these methods does not require probate for the transfer of titled property.

Make gifts (with the exception of life insurance policies): You can take advantage of unlimited gift-tax exclusions on payments made for medical and educational expenses. However, you must make the payments directly to the hospital or college. Money donated to charities is also eligible for gift-tax exclusions.

Name beneficiaries in contracts such as life insurance: In most cases, ownership of contracts such as life insurance passes to the beneficiaries upon death of the owner without the contract having to be probated.

Use trusts: Two types of trusts allow you to avoid probate: a living trust, which takes effect before death, and a testamentary trust, which takes effect upon death.

Other Estate-Planning Documents

There are a number of estate-planning documents you should be aware of:

Durable power of attorney: This document allows someone to act on your behalf if you should become mentally or physically incapacitated. This document is separate from the will and goes into effect before your death. A durable power of attorney should be very specific as to which legal powers it transfers.

Living will: A living will is a document that states your wishes regarding medical treatment in the event of a terminal illness or injury.

Health-care proxy: A health-care proxy designates someone to make health-care decisions for you if you should become unable to make them yourself.

Understand and Create Your Advance Plan

In putting together your Advance Plan, which includes your will, Advance Health Care Directive, and your Estate plan, it is similar to your other Plans. Following are a few ideas for helping you put together your Estate Plan.

Vision

- From your plan for Life. It may also include:
  - My first priority is to live life fully and take care of my spouse. They will be able to enjoy their remaining years of life in dignity and with family.
  - If there are sufficient resources remaining, we will use them for our individual and family vision and goals.

Goals

- We will live life to the fullest, and will use probate strategically and will have a plan for the disposition of our assets according to our vision and goals
- I will plan for future medical care and accidents by signing a Utah Advanced Health Care Directive (LT14)
- We will have sufficient assets saved to be able to take care of my spouse and I throughout our lives.
- We will help our children and grandchildren with worthy goals including missions and education

Plans and Strategies

Single and Young Marrieds

- We will start with a holographic will while in school (we will do one in this class).
- We will complete our Utah Advanced Health Care Directive (LT14)
- As we graduate, begin work and have children, I will get a will from a qualified lawyer

Married with children

- We will prepare a holographic will while in college, and then get a will from a qualified lawyer
- We will agree to the same guardian of the minor children and the same personal representative to ensure two different people looking after our children should we pass
- As our assets increase, we will set aside money to help with missions and education

- As our asset size increases above $100,000 or we purchase a home, we will create a living trust, that will allow the assets to pass to heirs without probate and reduce probate costs (which is roughly 5% of the estate value)

Empty Nesters

- We will determine our needs for the remainder of our lives. If they are sufficient, we will:
    - Create a living trust to help our grandchildren and great grandchildren pay for missions and college
    - We will create a Family Foundation to teach children financial skills and the importance of giving to others. It will also pay for expenses to bring the family together once a year to talk about foundation issues (and to be a great family vacation)
- We will review our Advance Plan every 3-5 years.

Constraints

- Inability to live on a budget and save will directly reduce amounts available
- Excessing spending will limit amounts for children and grandchildren
- Sin will eliminate the desire to save, will cause us to seek the things of the world, and will definitely increase spending
- Health care costs may eat into the amounts available to put into trusts for children and grandchildren

Accountability

- We will work on these plans together with my spouse
- We will share them with our children and grandchildren as appropriate times
- We will not use inheritance as part of a negotiation strategy with our children.

Summary

Estate planning is the process of planning for the accumulation, conservation, and distribution of estate assets; this process can help you accomplish your personal and family goals. Every estate is planned, either by the individual or by default through rules established by the state and local governments. The purpose of estate planning is to ensure that you—and not others, such as the government or lawyers—choose who will inherit your wealth.

There are four steps in the estate-planning process: (1) determine how much your estate is worth, (2) choose your heirs and decide on the assets they will receive, (3) determine the cash needs of the estate and calculate your estate taxes, and (4) select and implement estate-planning techniques to maximize goals and minimize taxes. Estate planning can help you use your assets wisely in order to achieve your personal goals even after you die. The four key taxes on estates are estate taxes, gift taxes, unlimited marital deductions, and generation-skipping taxes.

When you create a trust, you enter into a legal contract that gives you professional management

of your assets and provides for confidentiality. Trusts may allow you to reduce your personal assets by transferring ownership to the trust, thus helping you avoid estate taxes. They may also allow you to avoid probate. Other benefits include that they may allow you to more clearly specify your desires regarding your assets, since trusts are much more difficult to challenge than wills. They may allow you to specify which assets should go to specific children (particularly children from a previous marriage). Finally, trusts can be used to provide for children with special needs or to hold money until a child reaches maturity.

A will is a legal document that indicates the way the state should distribute your assets upon your death. Someone who dies without a will is "intestate." When someone dies intestate, the state determines, based on specific state laws, which assets will go to which individuals, regardless of the intentions of the deceased. Having a will ensures the state law will not dictate the distribution of your assets, the custody of your children, or the care for those under your responsibility with special needs. A will also allow you to avoid having a court-appointed administrator and the associated costs.

Finally, we discussed ideas for putting together your Estate Plan.

Assignments

Financial Plan Assignments

First, review the goals you made in Chapter 2. Do you have specific goals that may extend beyond your lifetime and would require a trust? If so, what would you like to do about these goals? Are they feasible given your current financial condition? Review your net worth (discussed in Chapter 3). Does your current net worth exceed the estate tax threshold established by the IRS? How close are you to the threshold? If you are close, you should get qualified help.

Second, do you have a will? If you have children, a will is critical because it states your wishes regarding who should take care of your children should you pass away. Your choice is either to write your own will or let the government determine how you would have wanted your assets distributed. If you have few assets and you reside in a state that allows holographic wills, write one immediately. At least write your wishes regarding who is to take care of your children. If you are beginning to acquire assets, it is recommended that you visit a legal attorney who can, for a fee, help you write up a will that is valid for your state. Wills should be reviewed every three to five years, or more often if your situation changes.

Finally, are you concerned that your wishes regarding health-care might not be made known to medical personnel should something happen to you and you are unable to communicate your wishes? Filling out Utah Advance Health Care Directive (LT14) will allow you to state your intentions for medical care in the event of an emergency in which you are unable to make your wishes known.

Once you answer these three questions, you can begin to put together your Advance Plan. Remember that giving things to others may not always be a blessing.

Learning Tools

Utah Advance Health Care Directive (LT14).

This is an example of a Advance Health Care directive. If you move to another state, you should likely fill one out in that state.

Estate Planning Spreadsheet (LT40)

This tool can help you as you determine your estate taxes for 2018. It separates out total, adjusted gross income, taxable income, and helps you calculate your refund or payment.

Review Materials

Terminology Review

Advanced Health Care Directive. This document, also known as a living will or personal or advance directive, is a legal document where a person specifies what actions should be taken for their heath care if they are no longer able to make decisions for themselves due to illness or other reasons.

Beneficiaries. The people who receive the property or assets.

Children's Trustee. The person who manages the assets for the children.

Children's Trusts. Trusts specifically for underage children.

Codicil. A document which institutes minor changes in the original will. Must be signed, witnessed, and attached to the original will.

Community Property. A form of ownership is equal and only between partners. Lifetime control is shared by both spouses, consent from both is required to sell, income is shared between owners, and testamentary control in the one-half interest is unlimited unless property has right of survivorship feature (applicable in some states).

Durable power of attorney. This provides for someone to act on your behalf in the event you should become mentally or physically incapacitated. This document is separate from the will and goes into effect before death. This document should be very specific as to which legal powers it transfers.

Estate planning. The process of anticipating and arranging for the disposal of your resources to accomplish your personal and family goals after you pass away.

Estate Taxes. These are taxes, paid to the government, due on passing of an individual. Estate taxes are equal to the gift-adjusted taxable estate multiplied by the appropriate tax rate. To determine the net tax owed, calculate the total tax owed and subtract the unified gift and estate tax credit.

Estate transfer. This is the process that property interests are legally transferred from one to another, either during the person's lifetime or at death

Exclusion Amount. This is the amount of estate value that is excluded from the estate tax.

Executor or personal representative. This is the person who is responsible for carrying out the provisions of the will.

Generation-Skipping Tax. This is a tax on revenue lost when wealth is not transferred to the

next generation, but to a succeeding generation. It is a flat tax, in addition to the regular estate tax, imposed on any wealth or property transfers to a person two or more generations younger than the donor.

Gift Tax Exclusions. A gift tax must be paid on all transfers to others (other than a spouse) that are in excess of the maximums specified. The maximum specified is your exclusion.

Gift-Adjusted Taxable Estate. This is equal to your taxable estate plus any taxable lifetime gifts, which is the cumulative total of all gifts over the annual limit.

Gross Estate. This is the value of all your assets, including life insurance, pensions, investments, and any real or personal property.

Guardian. The person who cares for minor children and manages their property.

Health care proxy. A health care proxy designates someone to make health care decisions should you be unable to do so for yourself.

Holographic Will. A will and testament that is entirely handwritten and signed by the testator. Traditional wills require signatures of witnesses as well as the testator's signature and intent. Holographic wills are treated equally with witnessed will and need only to meet minimal requirements in order to be probated

Intestate. The process whereby the state essentially writes the will for a person because they did not prepare a will during their lifetime.

Irrevocable Living Trust. A trust that cannot be changed by the owner once established, because the trust becomes another legal entity which owns all the assets contained in the trust and pays taxes on the assets and gains they produce. The assets are not subject to estate taxes since they are not part of your estate and assets in the trust do not pass through probate.

Issue. These are children.

Joint Tenancy with Right of Survivorship (JTWROS). Ownership is shared equally and lifetime control is shared, income is shared between owners, testamentary control is absent, and then right of survivorship is key.

Lifetime transfers. Methods of transferring property including the sale or gifting of one asset to another.

Living Trust. A trust where assets are placed in the trust while you are still living. You can take them out and move them according to what you want to do before you die.

Living will. It is a legal document that details your end-of-life wishes for health care. It is used when you are still alive but unable to make health care decisions for yourself. A living will states your wishes regarding medical treatment in the event of a terminal illness or injury

Non-probate transfers. These are "will substitutes," and include state law, right of survivorship, beneficiary designations, and gifts causa mortis.

Personal Representative (Executor). This is the person who fulfills the requirements of the trust or will.

Probate. Probate is the process of distributing an estate's assets after death. Probate is a matter of state law. It is the matter of administering the portion of the person's estate that is disposed of in either by will provisions, for those with a valid will, or by intestate succession, for those who die without a will.

Q-TIP (Qualified Terminable Interest Property) Trust. A Q-TIP Trust is a testamentary trust which provides a means of passing income to the surviving spouse without turning over control of the assets. These trusts ensure that assets will be passed to your children upon the death of the surviving spouse.

Revocable Living Trust. It is the most common type of living trust. It is a trust which allows for unlimited control by the trust's owner, because the owner retains title to all the assets in the trust.

They do not pass through probate. They provide greater ease and privacy of distribution upon death.
Sole ownership. Ownership where ownership and control is absolute in one individual. Income belongs to sole owner and testamentary control is absolute.
Sprinkling Trust. A Sprinkling Trust is a testamentary trust that distributes assets on a needs basis rather than according to some preset plan to a designated group of beneficiaries.
Standard Family trust. This is a testamentary trusts which hold the assets of the first spouse to die until the second spouse dies. The spouse has access to income from the trust, or the trust principal, if necessary. They reduce the estate of the second spouse so that the estate taxes can be reduced.
Stepped Up Basis. This is the process of the value of an asset being stepped up, or changed from the original value when purchased, to the current value when the person dies and it is transferred to heirs.
Successor Trustee. This is the person to succeed the trustee should the trustee not be able to manage the trust.
Taxable Estate. This is equal to the gross value of your estate, less estimated funeral and administrative expenses, debts, liabilities, taxes and any marital or charitable deductions.
Tenancy by the entirety. Ownership is shared equally and limited to spouses, lifetime control is shared by both spouses, consent from both is required to sell, income is shared between owners, testamentary control is absent, and the right of survivorship is key.
Tenancy in Common. Ownership is shared, with each owning an undivided fractional interest that may be unequal, lifetime control is unlimited, income is shared between owners in relation to fractional interest, and testamentary control is unlimited.
Testamentary transfers. Methods by which property is transferred at death.
Testamentary Trust. The process where assets are placed in trust after you die. The trust is created after probate according to your will.
Trust Grantor. The person who created the trust.
Trustee. The person who will manage the trust.
Trusts. A trust is a legal contract. When you create a trust you are simply creating another legal entity. Trusts avoid probate and are more difficult to challenge than wills. They may reduce estate taxes, allow for professional management, provide for confidentiality, can be used to provide for children with special needs, can be used to hold money until a child reaches maturity, and can assure that children from a previous marriage will receive some inheritance in the future.
Unlimited Marital Deduction. There is no limit on the value of an estate that can be passed tax-free to a U.S. citizen spouse. This does not apply to non-U.S. citizen spouses. The tax-free maximum gift per year to non-citizen spouses is specified.
Will. A legal declaration by which a person provides for the disposition for their property and other assets at death.

Review Questions

1. What is estate planning?
2. What are the five main goals of estate planning?
3. What are four ways to designate where property should go after you die?
4. What are the four steps of the estate-planning process?
5. What are the four taxes that may be imposed on an estate?

Case Studies

Case Study 1

Data

Jonathan, a single man, passed away in December 2019. The value of his assets at the time of his death was $16,155,000. He also owned an insurance policy with a face value of $315,000 (which was not in an irrevocable trust). The cost of his funeral was $19,750, and estate administrative costs totaled $67,000. As stipulated in his will, he left $154,000 to charities. Also, for each of the years 2014 to 2017, Jonathan provided his niece Suzy with $20,000 per year for college tuition. Of this $20,000, $5,000 was paid directly to the college for tuition and fees, and the remaining $13,000 was paid to his niece to cover her living expenses while she was going to school, and $2,000 was for clothes. In addition to paying for his niece's schooling, he also gave her $25,000 as a late graduation present in 2018 for a down payment on a new house.

Calculations

Determine the value of Jonathan's gross estate, his taxable estate, his gift-adjusted taxable estate, and his year 2018 estate tax. The annual tax-free gift limits are as follows: 2018-19, $15,000; 2013-2017: $14,000; 2012–2009: $13,000; 2008–2006: $12,000.

Case Study 1 Answers

What is the gross value of Jonathan's estate?

Gross Estate = assets + life insurance policies not in irrevocable trusts

Gross Estate = $16,155,000 + $315,000 = $16,470,000

Determine the value of his taxable estate?

Taxable Estate = Gross Estate – liabilities – funeral expenses – administrative expenses – charitable deductions

Taxable Estate = $16,470,000 – $19,750 – $67,000 – $154,000 = $16,229,250

Determine his gift-adjusted taxable estate

Gift-Adjusted Taxable Estate = Taxable estate + gifts in excess of the annual allowance

Gift-Adjusted Taxable Estate = $16,229,250 + $1,000 (2014) + $1,000 (2015) + $1,000 (2016) + $1,000 (2017) +$10,000 (2018) = $16,243,250. Of the $20,000 each year, $5,000 was paid directly to the school, so the $5,000 is not counted in the tax-free gift. Only the payments of $15,000 are counted. After the limits are reached, there is an excess of $1,000 each year. Of the $25,000 in 2018, $15,000 was the tax-free exclusion, resulting in $10,000 to be added in excess of the allowance. Total to add back is $14,000.

Determine his estate tax liability for 2019 on gift-adjusted tax of $6,243,250.

Amount Above	Year	Tax on Column A	Rate on Excess
$11,400,000	2019	$4,560,000	40%

Two ways to calculate the tax

a. ($16,243,250 – $11,400,000) * 40% = $1,937,300

The estate tax is the difference between tax owed and the unified credit

Year at Death	2019

Total Excess of Annual Limits	14,000

Key Data:

Value of Assets at Death	16,155,000
Life Insurance Policies	315,000
Insurance Death Benefit	
Funeral costs	19,750
Estate Administrative Costs	67,000
Charities	154,000

Note: Irrevocable Trusts (ILITS) are not included

Year	Amount	Exclusion	Excess
2011		13,000	-
2012		13,000	-
2013		14,000	-
2014	15,000	14,000	1,000
2015	15,000	14,000	1,000
2016	15,000	14,000	1,000
2017	15,000	14,000	1,000
2018	25,000	15,000	10,000
2019		15,000	-

I. Detrmine your Gross Estate:

Assets	16,155,000
Life insurance (not in an ILIT	315,000
Insurance Death Benefits	-
Gross Estate	16,470,000

2019 Estate Tax Information

Annual Exclusion	15,000
Estate Tax Tax-Free Exclusion	11,400,000
Tax Rate on on Excess	40.0%

II. Calculate your Taxable Estate

Gross Estate	16,470,000
Funeral expenses	19,750
Administrative expenses	67,000
Charitable deductions	154,000
Taxable Estate	16,229,250

IV. Calculate your Estate Tax Liability

Gift-Adjusted Taxable Estate	16,243,250
2019 Unified Credit Amount	11,400,000
Excess (if <= 0, no tax liability)	4,843,250
Tax Rate on Excess	40.0%
Estate Tax Liability	$ 1,937,300

III. Determine your Gift-Adjusted Taxable Estate

Taxable Estate	16,229,250
Gifts in Excess	14,000
Gift-Adjusted Taxable Estate	16,243,250

Case Study 2

Data

The value of Suzy's estate plus taxable gifts is $11.7 million at the time of her death in 2019.

Calculations:

A. What is her estate tax liability?

B. How would the estate tax liability change if $1.3 million of his estate was held in an irrevocable trust?

Case Study 2 Answers

IV. Calculate your Estate Tax Liability

Gift-Adjusted Taxable Estate	11,700,000
2019 Unified Credit Amount	11,400,000
Excess (if <= 0, no tax liability)	300,000
Tax Rate on Excess	40.0%
Estate Tax Liability	$ 120,000

A. Calculating federal estate tax requires calculating Suzy's estate tax and then subtracting his unified credit. On an estate of $11.7 million, the amount in 2018 would be:

Amount Above	Year	Rate on Excess
$11,400,000	2019	40%

($11,700,000 – $11,400,000) * 40% = $120,000

IV. Calculate your Estate Tax Liability

Gift-Adjusted Taxable Estate	10,400,000
2019 Unified Credit Amount	11,400,000
Excess (if <= 0, no tax liability)	(1,000,000)
Tax Rate on Excess	40.0%
Estate Tax Liability	$ -

C. Assuming that $1.3 million is held in an irrevocable trust, the taxable estate drops to $10.4 million, which is less than the exemption equivalent of $11.4 million in 2019, so estate taxes would be $0.

Case Study 3

Data

In 2019, Dave and Sally gave $32,000 to their son for a down payment on a house.

Calculations:

A. How much gift tax will Dave and Sally owe?
B. How much income tax will their son owe?
C. List three advantages of making this gift.
D. How could they have avoided the gift tax?

Case Study 3 Answers

A. There will be a gift tax in 2019 as the amount is $2,000 in excess of the $30,000 maximum transferable each year ($15,000 per individual in 2019). They will need to fill out a gift-tax form. The gift tax before exclusions will be $2,000 * .18 = $360.

B. Their son will not have to pay any income tax because recipients of a gift do not have to pay tax on the gift. Recipients do have to pay tax on future income generated by the gift but not directly on the gift.

C. Advantages include (1) providing needed income to a family member, (2) reducing the donor's estate taxes (the recipient is not taxed), and (3) helping avoid probate as gifted assets no longer belong to the donor.

D. They could have eliminated this need for a gift tax by splitting the gift over two years. One idea would be to give their son $30,000 in cash in 2019, and give him a loan for $2,000 for the remainder. Then in 2020, they gift him another $2,000 to repay the loan.

<u>Case Study 4</u>

Data

Anne Smith had a $5,500,000 net worth at the time of her death in 2019. In addition, she had a $250,000 whole life policy with $40,000 of accumulated cash value; her niece was the beneficiary. She also had a $150,000 pension plan benefit.

Calculations

A. What was the gross value of Anne's estate?
B. How much of her estate is taxable?
C. How much estate tax will need to be paid?
D. How much of her estate must pass through probate?

Case Study 4 Answers

A. Anne's estate is calculated by adding to her net worth (estate taxes minus debts) the value of her life insurance death benefit plus death benefits associated with her employer retirement plan. Note that cash value is not distributed (unless with an insurance rider).
$5,500,000 + 250,000 + 150,000 = $5,900,000

B. All of Anne's $5,900,000 estate is taxable.

C. Anne will pay no estate taxes as the value is less than $11.4mn

D. Any of the $5,500,000 that passes to the heirs must go through probate.

Case Study 5

Data

Suzanne and Steve Smith have $2.2 million of assets in 2019: $600,000 in Steve's name, $600,000 in Suzanne's, and $1,000,000 of jointly owned property. Their jointly owned property is titled using joint-tenancy with right of survivorship. Suzanne also co-owns a $400,000 beach house with her sister Emily as tenants-in-common.

Application

A. What is the maximum amount of estate value that can be transferred by the Smiths free of estate tax in 2019?
B. What do the Smiths need to do to reduce their expected tax liability?
C. Who would receive Suzanne's half-share in the beach house if she were to die?

Case Study 5 Answers

A. The Smiths could jointly transfer a total of $22.8mn before incurring federal estate tax in 2019.
B. The Smiths should re-title their ownership of the property and put it in a trust to take advantage of taxes. In this way they can take advantage of a standard family trust and gift-giving.
C. Suzanne's half-share of the beach house would go to whomever she names in her will. If she dies intestate, state law will determine how her share in the beach house is transferred.

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[1] "Preparing for Emergencies," *Ensign*, Dec. 1990, 59

Personal Finance Glossary

% Rank in Category. This is the number the fund ranks in its category or versus the benchmark. It is the top percentile, i.e., the lower the number the better.

12-b1 fees. These are fees paid by the shareholders to market the fund to other possible shareholders. These are just marketing fees. Avoid them.

401k Plans or Roth 401k Plans. These are defined contribution plans where employees contribute a percent of salary up to a specified amount. Employers may contribute a matching amount (free money) to encourage participation.

403b Plans or Roth 403(b) Plans (also called Tax Sheltered Annuities). These are defined contribution plans, and are the same as 401k but for non-profit tax-exempt companies and institutions (i.e., schools).

457 Plans. These are defined contribution plans, the same as 401k plans but for state and municipal workers and tax-exempt organizations.

529 Prepaid Tuition Plan. This is an education plan where you can prepay tuition for a child and you know tuition will be covered, regardless of raises in costs of tuition. May be useful if you think your children will not be eligible for financial aid.

529 Savings Plan. This is an education plan where you can put money aside after tax and it grows tax free if principle and earnings are used for qualified educational expenses. Control of the funds resides with the contributor, who chooses the assets within options provided.

60% Solution budgeting method. A process of budgeting where you determine your gross salary each month, take 60% of that amount and only spend that amount each month. Do not spend beyond that amount. This leaves 20% of your salary for long-term goals and 20% of your salary for taxes at year-end.

Account maintenance fees. These are fees for maintaining your account.

Account Transfer Fees. These are charges for moving assets either into our out of an existing account.

Account Transfer Fees. These are charges for moving assets either into our out of an account.

Accountability. This is a principle is that states we are accountable for every choice we make. We do not make choices with no consequences or accountable; rather, we will be held accountability for the decisions and choices we make.

Accumulation Stage (of retirement). This first stage of retirement begins when you first begin to work and is the time where you accumulate assets which you will later use for retirement needs.

Accumulation strategies. These are possible strategies to use while you are in the accumulation stage of retirement. They could include to save 20% of every dollar you earn after school, with 10% into the company 401k (or Roth 401k), 5% into the taxable account for retirement , and 5% into children's mission and education funds; save 20% of every dollar, with the priority of maxing out the Roth IRA for both yourself and your spouse, 3% into education IRAs for kids, etc.; or convert funds from traditional 401k and IRA accounts into Roth accounts with a minimum tax impact if financially viable.

Action Plan. This is your plan to accomplish our individual and family goals.

Active management. Active management is the process of trying to beat market returns by the active buying and selling of mutual funds and stocks.

Active portfolio management. It is the process of using publicly available data to actively manage a portfolio in an effort to beat the benchmark after all transactions costs, taxes, management, and other fees. However, to do this successfully you must do this consistently year-after-year, and not just from luck.

Actively managed funds. These are funds where the portfolio managers try to beat the performance of a benchmark through the active purchase and sell of securities in their asset class. Actively managed funds generally have higher management fees which must be overcome through higher returns

Adjustments. Adjustments are deductions from total

income allowed by the IRS to get your Adjusted Gross Income (AGI). These include (among others):qualified medical savings contributions (flexible spending accounts), contributions to individual retirement accounts (IRA), contributions to Health Savings Accounts (HSAs), student loan interest and tuition and fees deduction (IRS 970) (within limits), one-half self-employment tax, etc. Losses include net capital losses (up to $3,000), sole proprietorship losses, and active participation real estate losses

Advanced Health Care Directive. This document, also known as a living will or personal or advance directive, is a legal document where a person specifies what actions should be taken for their heath care if they are no longer able to make decisions for themselves due to illness or other reasons.

After-tax return. This is your return after you pay taxes. It is calculated as: after-tax return = before-tax * (1 – marginal tax rate) and your marginal rate includes both your federal, state and local (if any) taxes.

Agency bonds. Bonds issued by government agencies which were authorized by Congress including the Federal National Mortgage Association (FNMA), Federal Home Loan Banks (FHLB), and Government National Mortgage Association (GNMA).

Agency. This principle is that we have choice in our lives. We are agents of will, who can make choices consistent with our beliefs and values. Moreover, the gift of "choice" is man's most precious inheritance, and we should protect it carefully.

Annual Percentage Rate (APR). The APR is a rate that is generated from a precise calculation specified in Regulation Z. It only takes into account the fees going into the loan and does not take into account the time value of money.

Annuities. These are financial products developed and sold by insurance companies designed to accept and grow funds, and then, upon annuitization, pay out a stream of payments for a specified length of time. Annuities can be structured many different ways, such as payments for life for annuitant or spouse (i.e., for life of both), duration of payments (i.e., 20 years certain or life, whichever is longer), the type of payments (i.e., fixed or variable), etc. The different ways in which annuities can be structured (they are insurance products) provide the flexibility to construct an annuity contract to be meet your needs. However, it also increases expenses.

Annuitization. The process of determining what percent of retirement assets should be annuitized to ensure sufficient funds for the recipient's life.

Annuity types. These are the different types of annuities.

Application. Application is the "how' of how we do things. It is how we apply the doctrines and principles in our lives.

Appreciating assets. These are assets which may or which have historically appreciated in value.

Asset allocation funds. These are mutual funds which rotate asset classes among stocks, bonds, and cash for the best return. Asset allocation funds invest the fund's assets in the asset classes expected to perform the best over the coming period of time.

Asset allocation. This is the process of managing risk in your investment portfolio. Asset allocation is the process of allocating assets between various asset classes. It determines the risk of the portfolio and is the percentage allocated to each of the different asset classes.

Asset backed bonds. Bonds backed by specific holdings of the issuing company, such as equipment or real estate.

Asset classes. Asset classes are broad categories of investments with specific (and similar) risk and return characteristics. Asset classes are distinguished by characteristics specific to particular groups of securities, such as type of financial instrument, market capitalization, maturity, geographic location, etc. The major asset classes are cash and cash equivalents, fixed income, and equities.

Assets under management. This is another way an investment advisor is paid. It is calculated as a percentage of your assets under management, i.e., if you have $500,000 with an advisor and their fee is 1.0% per year, you will pay them $5,000 per year.

Assets. These are things that you own that have value.

Auto Loans. Auto loans are consumer loans that are secured with an automobile. Because they are secured, they have a lower interest rate than an unsecured loan or credit card. They normally have a maturity length of 2 to 6 years. The risk is that you

will often be left with a vehicle that is worth less than what you owe on it.

Automobiles and Other Vehicles. These are depreciating assets, such as cars, trucks, and RVs that normally must be inspected and licensed.

Average Amount Borrowed. This is the average amount borrowed over the life of the loan. In leasing, it is the (Net capitalized cost + residual)/2.

Average compensation. The average of the years of salary considered in making the defined benefit calculation.

Average Daily Balance (ADB): A common way of calculating interest to charge. Computed by adding each day's balance for a billing cycle and then dividing by the number of days in the cycle.

Average Indexed Monthly Earnings (AIME). The average lifetime earnings indexed for inflation is your top 35 highest earning years up to age 60. It entails adjusting each year's earnings total to reflect its value in the year in which eligibility is requested.

Average Monthly Interest Rates. This is the Annual Percentage Rate (APR) divided by 12.

Average tax rate. This is the average amount of every dollar you earned that was paid for federal income taxes. It is generally calculated at income taxes paid divided by AGI or Total income.

Baby bonds. A bond with a par value of less than $1,000.

Balance sheet (personal). This is a financial snapshot of your financial position on a given date.

Balanced funds. These are mutual funds which purchases both stocks and bonds generally in a specific percentage or relationship, i.e. 60% stocks and 40% bonds. Their benefit is that they perform the asset allocation, stock selection, and rebalancing decision for the investor.

Balloon loans. These are loans which payments including interest and principle are not sufficient to pay off the loan at the end of the loan period, but require a large "balloon" payment at some point in the future to fully pay off. This type of loan is not recommended.

Balloon Mortgages. These are mortgage loans whose interest and principal payment won't result in the loan being paid in full at the end of the term. The final payment, or balloon, can be significantly large. These loans are often used when the debtor expects to refinance the loan closer to maturity.

Bankruptcy Chapter 13. This process prepares a repayment plan in which the court binds both the debtor and the creditors to terms of repayment. The debtor retains property and makes regular payments to a trustee out of future income to pay creditors over the life of the bankruptcy plan.

Bankruptcy Chapter 7. This process liquidates assets and uses them to pay creditors according to precedence in the Bankruptcy Code. It is the quickest, simplest and the most frequently selected (75%) kind of bankruptcy filing. Certain debts cannot be waived by Chapter 7 bankruptcy such as child support, student loans, drunk driving fines, etc.

Basic Health Insurance. This is basic health coverage which covers hospital, surgical and physician expense insurance. It covers hospital insurance, which is hospitalization expenses including room, board, nursing, and drug fees; surgical insurance, which is the direct costs of surgery including the surgeon's and equipment fees; and physician expense insurance, which covers physicians' fees including office, lab, X-ray, and fees for other needed tests.

Bearer bonds. Bonds with coupons attach that pay interest only to the bearer upon surrender of the coupons.

Behavioral finance. Behavioral finance is an upcoming field of financial theory that attempts to further understand securities prices through understanding investor behavior. It came about because the assumptions which Finance makes, that people make rational decisions and people are unbiased about their predictions of the future are not always valid. Behavioral finance tries to incorporate "personal behavior" in an effort to extend finance beyond its narrow assumptions.

Benchmark. This is the relevant index for the specific category tracked by Morningstar or other fund monitoring company.

Bend Points. Calculating your PIA from AIME is divided into three calculations called "bend points" because the formula, when graphed, appears as a series of line segments joined at these amounts. These bend points change year to year.

Beneficiaries. The people who receive the property or assets.

Bidding and the Winner's Curse. Bidding may lead to a suboptimal result when you bid your fair value. Assuming everyone else has the correct value, if you won you overpaid.

Blend stocks. These are stock that are a part of both value and growth.

Bond interest and bond fund distributions. These are taxed at your Federal and state Marginal Tax Rate.

Bond mutual funds. Bond mutual funds are funds which invest a majority of their assets in bonds of specific types of companies or institutions. These funds generally have a specific objective, i.e. "corporate," "government", "municipals," "growth," etc. which relates to the types of bonds the mutual fund invests in. In addition, most have a specific maturity objective as well, which relates to the average maturity of the bonds in the mutual fund's portfolio.

Bond rating companies. A private sector company that evaluates the financial condition of the bond issuing company, its revenues, profits, debt, and other critical areas, and gives the company a rating which indicates the relative safety of the bond. They only rate corporate and municipal bonds. They include: Standard & Poor's, Moody's, and Fitch's.

Bond ratings. Bond ratings are measures of the riskiness of a company. Ratings run from "AAA" (Standard & Poor's) or "aaa" (Moody's) for the safest to "D" for the extremely risky. Ratings categorize bonds by default risk, the risk of the company being unable to repay the bond

Book-entry bonds. Bonds which are registered and stored electronically, similar to stock purchases.

Breakeven Analysis. This is a form of loan analysis that does not take into account the time value of money, but is simple to calculate. You calculate all new costs and fees for the new loan, and savings in principle and interest over the old loan. You then divide all new costs by monthly savings which will give you your breakeven point in months. If your breakeven point is less than 4 years, it may be a good idea, 5-7 years, it might be considered, or greater than 7 years, be careful. You may likely move before 7 years.

Budgeting Process. These are the steps you take to create your budget. It includes: 1. Know what you want to accomplish, 2. Track your spending (your expenses), 3. Develop your cash budget, 4. Implement your budget, 5. Compare it to actual expenses, then make changes where necessary to achieve your goals.

Budgeting the Better Way. This is a budgeting process where you pay the Lord first, and yourself second, then pay your bills. This makes paying yourself a higher priority.

Budgeting the Old Way. This is a budgeting process where whatever was left at the end of the month went into savings. The challenge is that there is never anything left at the end of the month.

Business risk. Risk that the bond's value will decline due to problems with the company's business.

Buyer's broker. This is a realtor that works specifically for the buyer and is paid by the buyer. The have a fiduciary responsibility to the buyer and not the seller which is different from the traditional buyer seller broker relationship.

Buying on margin. Buying on margin is borrowing money to invest. You borrow money from your broker and use it to purchase financial assets. If the stock goes up and you sell the stock, you make a profit due to leverage. Be careful as you can lose much more than your original investment.

Calendar Effects. The impact of tax and reporting is not consistent with theory. Behaviorists point out that returns are a function of cash flows, which tend to be concentrated around calendar turns. Institutions tend to "window dress," i.e., sell unwanted and buy desired stocks for period-end reports.

Call provision. A provision that allows the issuer to repurchase the bonds before the maturity date. Deferred calls provide more protection.

Callable bonds. Bonds which can be called, i.e. redeemed, before maturity at the option of the issuer.

Capital gains taxes. Capital gains are realized earnings from selling a financial asset at a profit. It is the sale price less the purchase price, and are divided into short-term and long-term. Short-term capital gains are gains from the sale of an asset where the asset was held for less than 366 days and is taxed at your marginal tax rate. Long-term capital gains are gains on the sale of an asset where the asset was held for more than 366 days and is taxed at a preferential federal rate. These are taxes you pay on assets held a specific period of time.

Capital gains. Capital gains are the best type of earnings as capital gains at the share level are not taxed until you sell your mutual fund shares. You decide when to be taxed. This is the difference between what you paid for the bond and what you sold it for, or the par value if you held the bond to maturity.

Capitalized cost reduction: Any reductions in capitalized cost, such as rebates, down payment, dealer incentives, trade-in, etc.

Capitalized cost: The cost to which you agree or negotiate when purchasing a vehicle.

Captive brokers. These are brokers whose company is part of a group which owns a mutual fund company. These brokers may be encouraged to sell company mutual funds which may not be the best fit for the investor but are in the interest of the company.

Carelessness. A reason for debt. We understand its costs, but we become lazy.

Cash accounts. This is money with the broker which you use to pay for purchases or receive any cash. There is a specific time between notification of purchases and when the purchases must be paid.

Cash Advance: Using a credit card to obtain cash, such as through an ATM or over the counter at a bank. This is an extremely expensive way to borrow, and carries several pricy fees.

Cash and Cash Equivalents. Cash and cash equivalents is an asset class whose major goal is liquidity and to preserve capital. Cash includes CDs, money market funds, T-bills, and commercial paper, etc. It also includes short-term interest-bearing investments such as treasury bills and savings bonds, loans to the U.S. government, commercial paper, and loans to corporations. It is a good investment asset class for money you plan to use in less than 3-5 years and don't want to take risks. It is less attractive as medium-to-long-term investments (> 5 years) as returns on cash and cash equivalents are unlikely to keep up with inflation.

Cash Dividends. Theory has shown that dividends are irrelevant in the absence of taxes and transactions costs. Behaviorists suppose that dividends can be justified by "mental accounts" which increase current income at the expense of "higher self-control" equity accounts. Older high-net worth investors value dividends more highly and concentrate in high income securities (preferred habitat) theory.

Cash-Balance Plans. A type of DBP in which provides specific annual employer contribution (generally 4-7%) each year, plus a low but guaranteed rate of investment earnings. Accounts grow at a predetermined rate, regardless of how much is in the account. Employees do not make any investment decisions.

Category. These are all funds in the same category as established by Morningstar.

CD Laddering: the process of getting a higher interest rate by buying longer term CDs and purchasing them more often. For example, 1 month CD rates are too low, but you like 6 month rates. Take the amount of money you want to invest, divide it by 6 (or any number), then invest 1/6 of your money every month in a 6 month rate. You are creating a ladder of CDs, and every month you have money coming in. You would then reinvest that in another 6 month CD.

Child's Benefit. Any child who is under 18 (19 if still in high school), is eligible for a benefit of 50% of the retired workers PIA, subject to a family maximum. Child's benefits terminate at age 18, marriage, or death. The dependent child of a fully or currently insured worker will receive a benefit of 75% of the worker's PIA (subject to family maximum) if the child is under age 18 (or age 19 is a full-time high school student), or is over age 18 and has been disabled since before age 22, and is not married.

Children's Trustee. The person who manages the assets for the children.

Children's Trusts. Trusts specifically for underage children.

Class A Shares: These shares commonly have a front-end or back-end load to compensate for the sales person's commissions. Because of the front-end loads, they usually have lower management fees.

Class B Shares: These shares commonly only have a back-end load that is paid only when the shares are sold. This load traditionally declines over time. Class B shares generally have higher expense ratios when compared to Class A shares.

Class C Shares: These shares generally have a lower front- and back-end load fees, but higher management fees.

Class R Shares: These shares are generally for

retirement purposes. Check the loads and management fees which may be substantial.

Class Y Shares: These are shares with very high minimum investments, i.e., $500,000, but which have lower management fees and waived or limited load charges. These are generally for institutional investors.

Class Z Shares: These are shares only available for employees of the fund management company.

Closed-end mutual funds. These are mutual funds with a specific number of shares outstanding. Individuals must purchase shares from existing shareholders, and shares may trade at a premium to (more than) or discount (less than) the underlying Net Asset Value (NAV). These premiums or discounts may be based more on investor demand than the underlying share value.

CLUE Report. A report, prepared by insurance companies that keep a record of all payments by insurance companies to individuals and institutions. Under the FACT Act (Fair and Accurate Credit Transactions Act of 2003) you can obtain the following Comprehensive Liability Underwriting Exchange (CLUE) reports each year: CLUE Auto: A 5-year loss history report of your automobile claims (if a loss was filed against your automobile insurance policy and if the insurance company reported the information to CLUE); and CLUE Personal Property: A 5-year loss history report of your homeowners claims.

Codicil. A document which institutes minor changes in the original will. Must be signed, witnessed, and attached to the original will.

Collateralized mortgage obligations (CMOS). More complex and specialized versions of mortgage backed bonds.

Commission costs. These are the cost associated with trading of bonds. While all bond trades incur commission costs, some newly issued bonds are sold without commission cost as the issuer absorbs the costs. Most trades however, incur commission costs, which are paid to the broker who arranged the trade.

Commissions. Commissions are the way a broker or investment advisor is paid. It is either a percentage of every buy or sell order (e.g., 20 bps per trade), or a specific charge for a trade (e.g., $9.99).

Community Property. A form of ownership is equal and only between partners. Lifetime control is shared by both spouses, consent from both is required to sell, income is shared between owners, and testamentary control in the one-half interest is unlimited unless property has right of survivorship feature (applicable in some states).

Compulsiveness. A reason for going into debt. We lack the self-control to discipline our purchases.

Computer Software budgeting method. This process uses commercially available budgeting software such as such as Mint.com (free), Quicken, Mvelopes, or others. Determine your gross salary and take home each month after taxes and other deductions, determine spending by category, and budget each category. Work to within your budget for each spending category. You will obtain receipts and credit card information directly via internet from financial institutions.

Conventional loans. These are loans that are neither insured nor guaranteed. They are below the maximum amount set by Fannie Mae and Freddy Mac of $424,000 in 2018 (single family). They require Private Mortgage Insurance (PMI) if the down payment is less than 20%.

Convertible bond. Bond which gives the holder the right to convert the bond to company stock instead of getting the cash repayment.

Convertible loans. These loans begin as a variable-rate loan and can be locked into a fixed-rate loan at the then current interest rate at some predetermined time in the future (for a specific cost).

Cooperation and Altruism. The process where we work with others and are concerned about them, not just ourselves and what we want. Cooperation may be a viable investment strategy. People's motives may lead to actions different than conventional rationality, i.e. individual selfishness, would suggest.

Corporate Bonds. (1)Bonds secured corporate debts by collateral or real property liens. (2) Debt instruments issued by corporations to fund the requirements of the companies.

Cost. These are the fees and expenses you pay to own a mutual fund or asset. Invest low cost. In a world where investment returns are limited, investment costs of any kind reduce your returns. We recommend you invest in no-load mutual funds to reduce costs.

Counseling: non-profit credit counseling agencies. These are agencies set up specifically to help people reduce the credit-card debt load in their lives. The non-profit companies have arrangements with many of the credit companies. Working with them, they can reduce or even eliminate your interest payments with specific creditors.

Counseling: For-profit credit counseling agencies. These are companies whose goal is to make money through helping people get out of debt. They often consolidate debt into a single loan with a lower rate, or get homeowners into an interest-only home loan and use the excess cash to pay down debt.

Coupon interest rate (or interest rate). The percentage of the par or face value that will be paid annually to the holder in the form of interest.

Covenants, Conditions and Restrictions (CCRs). These are legal documents that can affect what you can do with any potential homes. These can be quite restrictive as to what you can and cannot do with your home including exterior, landscaping, and other requirements. If you cannot live with the CCRs, don't buy there.

Credit Bureau: Private organizations which maintain credit information on individuals, which it allows subscribers to access for a fee. The three major credit bureaus to know are: Equifax, Experian, and Trans Union.

Credit Card: A financial instrument that allows the holder to make purchases through an open line of credit.

Credit Counseling Agencies (CCAs). These may be either non-profit or for-profit agencies to help you get out of debt. You should use these with caution.

Credit Limit: The maximum amount that one can borrow on a single credit card. This amount is often influenced by one's credit score.

Credit Report: Information collected by credit bureaus from subscribers, creditors, public court records, and the consumer.

Credit Score: A numerical evaluation of your credit based on specific criteria determined by the credit scoring company.

Credits. Credits are dollar for dollar reductions in your taxable liability. Credits are worth significantly more than deductions.

Current ratio. This is your monetary assets divided by your current liabilities. This ratio tells you how many times you could pay off your current liabilities with your liquid cash on hand.

Current Yield. It is the ratio of annual interest payments to the bond's market price.

Currently Insured Status. To be "currently insured", you must have at least 6 quarters of coverage in the previous 13 quarter period. Currently insured is adequate for eligibility for survivor benefits paid to children and for a surviving spouse caring for a qualifying child. Eligibility for other benefits generally requires fully insured status or 40 quarters of coverage

Custodial Accounts (UGMA/UTMA). These are investment vehicles that are managed for the child until the child turns a certain age. They can be invested in all types of financial assets, stocks, bonds, mutual funds, etc. UTMA (Uniform Gift to Minors Account) has fewer restrictions and may include real estate. These can be used for any educational or other expenses, including missions. The risks are there are no tax advantages and it is considered the child's money as soon as the child is of age—it cannot be taken back by the issuer. I prefer a tax-efficiently invested account.

Custody (or annual) fees. These are fees the brokerage house charges to hold the mutual funds or ETFs in your account. May be a minimum amount for small accounts ($15 per year), a specific charge per holding (8 basis points per security), or a percentage of assets for large accounts (25 basis points on assets under management).

DALBAR. DALBAR is a private company that does research on investor returns. It puts out an annual survey in a book titles "Quantitative Analysis of Investor Behavior." It discusses how average equity fund investors have done versus benchmarks over the past 20 years in the equity, fixed income, and balanced categories.

Day orders. These are orders to buy and sell securities which are good only until the end of the trading day.

Day trading. It is the process of an individual giving up all his spare time in an area in which he has little or limited competence, in an attempt to consistently beat the market and other professionals after taxes, costs and fees.

Debenture. A long-term unsecured bond. It can have a hierarchy of payment, with unsubordinated and subordinated debentures. These are bonds backed by the credit of the issuing company.

Debit Card: Unlike credit cards, debit cards act like a personal check. When used, money is taken straight from the connected account to pay for the purchased item.

Debt Cycle. It is the process of why and how we go into debt.

Debt Elimination: Expensive Debt First. This is one of the personal strategies. The logic is to pay off your most expensive debts first.

Debt Elimination: Smallest Debt First. This is one of the personal strategies. The logic is to pay of the smallest debts first. Then take the money saved to pay off all your other debts. You have success early on as you pay off the smallest debts first.

Debt Obligations or Back-end Ratio. This housing affordability ratio calculates what percent of your income is used for housing expenses plus debt obligations. It should not exceed 36% of your monthly gross income. The formula is: Monthly PITI and other debt obligations/ monthly gross income < 36%. Debt obligations include mortgage payments, credit card, student loan, car, and other loan payments. PITI = Principal, interest, property taxes, and property insurance

Debt ratio. This is your total liabilities divided by your total assets. This ratio tells you whether you could pay off all your liabilities if you liquidated all your assets. This represents the percentage of your assets financed with borrowing.

Debt Reduction Strategies. These are strategies for reducing debt. It is a six-step process: 1. Remember perspective, the "why's" and "what's." Accept that you have a debt problem; 2. Write down your goals so you know where you want to be. Stop incurring new debt; 3. See where you are by making a list of all your bills and debts. Admit the need to change your habits and lifestyle if being debt free is important; 4. Look for one-shot ways of reducing debt; 5. Organize a debt repayment Plan; and 6. Follow through on the Plan until total debt elimination.

Debt. It is the process of borrowing something with the expectation to pay it back in the future with interest.

Deductions. Deductions are IRS allowed reduction amounts (standard deduction) or taxpayer determined amounts (itemized deductions) to get taxable income from your Adjusted Gross Income.

Deep-discount and on-line brokers. These are brokers who are even cheaper than discount brokers. They do only trading, but at a 90% discount to full-service brokers. On-line can even be cheaper with other services.

Deferred. Payments are deferred until the specified time the investor elects to begin receiving the payments.

Defined Benefit Pension Plans. A Defined Benefit Pension Plan is a DBP where payments are based on a benefit payout formula. The formula is based on your salary, years worked and a company determined factor to calculate how much you will get each year. Employees do not contribute and bear no risk.

Defined Contribution Plan (DCP). A retirement plan where the employer contributes a specific amount to the employee's retirement funds while the employee is working and then has no responsibilities once the employee retires. Employer contributes to a fund, and then has no additional obligation when the employee retires. Employee may also contribute to the fund. Pension is determined by how much is invested by both the employer and employee, and how fast it grows.

Delayed Retirement Credit. Delaying payment beyond full retirement age results in a benefit increase for each year of delay. With a delay the worker's PIA is not increased and the benefits to family members is not increased.

Dental and Eye Insurance. This is insurance which covers only dental work and expenses relating to the eyes and teeth. Generally, it is only partial costs of eye exams, glasses, contact lenses, dental work, and dentures. Know your coverage, as the amount covered varies by plan provider. These plans are generally expensive, unless they are provided as part of an employer plan.

Depreciating assets. These are assets which depreciate. Often, the minute you take ownership of these assets, i.e. drive these assets off the car lot, they drop in value.

Direct PLUS Loan. These are loans available for parents of undergraduate, dependent students to help with school-related expenses, and the parent is

responsible for interest during school. Repayment begins six months after student graduates, discontinues, or drops below half time, and the parent is the borrower.

Direct Subsidized Loans. These are loans direct from the Federal government. The government pays interest while student is enrolled in school at least half-time, and repayment begins 6 months after student graduates or drops below half-time enrollment.

Disability Benefits. Workers who qualify for disability benefits are entitled to 100% of PIA until the earliest of the following: disability ends: benefits are terminated in the second month after the end of disability, or the workers dies: benefits are terminated in the month prior to the month the worker dies. If the worker attains full retirement age: disability benefits convert to retirement benefits.

Disabled Child. The disable child of a retired or disable worked is entitled to benefits past age 22 if the disability began before age 22.

Discount bonds. A bond that is sold at a discount to its par value. Generally, upon maturity the accrued interest and original investment add to the bond's par value.

Discount Points: These are payments made by the lender to reduce the interest rate on the loan. They are somewhat similar to prepaid interest. You pay more upfront in points but you will pay less on interest costs in the future. Your challenge is to minimize your overall interest costs, i.e., your effective interest rate.

Discount-service brokers. These are brokers who only perform trading, but usually at a 50% to 70% discount to full-service costs.

Discretionary accounts. These are accounts where you authorize a broker or investment advisor to make trades for you and your account. Exercise caution with this as the broker can buy and sell securities at will and you are responsible for all taxes and commission costs.

Discretionary contribution plans. Retirement plans where contributions are at the employer's discretion. These include profit sharing plans, stock bonus or ESOP plans, and money purchase plans.

Distribution Options. This is the decision as to how a distribution or payout is to be received. Make sure you understand the tax consequences of any payout or distribution option chosen.

Distribution/disposition/decumulation Stage (of retirement). This stage begins after you have retired. This is your plan as to how best take distributions from your remaining retirement and taxable accounts to minimize taxes and maximize the availability of your assets.

Distribution/disposition/decumulation strategies. These strategies help you set up a framework where you will not outlive your assets. Recommendations include taking out maximum distribution of 3.6% of total assets each year; only taking out maximum earnings from investments of previous year; or during your later years which income is less, i.e., during missions, transfer money from your tax-deferred to tax-eliminated accounts.

Distribution/Payout Options. These are options as to how you will take the benefits over your retirement.

Distributions. These are distributions of interest, capital gains, and dividends by a mutual or index fund while you own the underlying shares. Even though you have not sold the shares, you are responsible to pay taxes on this distributions because the mutual fund is a pass-through vehicle and the taxes on these distributions are paid at the shareholder level.

Diversification. Diversification is the process of allocating your assets so they are not concentrated in a single asset class. It is "not putting all your eggs in one basket". Having a diversified portfolio in many different asset classes is your key defense against risk

DNAH-ial Budgeting Method. This is a method many people use. It stands for DNAH ial - Do nothing and hope. It is not recommended.

Doctrines. Doctrines are the reasons behind why we do things. They answer the "why" questions of our lives, which are generally the most difficult questions to answer.

Down payment. This is the amount that you pay on the house to reduce the cost of the loan. Generally, lenders like a significant down payment as that indicates that the borrower is not likely to walk away from the loan. Different loans require different down payment amounts, i.e Conventional loans – 20 % recommended (but you can get in with 5%), FHA loans – 3.5%, and VA loans – 0% down payment

required.

Downgrade. A situation where a bond rating company reduces the bond rating of a bond generally due to a deterioration in the company's financial condition.

Dread Disease and Accident Insurance. This is a special insurance to cover a specific type of disease or accident. Generally it provides only for 'specific' illnesses or accidents on the "covered" list, and it provides a set maximum dollar amount of reimbursement. This insurance is generally expensive, unless included in your company's total health plan. Generally, concentrate on making your health coverage as comprehensive as possible.

Durable power of attorney. This provides for someone to act on your behalf in the event you should become mentally or physically incapacitated. This document is separate from the will and goes into effect before death. This document should be very specific as to which legal powers it transfers.

Earnings multiple approach. This is one approach for determining the amount of life insurance required. The goal is earnings replacement. The earnings multiple approach seeks to replace the annual salary stream of a bread winner for X years, normally 10 – 15 times gross salary.

Education investment vehicles. These are investment vehicles with the purpose to help you save for your children's education, i.e., Education IRA, 529 plans.

Education IRA. An Education IRA, also called a Coverdell ESA, is an investment vehicle for planning for the future cost of a child's education. The plan allows after-tax contributions each year for each child until age 18. Contributions and their subsequent earnings are tax-free when withdrawn to pay for qualified secondary and post-secondary education expenses.

Education Savings Account (Coverdell or Education IRA). The investment vehicle is similar to a Roth IRA where you invest in this account with after tax dollars, and if you use the proceeds for qualified educational expenses, distributions are tax-free. You choose your investments and the proceeds can be used for eligible elementary, secondary and post-secondary education expenses.

EE Bonds: US government savings bonds where the interest rate is set every 6 months and tied to current market interest rates.

Effective Interest Rate. This is the precise interest rate you are paying, after all costs and fees (regardless whether they are paid in the loan or out of the loan). The goal of a good loan is to have the lowest effective interest rate, which takes into account the time value of money.

Effective marginal tax rate. This is the average amount of every dollar you earned that paid for all local, state, and federal income taxes.

Emerging Market stocks and emerging market mutual funds. These are stocks or mutual funds of companies that trade in the countries not considered develop by the IMF. These are often smaller companies in smaller markets. International investments involve additional risks, which include differences in financial accounting standards, currency fluctuations, political instability, foreign taxes and regulations, and the potential for illiquid markets.

Employee Contribution (or Salary Reduction Plans). These are defined contribution plans where employees contribute before tax dollars reducing their taxable income and earnings accumulate tax deferred. The major plans are Roth or Traditional 401k and 403b plans and 457 plans. Employees direct the funds into different financial asset options provided by the company including mutual funds, index funds, fixed income, equities, money market funds, and GICs (guaranteed investment contracts). Companies have their list of approved investment assets. Employees choose where to invest their assets subject to the company list, and employees are not allowed to invest outside of approved investment assets.

Employer Qualified Retirement Plans. These are retirement plans, established by a company, that have specific tax and other benefits to both the company and the employee. Benefits include competition, tax shelters, personal retirement for the owners, and personal retirement for the employees. They can be either defined benefit or defined contribution plans.

Employment. This is working during college to help offset the cost of educational expenses.

Endowment Effect. Sometimes we perceive that an asset's value increases by virtue of our ownership. Once you own something, its value hasn't increased or changed.

Envelope budgeting method. A process of budgeting where you prepare divide spending each month into categories, create envelopes for each category of spending, and once a bill comes, take the money from the corresponding envelope and pay the bill.

Equities (or Stocks). Equities are an asset class that provides growth and earns returns in excess of inflation. Over longer periods of time, the stock market historically has been the only major asset class to consistently outpace inflation. Equity ownership is ownership in a businesses' earnings and assets. Equity asset classes are delineated by market capitalization (which is shares outstanding multiplied by the stock's current market price), type of company (growth versus value), and geographic area. The benchmarks for equity asset classes can be generally defined as capitalization: Large, mid, and small; type: Growth, blend, and value; or geographic area: US, international, global and emerging markets. Equities have offered the highest return of the major asset classes historically and have been a good investment for long-term investing—they have consistently beat inflation over the long-term. However, they offer less stability of principal than other asset classes, and subject to short-term price fluctuations (so very risky for short-term investments).

Equivalent Taxable Yield: This is the yield you would need to earn on a fully taxable security to give the same after-tax return that you receive on a tax advantaged security, i.e., a security that has specific tax advantages (i.e., tax free for Federal or State or both).

Estate planning. The process of anticipating and arranging for the disposal of your resources to accomplish your personal and family goals after you pass away.

Estate Taxes. These are taxes, paid to the government, due on passing of an individual. Estate taxes are equal to the gift-adjusted taxable estate multiplied by the appropriate tax rate. To determine the net tax owed, calculate the total tax owed and subtract the unified gift and estate tax credit.

Estate transfer. This is the process that property interests are legally transferred from one to another, either during the person's lifetime or at death

Euro Bonds. Bonds issued by U.S. companies and sold outside of the U.S. in U.S. dollars.

Exchange rate risk. Risk that changes in exchange rates will impact profitability for firms working internationally.

Exchange traded funds (ETFs). These are portfolios of stocks similar to mutual funds which trade on organized exchanges. ETF's trade like stocks, are purchased with all the transaction/custody costs, are priced throughout the day (rather than at day's end like mutual funds), and can be sold short and purchased on margin. ETFs can be either in a unit investment trust (UIT) format or an open-end mutual fund structure. The UIT structure does not allow for reinvestment of dividends.

Excise "sin taxes" and state sales taxes. These are taxes imposed when goods are purchased.

Exclusion Amount. This is the amount of estate value that is excluded from the estate tax.

Exclusive Provider Organization (EPO). These are similar to an HMO, but operates through an insurance company. It is funded through an insurance company, with health care provided by contracted providers. Only care received from contracted providers is covered (unless in an emergency situation).

Executor or personal representative. This is the person who is responsible for carrying out the provisions of the will.

Exemptions. An exemption is an amount of money set by the government that you can deduct for each qualifying person in your household.

Expenses. This is where your money goes. There are two types of expenses: fixed expenses, which are expenses you don't directly control; and variable expenses, which are expenses you can control.

Family Giving Plan. A family plan which states how the family will give, to whom it will give to, as well was what the family will or will not do or give to.

Family Money. This refers to the use of personal savings and help from parents or other family.

Fee for-service (or traditional indemnity plans). These are health care plans where the doctor bills the patient directly, and the patient is reimbursed, to a specific percentage, by the insurance company. They provide the greatest flexibility for choosing doctors and hospitals, they define the percent of each claim the policy will cover, and they define the amount the insured must pay before a claim is eligible for reimbursement. Generally these plans are more

expensive and require more paperwork.

FHA Loans. These are Federal Housing Administration (FHA) Insured Loans. The FHA does not originate any loans, but insures the loans issued by others based on income and other qualifications. There is lower PMI insurance, but it is required for the entire life of the loan (1.5% of the loan). While the required down payment is very low, the maximum amount that can be borrowed is also low.

FICO Score: This is the most commonly used credit score. It ranges from 300 to 850.

Fill or kill orders. These are orders which must be either filled or canceled immediately. Most often these are market orders.

Financial assets/instruments. These are different types of securities that are sold in financial markets.

Financial Goals. Financial goals are personal goals with a cost attached.

Financial markets. Markets in which financial securities or assets are bought and sold.

Financial Planning. This is the process of helping yourself and others to use their resources more wisely to achieve their personal and family goals. It should help determine where you are, where you want to be, and how you will get there.

Financial Ratios. These are ratios that can help you to analyze your spending.

Financial risk. How the firm raises money could affect the financial performance of the firm and the value of the bonds.

Fixed contribution plans. These are defined contribution plans where contributions are fixed by the employer. Examples are thrift and savings plans and target benefit plans.

Fixed Income. Fixed income is an asset class that attempts to provide income and to earn returns in excess of inflation. There are two different types of fixed income assets: Taxable bonds. Taxable bonds include U.S. Treasuries, corporate bonds and agency issues (bonds issued by U.S. government agencies, like Ginnie Mae). Tax-free bonds include revenue or general obligation bonds issued by local or state governments and agencies. Such bonds are generally free from federal and state taxes. Fixed income includes short-term bonds/bond funds, intermediate-term bonds/bond funds, and long-term bonds/junk bonds/bond funds issued by governments or corporations. Fixed income offers greater returns than cash, but with greater risk. It offers good diversification tool when holding a long-term stock portfolio, as bonds move differently than stocks. However, returns have been historically lower than stocks, they are very susceptible to interest rate and other risks, and generally, fixed income assets alone are not good long-term investments because they don't provide enough growth to beat inflation over long periods of time.

Fixed rate mortgages (FRMs). These are mortgage loans with a fixed rate of interest for the life of the loan. These are the least risky from the borrower's point of view, as the lender assumes the major interest rate risk above the loan rate. These are the most-recommended option for new home buyers.

Fixed. Payments are a fixed amount, and are made to the investor until the end of the contract, usually till the investor dies.

Fixed-rate loans. Have the same interest rate for the duration of the loan. Normally have a higher initial interest rate as the lender could lose money if overall interest rates increase. The lender assumes the interest rate risk, so they generally add an interest premium to a variable rate loan

Floating rate bond. Bond whose interest payments fluctuate according to a specific benchmark interest rate.

Free Application for Federal Student Aid (FAFSA). This is the application form for obtaining government student aid.

Free money. This is money that is made available by a company, generally on a matching basis, to encourage greater participation in company sponsored retirement plans, i.e., 401k, Roth 403b, Keogh, etc. It is also money made available through education tax benefits, i.e. 529 plan contributions deductible from state taxes.

Free Money. This is money you do not physically work for and is not paid back. It includes scholarships and grants.

Full Retirement Age (FRA). This is the age at which a retiree will receive 100% of their entitled benefits. Receiving benefits prior to FRA will result in a reduction in benefits. Receiving benefits after FRA will result in an increase of benefits.

Full-service brokers. These are brokers who will give you all the tools, research and other advice to help you trade and invest.

Fun. Sometimes we trade for fun and entertainment instead of financial performance. This is OK, but make sure your fun money is no more than 5% of the value of your portfolio—that way you don't lose too much.

General Obligation bonds. Bonds backed by the taxing power of the issuer.

Generation-Skipping Tax. This is a tax on revenue lost when wealth is not transferred to the next generation, but to a succeeding generation. It is a flat tax, in addition to the regular estate tax, imposed on any wealth or property transfers to a person two or more generations younger than the donor.

Gift and estate taxes. These are taxes imposed when assets are transferred from one owner to another.

Gift Tax Exclusions. A gift tax must be paid on all transfers to others (other than a spouse) that are in excess of the maximums specified. The maximum specified is your exclusion.

Gift-Adjusted Taxable Estate. This is equal to your taxable estate plus any taxable lifetime gifts, which is the cumulative total of all gifts over the annual limit.

Giving Plan. A plan on your thoughts on your personal and family giving. It discusses how you will handle both your institutional (through Church and other institutional contributions) and personal (personal and family contributions and service) giving.

Global stocks and global stock mutual funds. These are stocks or mutual funds of companies that contain a mixture of U.S. and foreign or international holdings. International investments involve additional risks, which include differences in financial accounting standards, currency fluctuations, political instability, foreign taxes and regulations, and the potential for illiquid markets.

Goals. These are things we would like to accomplish. They are often divided by time, i.e., short-term, in the next 12 months; medium-term, from 2-10 years; and long-term, beyond 10 years. They may also be divided by type, i.e., identity, integrity, and temporal goals. They will take effort and resources, but are things that are important to us and are what we want to accomplish.

Good Faith Estimates (GFE). This is an estimate from each lender (not just a Summary) of the likely costs you will likely pay as you complete the loan process. I recommend you get GFEs from each potential lender and compare them.

Government-Sponsored Health Care Plans. Government-sponsored health care plans are insurance plans which are sponsored either by the state or the federal government. These plans fall under three headings: Workers' Compensation, Medicare, and Medicaid.

Grace Period: The amount of time given by a credit card company to pay a due balance before interest starts to accrue. Normally 20 to 25 days, excluding cash advances. It does not apply if the card already carries a balance.

Grad PLUS Loan. These are loans available for graduate students to help with school-related expenses. The student is responsible for interest during school, repayment begins six months after student graduates, discontinues or drops below half time, and the graduate student is the borrower.

Grants. Money given to individuals for education on the general basis of need.

Gross Estate. This is the value of all your assets, including life insurance, pensions, investments, and any real or personal property.

Gross Income. Gross income for tax purposes is all income, unless specifically excluded or deferred.

Gross Savings Ratio. This is your income for savings divided by your gross income. This ratio tells you what proportion of your total income is being saved.

Growth stocks. These are fast-track companies whose earnings are expected to grow very rapidly. Frequently these are companies developing new technologies or new ways of doing things.

Guardian. The person who cares for minor children and manages their property.

Health Care Coverage. Health Care Coverage is divided into four areas: basic health insurance, major medical expense insurance, dental and eye insurance, and dread disease and accident insurance.

Health Care Providers. These are the major providers of health care. They fall into three types: Private health care plans, which are either fee-for-

service (or traditional indemnity plans) or managed health care (HMO, PPO); Non-group (individual) health care plans, or Government-sponsored health care plans.

Health care proxy. A health care proxy designates someone to make health care decisions should you be unable to do so for yourself.

Health Maintenance Organizations (HMOs). HMOs are prepaid insurance plans which entitle members to the services of specific doctors, hospitals and clinics. They are the most popular form of managed health care, due to their costs, which are roughly 60% of fee-for-service plans. They provide a system of doctors and hospitals for a flat fee, and emphasize preventive medicine and efficiency, and subscribers pay a relatively small co-pay for services rendered. They provide little choice of doctors and hospitals. As such, service may be less than at other facilities and referrals sometimes difficult to get.

Hedge funds. Hedge funds are less-regulated mutual funds which take much more risk than normal with the expectation of much higher returns. Generally they can take both long positions (where they buy assets) and short positions (where they short-sell assets, i.e., borrow assets and sell them). They hope to later buy back the assets at a lower price before they must return them to the borrower.

Holographic Will. A will and testament that is entirely handwritten and signed by the testator. Traditional wills require signatures of witnesses as well as the testator's signature and intent. Holographic wills are treated equally with witnessed will and need only to meet minimal requirements in order to be probated

Home Equity Lines of Credit (HELOC). Home equity lines of credit are basically second mortgages which use the equity in your home to secure your loan. These are generally adjustable rate notes that have an interest only payment, at least in the first few years of the note. Interest rates are variable and are generally interest only in the first few years. They have lower rates of interest than other consumer loans.

Home Equity Loans. This is a personal debt strategy. You take out a home equity loan, which is a loan against the equity in your home (the difference between what the home is worth and how much you owe on it) to pay off your debts. Home equity loans are basically second mortgages which use the equity in your home to secure your loan. Normally can borrow up to 80% of your equity in your home.

Home Inspection. This is a service, usually paid for by the buyer, to alert them to potential problems with the home. Many of these problems should be fixed by the seller prior to purchase and so these problems need to be discovered and disclosed. Don't buy someone's problems.

Housing Expenses or Front-end Ratio. This is a housing affordability ratio that calculates what percent of your income is used to make mortgage payments. Housing expenses should be less than 28% of your monthly gross income. The formula is: monthly PITI*/monthly gross income <28%. PITI = mortgage principle, mortgage interest, property taxes, and property insurance.

Housing. These are appreciating tangible assets, such as land, dwellings, vacation home, or rental property used for personal goals or capital income.

Housing Ratios. As Christians, we have other important obligations that we also pay, i.e., tithing and paying ourselves, i.e., savings. As such, should have smaller houses (at least less expensive), because we pay the Lord first and ourselves second. For a spreadsheet that takes into account the fact that we pay the Lord first and ourselves second within this front-end and back-end ratio framework, see: Maximum Monthly Mortgage Payments for Christian Savers Spreadsheet (from the website).

I Bonds: Inflation linked US government savings bonds, where the rates on the bonds are tied to inflation.

Identity goals. These are goals that relate to our long-term view of who we are and how we see ourselves. These goals help us be better in our long-term view of who we are and what we want to become.

Ignorance. A reasons for going into debt. We don't understand interest and its costs.

Immediate Annuity Distribution. You can use your defined contribution plan to purchase an immediate annuity, either from your retirement Plan provider or from others outside the Plan.

Impound/escrow/reserve accounts. These accounts are that portion of a monthly payments held by the lender or servicer to pay for: Taxes, Hazard insurance, Mortgage insurance, Lease payments, and

Other items as they become due. These are for payments for items above which are over and above your monthly mortgage payments of principle and interest. These may or may not be required by your lender.

Inactivity/Minimum balance fees. These are fees because you did not have account activity during the period or because you failed to keep a minimum balance in your account.

Inactivity/Minimum balance fees. These are fees imposed because you did not trade or have account activity during the period or because you failed to keep a minimum balance in your account.

Income Statement (personal). This is a financial record your inflows and outflows of cash. It is on a cash basis. The statement is based entirely on actual cash flows, not accruals.

Income Taxes. Income taxes are a progressive tax meaning that the more you earn the more you pay.

Income-consuming assets. These are assets which require a constant infusion of cash to keep operative.

Income-generating assets. These are the best type of assets. These assets generate income or capital gains which may eventually allow you to have income without your having to work.

Indenture. A document that outlines the terms of the loan agreement.

Independent brokers. These are brokers whose company is not part of a major chain or who own a captive mutual fund company. They may be inclined to give unbiased advice as they do not sell specific mutual funds.

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Index funds. Index funds are mutual funds designed to match the returns of a specific index or benchmark. Different Index funds may track many different benchmarks, including the S&P500 (Large-cap stocks), Russell 5000 (small-cap stocks), MSCI EAFE (international stocks), Barclay Aggregate (corporate bonds), DJ REIT (Real estate investment trusts), etc. Index funds are tax efficient since they do little in buying and selling of securities, and their goal is to match the return of their relative benchmarks.

Index funds. These are mutual funds or ETFs which hold specific shares in proportion to those held by a specific index, i.e., the S&P 500 or Russell 2000. Their goal is to match the benchmark performance. Index funds have become the standard against which other mutual funds are judged.

Individual Biases. The brain does not work like a computer. Instead, it processes information through shortcuts and emotional filters to shorten the analysis time. These filters and shortcuts lead to predictable errors in investing. We must be wise to these prediction errors so we can be better investors and better stewards over our resources.

Individual Development Accounts (IDA). These are matching resources from local and other sources to encourage saving for specific goals including education. They must be used for education, or home purchase, or to start a business, you must be in the program for 12 to 36 months maximum, and must attend a basic money management class (Fin418 counts), reside in Utah, be 18 or older, have income to save and meet needs criteria.

Individual Retirement Accounts. These are retirement account created with the Taxpayer Relief act of 1997. While there are over a dozen different individual retirement accounts, the three major types of Individual Retirement Accounts are Traditional IRA, Roth IRA, and Education IRA, which is also called a Coverdell Education Savings Account (ESA).

Individual Retirement Annuity: An IRA set up with a life insurance company through purchase of annuity contract.

Inflation risk. Risk that a rise (decline) in inflation will result in a decrease (increase) in the bond's value.

Inherited IRA: An IRA acquired by the non-spousal beneficiary of a deceased IRA owner.

Initial public offerings (IPOs). These are the very first shares ever issued by a company. Investment bankers serve as underwriters or intermediaries for these IPOs

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Initial target portfolio. This your first goal for a target dollar amount as you begin building your portfolio. It is calculated by taking your emergency fund goal and dividing it by your percentage in bonds and cash.

Installment Loans. Installment loans are loans which are repaid at regular intervals and where payment includes both principal and interest. These are normally used to finance houses, cars, appliances, and other expensive items. These loans are amortized, which is the process of the payment going more toward principal and less toward interest each subsequent month. These may be secured or unsecured loans, variable-rate or fixed-rate loans.

Insurance. Insurance is a tool help you achieve your personal and family goals. It is a product that transfers the risk of certain types of losses or events from an individual to another institution. By transferring risk, it can help the individuals achieve specific goals if they die, get sick or become unable to work. But it is a tool that needs to be understood and used wisely.

Insured Worker. A worker is only entitled to receive benefits if that worker is fully insured. Workers are considered fully insured if they have worked forty quarters of work (a quarter is three months) and earned a specific amount of money per quarter.

Integrity goals. Integrity goals relate to the characteristics and standards you want to achieve in the work and service you provide. These goals relate to how we will work and live, what we will and will not do, and characteristics and skills we wish to attain.

Interest only Option loans. These are FRMs or ARMs with an option that allows interest only payments for a certain number of years, and then payments are reset to amortize the entire loan over the remaining years. Some will take out an interest only loan to free up principal to pay down other more expensive debt. Once the interest-only period has passed, the payment amount resets, and the increase in payment can be substantial. These are generally not recommended.

Interest or finance costs. This is the average amount borrowed times the monthly interest rate. In calculation form, it is the (Net capitalized cost + residual value) / 2 times your average interest rates which is the APR/12.

Interest rate risk. Risk that a rise (fall) in interest rates will result in a decline (rise) in the bond's value.

Interest. The cost of using borrowed money. Interest must always be paid.

Interest/coupon payments. These are payments received as part of the contractual agreement to receive interest payments from a bond. Bonds which have preferential interest tax treatment, i.e., muni's and Treasuries, must still pay capital gains taxes.

Intermediate-term bonds. Bonds with a maturity of 2 to 10 years.

Internal Rate of Return (IRR). This is a form of loan analysis to determine whether you should refinance or not. The process is to calculate all costs and fees for the loan, calculate the monthly savings, determine the number of months of savings, and set the number of months on the new loan equal to the number of months remaining on the old loan so you are not extending the loan! If your IRR is greater than your risk-free rate, then refinance.

International Bonds. Bonds issued by international companies and sold internationally in various currencies.

International stocks and international mutual funds. These are stocks or mutual funds of companies based entirely outside the U.S. These can be of any size (small-cap, large-cap), any type (value, growth) and from any part of the world outside the US. International investments involve additional risks, which include differences in financial accounting standards, currency fluctuations, political instability, foreign taxes and regulations, and the potential for illiquid markets.

Intestate. The process whereby the state essentially writes the will for a person because they did not prepare a will during their lifetime.

Investment advisor. A person or an organization that helps makes the day-to-day decisions regarding a portfolio's investments for investors.

Investment Assets. These assets include stocks, bonds, mutual funds that are invested for the future. These are also income-producing assets used to accumulate wealth to satisfy specific goals.

Investment Benchmarks. An investment benchmark is the standard by which to judge your asset performance. You never choose an asset without choosing an investment benchmark. Use your

investment benchmark to determine how well you are doing.

Investment Constraints. These are specific needs you have which will constrain how you will invest your portfolio.

Investment Guidelines. Your investment guidelines are the general road map on how you will be investing your assets over your life cycle. It integrates your personal goals and your financial goals into a complete financial perspective.

Investment Horizon. This is when will you sell the investment.

Investment Plan (also called and Investment Policy Statement). Your Investment Plan is the most important document you will prepare in regards to your investing activities. It sets the plan and framework on every investing activity. It states what you will do: what you will and will not invest in, how you will invest, why you will invest, what percentages you will invest, etc. In short, it is the key document that will impact your investment returns most for the rest of your future.

Investment risk. This is the risk of who takes responsibility for the investment outcome, the insurance company or the insured.

Investment vehicles. The investment vehicle is the tax-law defined framework that has specific tax advantages, i.e., 401k, 403b, Individual Retirement Account (IRA), SEP IRA, Roth IRA, Roth 401k, etc. Investment vehicles have different benefits, i.e., due to matching (free money), tax elimination, tax deferral, or just tax-efficient and wise investing. Investment vehicles are like shopping carts in the grocery store, they are the things you put your groceries, or financial assets, into.

Investment/financial assets. Investment or financial assets are the securities that are invested in by the investment vehicles, i.e., stocks, bonds, mutual funds, REITs, MMMFs, CDs, etc. They are like the groceries you put in your shopping cart, which is your investment vehicle.

IRA Rollover distribution (Be careful and don't touch the funds). You can roll over your distribution into an IRA. The benefits are you can defer taxes until you withdraw the funds, you can direct investment to different assets and asset classes, and you can continue to enjoy tax-deferred growth. The risks are that there is no guarantee that funds will last a lifetime and you must begin withdrawals at 70½ or 50% penalty is incurred.

Irrevocable Living Trust. A trust that cannot be changed by the owner once established, because the trust becomes another legal entity which owns all the assets contained in the trust and pays taxes on the assets and gains they produce. The assets are not subject to estate taxes since they are not part of your estate and assets in the trust do not pass through probate.

Issue. These are children.

Issuer. The corporation or government agency that issues the bond.

Itemized Deductions. These are allowable deductions (if you itemize) and include: charitable contributions (cash, in kind, and/or mileage), home mortgage interest, medical expenses (>10% AGI), un-reimbursed qualified job expenses (> 2% AGI), casualty and theft expenses (> 10% AGI), etc.

Jensen's Alpha. This is a risk-adjusted performance measure. This is the ratio of your portfolio return less CAPM determined portfolio return, or alpha = rp - [rf + ßp (rm – rf)] where ap = alpha for the portfolio, rp = average return on the portfolio, ßp = Weighted average Beta, rf = average risk free rate, and rm = average return on market index port. It is portfolio performance less expected portfolio performance from CAPM model.

Joint and Survivor Annuities (percent relates to the amount the spouse receives). You receive payment for as long as you live or for a certain guaranteed period, whichever is longer, and your spouse, after you die, receives that percent of your payment for as long as they live.

Joint Tenancy with Right of Survivorship (JTWROS). Ownership is shared equally and lifetime control is shared, income is shared between owners, testamentary control is absent, and then right of survivorship is key.

Jumbo loans. These are loans in excess of the conventional loan limits and the maximum eligible for purchase by the two Federal Agencies, Fannie Mae and Freddy Mac, of $424,000 in 2018 (some areas have higher amounts). Some lenders also use the term to refer to programs for even larger loans, e.g., loans in excess of $500,000.

Junk Bonds. Bonds with very low bond ratings, a

higher interest rate and default rate, and are almost always callable.

Keogh Plan. This is a small business retirement plan set up by a sole proprietor or partnership (not incorporated) which allows employers to make tax-deductible payments to retirement plans, similar to pension or profit-sharing plans. Plans can be either a defined benefit or defined contribution, but most commonly are DC profit sharing or money purchase plans. Contributions are tax deductible, earnings grow tax-deferred, and employers may borrow from the Plan

Large-cap (capitalization) stocks. Large caps are stocks with a market capitalization greater than roughly $10 billion in the US, and smaller capitalizations for international companies. These are the generally the largest, most well established companies in the US, with a history of sales and earnings as well as notable market share. These are generally mature corporations with a long track record of steady growth and dividends.

Lease cost: The total cost of a vehicle's lease.

Lease term: The number of months the vehicle is leased.

Lease: A contractual arrangement calling for the lessee (user) to pay the lessor (owner) for the use of an asset.

Leverage. The decision of using debt to invest. It is not recommended.

Liabilities. This is what you owe to others. Liabilities come in two major forms: current liabilities, liabilities that must be paid-off within the next year, and long-term liabilities, liabilities that extend beyond one year.

Liability Coverage. Liability is the financial responsibility one person has to another in a specific situation. Liability results from the failure of one person to exercise the necessary care to protect others from harm. Personal liability coverage protects the policyholder from the financial costs of legal liability or negligence. There are two major forms of liability insurance: the liability portions of homeowners and auto insurance and an umbrella liability coverage.

Life Annuities (guaranteed for the "certain" period). You receive benefits for as long as you live or for a certain guaranteed period, whichever is longer.

Life insurance. This is insurance that provides compensation to your beneficiaries should you die prematurely. It transfers the economic loss of death from an individual to an insurance company by way of a life insurance contract. It can help us take care of our own and extended families should we die.

Life-cycle funds. These are funds which change their allocation between stocks and bonds depending on investor age. As an investor ages, life cycle funds reduce their allocation to stocks and increase their allocation to bonds, more consistent with the goals and objectives of an older investor.

Lifetime transfers. Methods of transferring property including the sale or gifting of one asset to another.

Limit orders. These are orders to sell or buy a specific number of shares at a specific price or better. This is generally the best method in working with brokers.

Limited Partnership Basis. A process of teaching children about finance based on their age and consistent with their ability to learn.

Liquidity risk. Risk that investors will be unable to find a buyer or seller for a bond when they need to sell or buy.

Liquidity. This is the speed and ease with which an asset can be converted into cash.

Living Trust. A trust where assets are placed in the trust while you are still living. You can take them out and move them according to what you want to do before you die.

Living will. It is a legal document that details your end-of-life wishes for health care. It is used when you are still alive but unable to make health care decisions for yourself. A living will states your wishes regarding medical treatment in the event of a terminal illness or injury

Loads. Loads are sales charges to compensate the sales force for selling the fund. Loads directly reduce the amount of money invested by the amount of the load. Loads can either be front-end or back-end, depending on when the mutual fund company takes out the load or sales charge. Generally, research has found that the performance of load funds and no-load funds is identical. When the sales charges are included, no-load funds significantly outperform load funds. (Matthew R. Morley, "Should You Carry a Load? A Comprehensive Analysis of Load and No-Load Mutual Fund Out-of-Sample Performance,"

Journal of Banking and Finance, vol. 27, nu. 7 (2003), pp. 1245-71.)

Loan term. This is the duration of the loan. It can be 10, 15, 20 or 30 years depending on your goals and your cash flow situation.

Local income taxes. These are uncommon; but some larger cities, for example, New York City, impose such a tax.

Long-term bonds. Bonds with a maturity of greater than 10 years.

Long-term capital gains. These are capital gains where the Fund has owned the assets for more than a year (366 days). These are taxed at a rate dependent on your taxable income.

Long-term Debt Coverage ratio. This is your income available for living expenses divided by long-term debt payments. This ratio tells how long you could make monthly payments on your debt based on the amount of money you have available for living expenses (which is wages less taxes). The inverse of this ratio is the Debt Service ratio.

Loss Aversion. Often losses are given more weight in our minds than potential gains in any position. These weights are more than utility theory would suggest. We should give gains and losses equal weight in your analysis. It is the gains and losses of the overall portfolio that are important, not individual securities.

Low Income Filer. This is a single filer with provisional income below $25,000 or married filing jointly (MFJ) with income below $34,000. None of the benefits are taxable.

Lump Sum Benefit. A lump sum of $255 is available to the surviving spouse, nonresident spouse, or to children eligible for the monthly benefits (for 2018).

Lump Sum Distribution. This is taking the entire retirement account at retirement. You are responsible to ensure this amount lasts your entire life. The benefits are you can take the money out as you need it, and can invest/gift/use it elsewhere. The risks are that plans only allow distributions every 3 months, taxes are incurred immediately, and if you do not plan well, may not have sufficient money for retirement.

Lump-sum. You receive a single payment of all principal and interest at retirement that you are responsible to manage.

Maintenance margin. This is money you put up to buy on margin. If your maintenance margin falls below a specific level, you will be required to put up more money. If not, your position will be closed out.

Major Medical Insurance. This is major coverage of medical costs over and above the basic health insurance coverage. It covers medical costs beyond the basic plan. These normally require a co-payment and/or a deductible. There is a stop-loss provision, which limits the total out-of-pocket expenses incurred by the insured to a specific dollar amount and a life-time cap for the insurance company, which limits the total amount the insurance company will pay over the life of a policy.

Managed health care providers. These are insurance companies which provide pre-paid health care plans to employers and individuals. There are four main types of managed care: i. Health maintenance organizations (HMOs), Preferred provider organizations (PPOs), POS Plans (POS), and Exclusive Provider organization (EPOs). They pay for and provide health care services to policy holders and they provide the most efficient payment of bills. However, they limit choices to the doctors and hospitals that participate and they require policy holders to pay a monthly premium and share the cost of care.

Management fees. These are fee charged by the advisor to a fund generally on the basis of a percentage of average assets under management, i.e. 75 basis points or .75% a year.

Manager Style Drift. This is a check on the management style. Make sure the manager's investment style remains constant. Investment fund managers have no authority to change the asset class. If you purchase a small cap fund, the manager should purchase small cap shares. The fund's prospectus should clearly define the market size, company, and portfolio style tilt.

Margin accounts. These are accounts where you borrow from the brokerage firm to purchase financial assets. This is debt, and can amplify both gains and losses.

Margin call. This is a call by the broker to put up more money when your margin declines below a certain level. I recommend you do not buy on margin. It is using debt to invest and you can lose more than

your original investment doing this.

Marginal tax rate. This is your taxes on each additional dollar of earnings. If you made $1 more this year, at what rate would it be taxed.

Market capitalization. It is one measure of the size of a company. It is calculated by multiplying the market price of the stock by the number of shares (i.e. ownership pieces) outstanding. The greater the capitalization, the larger the company. Market capitalization is used to weight companies in various benchmarks and to determine certain classes of companies, i.e. large-cap, mid-cap, small-cap, etc.

Market orders. These are orders to sell or buy a specific number of shares at the currently available or market price. Be careful as the market can move quickly and dramatically between when you place the order and order execution time.

Markup. This is the difference between the buying price and the calculated selling price.

Maturity date. The date when the bond expires and the loan must be paid back.

Maximum Family Benefit. When benefits are payable to more than one family member, a family maximum applies. This includes all benefits paid to the family. For disability, the family maximum is the lesser of 150% of the workers disability benefit or 85% of the AIME used to calculate the benefit, but is not less than the benefit paid to the worker. When the worker is living, and benefits exceed the family maximum, the worker's benefit is not adjusted; rather, the reduction is made in other beneficiaries' payments.

Mean Reversion. Prices tend to correct themselves as investors correct for overreaction. Long-term prices tend to revert to the mean.

Medicaid. Medicaid is a medical assistance program, operated jointly by the states and federal government, to provide health care coverage to low income, blind, or aged persons. Medicaid payments may be used to offset the premiums, deductibles, and co-payments incurred with Medicare. There is no guarantee that this plan will be around in its present form.

Medicare Benefits. Medicate hospital insurance (HI) portion of Medicare, also known as Part A, is largely funded by the 2.9% HI tax on earnings. Part A is compulsory. Individuals at least age 65 and eligible for Social Security retirement benefits on their own behalf are entitled to coverage under Medicare Part A. If the individual has applied for Social Security (SS) retirement benefits, no separate application is required.

- Medicare Part A is compulsory and covers all hospital related expenses, such as bed and board, operating room costs, and lab tests. Patient pays a deductible and coinsurance payment.
- Medicare Part B is voluntary, with a monthly charge. It covers doctors' fees and other outpatient treatment. Patient pays a premium, deductible, and 20% of approved charges.
- Medicare Part C (Medicare Advantage) provides three program alternatives: coordinated care plans, private fee-for-service Medicare, and health savings accounts (HSAs).

Medicare. This is a health care insurance program for elderly and disabled. Medicare insurance provides medical benefits to the disabled and to those 65 and older who are covered by Social Security. Its cost is covered through Social Security taxes. Individuals can get insurance through Medicare that would be prohibitively expensive through other channels, however, it doesn't cover all the costs and expenses and individuals must pay certain amounts. In addition, there are limitations to the coverage, such as out-of-hospital prescription drugs and limitations to the number of days in skilled nursing facilities. Medicare is divided into three parts: A, B, C.

Mental Accounts. Often investors keep mental accounts rather than viewing individual assets as part of a total portfolio. We do this to try to save ourselves from ourselves.

Mid-cap or mid-capitalization stocks. These are stocks with capitalization between roughly $2 billion and $10 billion. These stocks tend to grow faster than big cap companies, and are generally less volatile than small cap companies. Mid-caps generally perform similar to the small-cap asset class. For asset-allocation purposes, mid-caps are generally not considered a major asset class.

Middle Income Filer. This is a single with income from $25,000 to $34,000 and MFJ with income from $32,000 to $44,000. Up to 50% of social security benefits are taxable.

Minimum purchase amount. This is the minimum

amount the mutual fund company will allow you to purchase in their funds to begin investing.

Mission Statement. This can be your individual and family purpose and passion. It can also include other things such as family mottos, family mission statements, what you stand for, etc.

Modified Adjusted Gross Income. This is your adjusted gross income adding back certain items such as foreign income, foreign-housing deductions, student-loan deductions, IRA-contribution deductions and deductions for higher-education costs.

Monetary (or Current) Assets. This is cash or other assets that can be easily converted into cash. These may be also income-producing assets. They provide necessary liquidity in case of an emergency.

Money factor: A way of expressing interest rates, calculated by taking the APR and dividing it by 24.

Money Market Account or Money Market Deposit Account: A non-financial account that pays interest based on current interest rates in the money markets. They typically require a higher minimum balance to avoid monthly fees and typically have a higher rate of interest.

Money market mutual funds. Money market mutual funds are funds which invest the majority of their assets in short-term liquid financial instruments such as commercial paper and government treasury bills. Their goal is to obtain a higher return, after fees and expenses, than traditional bank savings or checking accounts.

Money Purchase Plans. These are defined contribution plans where the employer contributes a percentage of employee salary each year, not dependent on company profits. Employees do not contribute.

Monitor performance. The process of understanding and reviewing the performance of a portfolio. Unless you monitor performance, you will not know how you are doing in working toward accomplishing your objectives. You need to know how every asset you own is performing, and performing versus its benchmark, so you can determine how well you are moving toward your goals.

Month's Living Expenses Covered ratio. This is your monetary assets divided by your monthly living expenses. This ratio tells you how many months you could survive in the event of the loss of all current income. Your living expenses do not include charitable contributions, taxes or savings.

Mortality risk. This is the risk that the insured dies outside the contract period and is therefore not covered by insurance.

Mortgage-backed bonds. Bonds backed up by a pool of mortgages.

Mother's or Father's Benefit. The surviving spouse of a fully or currently insured worker is eligible to receive a benefit of 75% of the worker's PIA if they are caring for a child who is under age 16 or who was disabled before age 22 (subject to family maximum).

MSRP: The price the manufacturer hopes to get for the sale of a product.

Mutual fund returns. Mutual fund returns include distributions of dividends, capital gains, and interest, and any NAV appreciation. Your total return: (ending NAV–beginning NAV)+ distributions / beginning NAV. Mutual Fund after-tax returns is your return after all taxes are taken out. Mutual fund before-tax returns is your return before taxes.

Mutual fund share classes. These classes of shares vary depending on the loads and management fees paid. While there are differences in classes of shares among investment management companies which charge loads, they generally are:

Mutual fund supermarkets. Mutual fund supermarkets i.e., Fidelity Funds Network, Charles Schwab, or Jack White, allows you the benefits of the mutual fund company while you get access to a whole range of mutual fund companies (but not all of them). Mutual fund companies rebate part of their management fees back each month to the "mutual fund supermarkets" to have them included in their list of funds.

Mutual fund. It is a way of holding financial and real investments. It is an Investment company that pools money from investors to buy stocks, bonds, and other financial investments. Investors own a share of the fund proportionate to the amount of their investment divided by the total value of the fund.

Necessity. One of the reasons for going into debt. It is we truly cannot feed our families.

Needs Approach. This is an approach for determining the amount of life insurance that is required. It determines the total needs of the

beneficiaries which includes immediate, debt elimination, transitional, dependency, spousal life income, education, and retirement needs. It is the most detailed of the approaches.

Negative Amortization Mortgages (NegAm). These are mortgage loans in which scheduled monthly payments are insufficient to amortize, or pay off the loan. Interest expense that has been incurred, but not paid is added to the principal amount, which increases the amount of the debt. Some NegAm loans have a maximum negative amortization that is allowed. Once that limit is hit, rates adjust to make sure interest is sufficient to not exceed the maximum limit.

Net capitalized cost (also called **adjusted capitalized cost**): The final amount paid. Found by taking the capitalized cost and subtracting capitalized cost reduction.

Net worth or equity. This is the difference between your assets, the things you own of value, and your liabilities, what you owe to others.

New investor bias. New investors dilute the value of existing investor's shares. Since new money comes into the fund at Net Asset Value, and since this money must be invested (at roughly 0.5% on average in the U.S.), existing investors are subsidizing new investors coming into the fund

NMD (New Money / Donations) Addendum. This is a way to rebalance using either of the rebalancing methods. Rebalance as determined previously, but pay your charitable donations using appreciated assets, and use the money you would have spent on charity to purchase the "underweight" assets, so you do not have to sell and incur transactions costs or taxable events.

No-load mutual funds. Mutual funds that are sold without a sales charge and are redeemed without a charge as well.

No-Load Shares: These are shares sold without a commission or sales charge. Generally, these shares are distributed directly by the investment management company, instead of going through a sales channel. They may have higher management fees to compensate for the lack of a front- or back-end load.

Non-deductible IRA. Individuals may contribute to a non-deductible IRA. The benefits are that money is contributed after-tax, and investment earnings grow tax-deferred. No taxes are paid on the investment earnings until the earning are withdrawn at retirement. Accurate record keeping is required to pro-rate the nondeductible portion of any subsequent distribution.

Non-group Coverage Plans. These are health insurance plans which cover individuals on a case-by-case basis and are traditionally the most expensive type of coverage. They provide a custom insurance policy to the purchaser. They are expensive, usually 15% - 60% more expensive than a group policy and may require subscribers to pass a medical exam.

Non-probate transfers. These are "will substitutes," and include state law, right of survivorship, beneficiary designations, and gifts causa mortis.

Non-refundable credits. Non-refundable credits include child tax, child and dependent care, elderly and disabled, adoption, hope learning, and lifetime learning and are only good up to the amount of taxes owed.

OASDI – HI (Old Age, Survivors, and Disability Insurance and Hospital Insurance). This is payment for Social Security and Medicare taxes. The employee and employer each pay (assuming your Adjusted Gross Income (AGI) is less than $250,000: Social security tax (OASDI) of 6.20%, Medicare tax (HI) of 1.45%, for a total of 7.65% each. Self-employed individuals pay the whole 15.30%. OASDI-HI taxes are on taxable wages including wages, salaries, bonuses, commissions, value of employer provided meals/lodging, sick pay during first 6 months, employer paid group life insurance premiums in excess of $50,000, salary reduction from 401k, 403b, 457 plans, non-qualified deferred compensation no longer at risk, non-qualified stock options, vacation pay, and severance pay.

Open orders (GTC: good till canceled, GTD: good till date specified). These are orders which are good until filled or canceled. Be very careful with open or GTC/GTD orders. If you fail to cancel specific orders, you might have orders filled that you forgot to close out.

Open-end mutual funds. These are mutual funds that can be purchased and sold each day at the fund's Net Asset Value, which is the fund's assets less liabilities, divided by the number of shares outstanding.

Option Adjustable Rate Mortgages (Option

ARMs). This is an ARM where interest rate adjusts monthly, and payments annually, with "options" on the payment amount, and a minimum payment which may be less than the interest-only payment. The minimum payment option often results in a growing loan balance, termed negative amortization, which has a specific maximum for the loan. Once this maximum is reached, payments are automatically increased and the loan becomes fully amortizing after 5 or 10 years, regardless of increase in payment and must be repaid within the 30 year limit. These are not recommended.

Ordinary dividends. These are stock dividends earned from holding a stock an insufficient number of days within a specific period to be reported as qualified dividends. Ordinary dividends are taxed at a federal marginal or ordinary tax rate.

Organized Exchanges. These are areas used to facilitate trading of financial instruments.

Origination fees: These are the costs and profits made by the mortgage broker for originating the loan.

Overreaction. Many investors assign a probability to asset returns based on past theory. Appropriate reaction to a negative event is to update a prior probability to the most recent event. Overreaction is when they assign too high a value.

Over-the-Counter (OTC) Market. This is an electronic network of dealers used to execute trades without specialists or middle-men.

Ownership. This is the principle that everything we have is the Lord's, and we do not own the things we have and are. It is based on scripture and helps us to see our blessings as gifts on loan from a loving Father in Heaven.

Par value. The face value or amount returned to the holder of the bond at maturity.

Passive management. Passive management is the process of accepting average returns through purchasing index funds rather than trying to beat the market. It is much cheaper and more tax efficient.

Passive portfolio management. It is the process of buying a diversified portfolio which represents a broad market index (or benchmark) without any attempt to outperform the market or pick stocks. Since most active managers fail to outperform their benchmarks, especially after costs and taxes, investors have realized that if you can't beat them, join them, so they buy low-cost passive funds which meet their benchmarks consistently and minimize taxes.

Payday Loans. These are short-term loans of 1-2 weeks secured with a post-dated check which is "held" by the lender and then cashed later. These have very high interest rates and fees, APR > 720%. Typical users are those with jobs and checking accounts but who have been unable to manage their finances effectively.

Pell Grant. A type of government grant to help students attend college.

Percentages. We sometimes move in and out of asset classes and stocks instead of keeping specific asset class percentages relatively constant (within our minimum and maximum amounts from our Investment Plan). We get lower returns from increased trading costs and may have more risk than we want.

Percent-range-based rebalancing. This is the process of rebalance the portfolio every time actual holdings are +/-5% (or +/-10%) from target ratios. Rebalance whenever you are outside this range. It is easy to implement and wider ranges will reduce transactions costs (at the expense of higher tracking error).

Performance evaluation. It is the process of evaluating a portfolio's performance with the goal of understanding the key sources of return.

Periodic Payments distribution. With this distribution, you can plan for regular payments at regular intervals, and can ensure that payments are available for a specific period of time. However, there is no assurance of lifetime income, and your tax rate may be high due to the amount of money withdrawn.

Periodic-based rebalancing. This is the process of rebalancing where you specify a time period, i.e. bi-annually, annually, etc. After each time period, rebalance the portfolio back to your original asset allocation targets. It is the most simple of the methods, and longer periods have lower transactions and tax costs (but higher tracking error costs).

Permanent insurance. Permanent insurance is an insurance contract that is purchased for the entire life of the policy holder with premiums divided between death protection and savings. Provides insurance that cannot be cancelled, may be used for estate

retirement, and savings. It is complex, expensive, and not transparent, and unless premiums are paid, it can expire worthless. Please note that certain permanent products are not permanent, i.e. they can lose money.

Personal Financial Plan. This is a document that contains all critical areas of your personal financial life. It is your individual and personal roadmap for achieving your personal and family goals. It entails 6 steps: 1: Decide What You Want, 2: Evaluate Your Financial Health, 3: Define your Personal and Financial Goals, 4: Develop a Plan of Action, 5: Implement Your Plan, and 6: Revise Your Plan as Necessary.

Personal Property. These are depreciating tangible assets, such as boats, furniture, clothing, etc.

Personal Representative (Executor). This is the person who fulfills the requirements of the trust or will.

Perspective. Perspective is how we look at things. It is important because it impacts choice. We can take many different perspectives in our view of different aspects of our lives, with the best perspective being the perspective that last the longest—an eternal perspective.

Piggyback loans. These are two separate loans, one for 80% of the value of the home and one for 20%. The second loan has a higher interest rate due to its higher risk. The second loan is used to eliminate the need for PM Insurance. With a piggyback loan, PMI is not needed, but these are much harder to get now.

Point of Service Plans (POS). These plans have attributes of HMOs, PPOs, and indemnity plans. The point at which benefits are received determines the amounts of benefits paid. POS may include HMO, PPO, and indemnity type programs, and the POS may also have a gatekeeper.

Points. Points are fees for a loan. 1 Point is one percent or one hundred basis points of the loan. This money is pre-paid interest, money paid to the mortgage broker (not the lender). It is deducted from the loan proceeds (you still must pay it back), and is essentially another fee for helping you arrange the loan (minimize points). Lenders charge points to recover costs associated with lending, to increase their profit, and provide for negotiating flexibility. You will like have to pay origination points, but buy-down points (to reduce the interest rate on the loan) are purely optional.

Political or regulatory risk. Unanticipated changes in the tax or legal environment will have an impact on a company's bonds.

Portfolio attribution. It is the process of separating out portfolio returns into their related components, generally attributable to asset allocation, securities selection, industry, and currency.

Portfolio evaluation. The process of monitoring financial asset performance, comparing asset performance to the relevant benchmarks, and determining how well the fund is meeting its objectives.

Portfolio management. It is the development, construction, and management of a portfolio of financial assets to attain an investor's specific goals.

Portfolio rebalancing. It is the process of bringing portfolios back into given target asset allocation ratios. Changes in allocation occur due to changes in asset class performance and investor objectives or risk, or introduction of new capital or new asset classes.

Portfolio reporting. The process of reviewing portfolio performance with the necessary participants, i.e. your spouse or your investment advisor.

Potential Cap Gains Exposure. This is an estimate of the percent of a funds asset's that represent capital gains. If this is high, the probability is high that these may come to the investor as capital gains.

Pre-approval. Pre-approval is the process whereby lenders have pull your credit score, looked at your tax records and approve you for a specific amount of a loan. Get pre-approved for your loan by a number of lenders (with mortgage loans, you can have multiple loans requested within a 90 period and it's counted as one loan request). You can borrow up to this pre-approved amount without a problem. Remember however that you do not need to borrow that amount. I recommend you borrow less than that amount.

Preferred Provider Organizations (PPOs). PPOs are insurance plans which are essentially a cross between the traditional fee-for-service and an HMO. PPOs are organizations where in-plan provider's fees are covered, and out-of-plan providers results in higher fees. Insurers negotiate with a group of doctors and hospitals to provide care at reduced rates, while giving insurers the ability to go to non-plan doctors. PPOs provides health care at a discount to

fee-for-service plans. They provide a group of doctors which work at reduced costs to the participants, while assessing an additional fee if the participant uses a non-member doctor or center. PPOs are more expensive than HMOs and use of non-PPO providers results in higher out-of-pocket costs.

Prepayment Penalties. These are penalties enforced by the lender for prepaying a loan too soon. Prepayment penalties have a stated period of time, i.e., 1, 2, or 3 years the prepayment penalty is in effect, a maximum pay down percentage (MPP), i.e., 6% of the principal per year, and a prepayment penalty if you sell it before, i.e., 6 months interest. With a soft prepayment you cannot within the stated period of time without penalty, refinance at all, sell the loan to family members, or pay down more than your MPP each year. The only way to get out of a soft prepayment penalty is to sell the property to an unrelated party. With a hard prepayment, you cannot within the stated period of time without penalty refinance at all, sell the loan to anyone, or pay down more than your MPP each year. There is no way to get out of a hard prepayment penalty before the defined period without paying the penalty.

Prepayment. Prepayment is the process where you repay the loan early, either through paying off the loan or selling the house and the new buying paying off the old loan.

Pre-qualified. Pre-qualified is a process where lenders estimate your credit based on information you tell them. I recommend you get pre-approved, not pre-qualified.

Price. The price that the bond sells for.

Pride. A reason for going into debt. How we look to others is more important than how we look to God.

Primary and Secondary markets. Primary markets are markets for trading newly issued securities. Secondary markets are for trading already issued shares of stocks, bonds, and other securities. Secondary markets consist of organized exchanges and over-the-counter or electronic markets where existing shares are traded.

Primary Insurance Amount (PIA). Your PIA is the basic unit used to express the amount of a worker's benefit if they received benefits at their full retirement age (FRA). The calculation of PIA is based on the workers AIME, which is split into three segments and multiplied by specific percentages for each segment and summing the parts.

Primary markets. These are markets for trading newly issued securities.

Principles. These are doctrinally based guidelines for how we should live our lives. Whereas doctrines answer the 'why" questions, the principles are the "what" questions, i.e., what are the things and guideline we should be following and doing.

Priority of money. This is an educational tool to help individuals determine the order of which they should utilize investment vehicles to achieve their personal and family goals.

Private Alternative Loans. These unsubsidized loans are much more expensive than federal unsubsidized loans, interest starts immediately and accrues, and you must begin paying the loan back immediately. The student is the borrower. These have higher up-front fees and may require a cosigner. Read the fine print VERY CAREFULLY.

Private Health Care Plans. These are health care plans sold by private insurance companies to individuals and employers as part of a benefits package.

Private Mortgage Insurance. Insurance paid for by the borrower to ensure that the lender is made whole should the borrower default. If equity in the home is greater than 20%, PMI is not required for conventional loans or VA loans (but is required by FHA loans for the life of the loan).

Probate. Probate is the process of distributing an estate's assets after death. Probate is a matter of state law. It is the matter of administering the portion of the person's estate that is disposed of in either by will provisions, for those with a valid will, or by intestate succession, for those who die without a will.

Profit Sharing Plans. These are defined contribution plans where employer contributions vary year-to-year depending on firm profitability (it may be zero if the firm is not profitable in that year).

Psychological biases. These are views on how the brain works and affect our investment decision making process. Poor investment decisions caused by psychological biases affect your wealth, so we need to learn to recognize and avoid poor investment decisions which come from those psychological biases.

Q-TIP (Qualified Terminable Interest Property) Trust. A Q-TIP Trust is a testamentary trust which provides a means of passing income to the surviving spouse without turning over control of the assets. These trusts ensure that assets will be passed to your children upon the death of the surviving spouse.

Qualified dividends. These are stock dividends earned from holding a stock a minimum number of days within a specific period. Qualified dividends are taxed at a federal preferential tax rate depending on your marginal tax rate.

Qualified stock dividends. These are payment of cash to the Fund by the companies owned where the company owned the shares for a specific length of time. These are taxed at a preferential rate depending on your taxable income.

Real estate and property taxes. These are taxes imposed annually or semi-annually on assets owned.

Real Goals. These are goals you really want to accomplish, and are willing to work hard and seek Heavenly Father's help in accomplishing them.

Realtor or Real Estate Broker. This is a person supposedly trained in the process of selling and buying real estate. You want a realtor that know the market in the area you are looking at. Remember that realtors are paid by the seller, so remember that in your associations. Sellers divide the sales commission (usually 6-8%) between the listing realtor and the buying realtor.

Redemption. The process of redeeming a callable bond before its maturity date.

Refinance. The process of getting another mortgage loan on your home and repaying the old loan with a goal to reducing your interest and other costs overall.

Refundable Credits. These are credits paid to the taxpayer even if the amount of the credits exceeds the tax liability.

Required minimum distributions. For tax deferred retirement plans, the government requires that a certain percentage of assets must begin by April 1st of the year following age 70½. The distribution is the account balance on Dec. 31 of the previous year (age 69) divided by the life expectancy from the table below. There is a 50% penalty on minimum distributions not taken.

Required Minimum Distributions. This is a legal requirement of many tax-deferred retirement vehicles which require savers to distribute a specific amount each year after age 69 of total plan assets. It is calculated by dividing the total amount in accounts by a specified number given.

Residual value: Expected value of a vehicle at term end. Often used as purchase price after a lease has ended.

Retirement Benefits. Retirement benefits can either be reduced or increased depending on your PIA, your FRA and the date when benefits begin. You can begin receiving benefits as early as age 62. Benefits that begin 3 years before FRA will be reduced by a maximum of 20% (or 5/9% of 1% per month for each month benefits begin before FRA or 6.67% per year). Additional reductions of 5% per year are effective when FRA exceeds age 65.

Retirement Payout Options. These are the types of annuity distribution payouts available at retirement. Investors and spouses jointly determine the types of payments at retirement.

Retirement plans. These are income-producing assets, such as pensions, IRAs, 401K, Roths, SEPs. etc. by you or employer used to accumulate wealth for retirement.

Retirement vehicles. These are a specific type of investment vehicles which are related to retirement. These include qualified retirement plans such as both traditional and Roth 401k, 403b, and 457 plans; Individual retirement plans such as Roth and traditional IRAs; and small business plans such as SEPs, Simple, and Keogh plans.

Retirement vehicles. These are investment vehicles to help you save for retirement. These include for private businesses: 401-k, Roth 401-k plans; non-profit tax-exempt businesses: 403-b/Roth 403-b plans; State and municipalities: 457 plans; Individual retirement accounts: IRA/Roth IRA; and small business plans: SEP IRA, SIMPLE IRA;

Retirement/Annuitization Stage (of retirement). This stage begins when you retire. It is your plan on how your assets will be distributed at retirement. Your goal should be to have sufficient assets for your lifetime to enable you and your spouse to live like you want in retirement.

Retirement/Annuitization strategies. These are strategies to use while you are in the retirement stage. They might include: calculate a minimum acceptable level of retirement income, and annuitize that

amount; take out on a specific percentage of assets each year in retirement, etc.

Revenue bonds. Bonds backed by the revenues of a specific project.

Reverse Mortgages. These are mortgage loans whose proceeds are made available against the homeowner's equity. Financial institutions in essence purchase the home and allow the seller the option to stay in the home until they die. Once they die, the home is sold and the loan repaid, generally with the proceeds. These are typically used by cash-poor but home-rich homeowners who need to access the equity in their homes to supplement their monthly income at retirement.

Revocable Living Trust. It is the most common type of living trust. It is a trust which allows for unlimited control by the trust's owner, because the owner retains title to all the assets in the trust. They do not pass through probate. They provide greater ease and privacy of distribution upon death.

Risk of Downgrading. Should a bond's rating be downgraded, the seller would need to reduce the price of the bond (resulting in a lower yield to the seller and a higher yield to the buyer) to make up for the increased risk.

Risk pooling. It is the process where individuals transfer or share their risks with others to reduce catastrophic losses from health problems, accidents, lawsuits, etc.

Risk. Risk is the possibility of having a return different from what was expected, whether it is losing all your money, losing principle, or not achieving a specific rate of return. There are many different types of risk including: inflation, business, interest rate, financial, market, political and regulatory, exchange rate, call, and liquidity risk.

Risk-adjusted Performance. It is the process of determining performance after adjusting for the risk of the portfolio.

Rollover IRA: A traditional IRA set up to receive a distribution from a qualified retirement plan.

Roth Conversion. This is the process of converting a traditional individual retirement account to a Roth account.

Roth IRA. This is an individual retirement account which provides no deduction for contributions but provides that all earnings and capital gains are tax free upon withdrawal after retirement. You are actually investing more with a Roth, since your investments are after-tax, and contributions can be withdrawn tax/penalty free. Earnings grow tax-free if the Roth IRA is in place for at least 5 years, and you are 59½ years old.

Savings Bonds: Bonds issued by the US government with tax advantages to encourage savings.

Savings Ratio. This is your income for savings divided by your income available for living expenses. This ratio tells you what proportion of your after-tax income is being saved.

Scholarships. Money given to promising students because of their shown abilities in specific areas. There are many scholarships available, but you have to find and apply for them individually.

Seasoned new issues. These are new shares being issued by a company that is already publicly traded.

Secondary markets. These are markets for trading already issued securities. Secondary markets trade previously owned shares of stocks, bonds, and other securities. Secondary markets consist of organized exchanges and over-the-counter or electronic markets where existing shares are traded.

Secured Credit Card: Similar to a standard credit card, but is tied to a checking or savings account. The card cannot be used once the money in the account is gone, until more funds are added. Useful for building credit.

Secured loans. Secured loans are guaranteed by a specific asset, i.e. a home or a car, and typically have lower interest rates.

Securities markets or organized exchanges. These are areas used to facilitate trading of financial instruments.

Securities markets. Securities markets are where securities, i.e., financial assets, are traded. The two different types of securities markets are primary and secondary markets.

Seeking Solace (abdicating responsibility). Sometimes we follow newspaper/newsletter advice which we know has been shown to under-perform. We prefer to take other's advice rather than doing our own homework. That way if the performance goes bad, we can blame others (we don't have to take responsibility).

SEP-IRA. The Simplified Employee Pension (SEP-IRA) is an Individual Retirement Account which allows a small business employer to contribute to the retirement of the employees. Employer contributes the same percentage to all employees, and no required annual contribution. Contributions are tax deductible, earnings grow tax-deferred, and employees own the plans.

Series EE and Series I Bonds. US savings bonds with the special tax advantage that earnings on the bonds are tax-free if used for paying tuition and fees

Sharpe Index. This is a risk-adjusted performance measure. It is the ratio of your "excess return" divided by your portfolio standard deviation, i.e., your (rp – rf)/sp where rp = Average return on the portfolio, rf = your riskfree rate, and sp = Standard deviation of portfolio return. The Sharpe Index is the portfolio risk premium divided by portfolio risk as measured by standard deviation.

Shortfall. This is the difference between what you have now saved for retirement and what you think you need for retirement.

Short-sell. A short-sell is where a lender allows a property to be sold for less than the amount owed on a mortgage and takes a loss. A short sell allows the borrower to avoid foreclosure, which involves hefty fees for the bank and poorer credit outcome for the borrower, and the lender to make "less" of a loss on the property and to not enter foreclosure. A short sell does not necessarily release the borrower from the obligation to pay the remaining balance of the loan.

Short-term bonds. Bonds with maturity usually a year or less.

Short-term capital gains. These are capital gains where the Fund has owned the assets for less than 366 days. These are taxed at your Federal and state "ordinary" or "Marginal Tax Rate (MTR)"

SIMPLE 401k. This is a small business qualified retirement plan that provides some matching funds by the employer. Employees can have no other qualified plan, and may contribute up to the specific amount each year. Contributions are tax deferred and grow tax-free, and there is a penalty for early withdrawal. The employer is "required" to either contribute at least 2% or to match employee contributions, usually 1-3%

SIMPLE IRA. This is one of the SIMPLE retirement plans where Employees can participate. Contributions are tax deductible, it is easy to set up and administer (compared with a traditional 401(k)). A small business qualified retirement plan that provides some matching funds by the employer.

SIMPLE Plans. These are Savings Incentive Match Plans (SIMPLE) that provides matching funds by the employer. It can be established as an IRA or as part of a 401k plan. Employees can have no other qualified plan, and can contribute up to 100% of compensation to a maximum limit each year. The employer is "required" to either contribute at least 2% or to match employee contributions, usually 1-3%.

Single payment (or balloon) loans. These are loans that are repaid in only one payment, including interest. These are generally short-term lending of one year or less, sometimes called bridge or interim loans, often used until permanent financing can be arranged. These may be secured or unsecured.

Sinking fund. Money set aside annually to pay off the bonds at maturity.

Small-cap or small capitalization stocks. Small-cap stocks are companies with a market capitalization less than $2 billion. These are smaller, sometimes newer, US and global companies that are still developing and may have a smaller market share than their large-cap counterparts.

Smart Card: Similar to a debit card, but rather than being connected to a certain bank account, they magnetically store a certain amount of money linked to the card itself.

SMARTER Goals. SMARTER is an acronym for helping you as you strive to set effective goals. It is: S = specific, M = measurable, A = assignable, R = realistic, T = time-bound, E = evaluated, and R = reassessed.

Social Security or FICA. Social security is a government provided retirement, survivor, and disability benefits. Franklin D Roosevelt signed the Social Security Act in 1935 to Aid the displaced and out of work. Social Security is a pass-through account, which means that FICA taxes being paid by current workers provided the money for benefit payments to current retirees.

Sole ownership. Ownership where ownership and control is absolute in one individual. Income belongs to sole owner and testamentary control is absolute.

Special Joint and Survivor Annuity (if there is a death in the marriage the benefit decreases). You receive payment for as long as you live or for a certain guaranteed period, whichever is longer, and your spouse, after you die, receives a percentage of that payment for as long as they live.

Spousal IRA. A Spousal IRA is an IRA contribution for a non-earning spouse. If one spouse is an active participant, the non-earning spouse can contribute to a Spousal IRA. Limits are the same as the traditional and Roth IRA.

Spouses benefit. A fully insured worker's spouse age 65 (FRA) is eligible to receive a retirement benefit of 50% of the worker's PIA subject to the family maximum. This benefit is reduced by 25/36% of 1% for each of the first 36 months that the spouse is under FRA (25% for 3 years). Once the FRA > 65, a reduction of 5/12 of 1% is imposed for each month beyond 36 months the spouse is under the FRA. The reduction of benefit from early retirement will not affect the amount of the spouses benefit. Disability benefits for spouses are 50% of the worker's PIA, reduced if the spouse is under FRA, subject to a family maximum amount.

Spreadsheet budgeting method. Using a computer and spreadsheets, determine your gross salary and take home each month after taxes and other deductions. Determine spending by categories (rows) and dates (columns), and budget for each category. As bills come in, input the spending on each date (column) and row (category).

Sprinkling Trust. A Sprinkling Trust is a testamentary trust that distributes assets on a needs basis rather than according to some preset plan to a designated group of beneficiaries.

Standard Family trust. This is a testamentary trusts which hold the assets of the first spouse to die until the second spouse dies. The spouse has access to income from the trust, or the trust principal, if necessary. They reduce the estate of the second spouse so that the estate taxes can be reduced.

State taxes. Most states impose an income tax; however, some, like Texas and Nevada do not. Alaska actually pays you to live in that state

Status Quo Bias. Sometimes individuals prefer the status quo over a new, more preferable position. There is an aversion to change, even if the change is for the better.

Stepped Up Basis. This is the process of the value of an asset being stepped up, or changed from the original value when purchased, to the current value when the person dies and it is transferred to heirs.

Stewardship. This is the principle that we are stewards over all that the Lord has, is, or will share with us. This view helps us realize the things we have are a gift and we should take care of them.

Stock Bonus Plan. These are defined contribution plans where employer contributions are made with employer shares of stock. Employee stock ownership plans (ESOPs) and leveraged ESOPs (LESOPs) are the most common.

Stock dividends. Stock dividends are dividends received from a company from the ownership of the company shares. Stock dividends are of two types, qualified or ordinary/not qualified. A qualified dividend is a dividend paid by a U.S. corporation where the investor held the stock for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date (see Teaching Tool 32). An ordinary dividend is a dividend that is not qualified, i.e., you have not held the stock for a long enough time period to get the Federal preferential tax rate.

Stock Market Secrets. These are supposed short-cuts or secrets that only the professionals know, but they will share them with you for a price. Don't get taken.

Stock mutual funds. These are stock mutual funds are funds which invest a majority of their assets in common stocks of listed companies. These funds generally have a specific objective, i.e. "large-cap," "small-cap", "value," "growth," etc. which relates to the types of stocks the mutual fund invests in.

Stockbroker. A stockbroker is a person who is employed by and solicits business for a commission house or merchant.

Stop (or stop-loss) orders. These are orders to sell a specific number of shares if the stock price falls below a certain price or buy a specific number of shares if the stock price rises above a certain price. These are used to set prices to safeguard against major fluctuations.

Student Loans. These are loans with low, federally subsidized interest rates used for higher education. Examples include Federal Direct (S) and PLUS Direct (P) available through the school; Stafford (S)

and PLUS loans (P) available through lenders. Some are tax-advantaged and have lower than market rates. Payment on Federal Direct and Stafford loans deferred for 6 months after graduation.

Style analysis. It is another way of obtaining abnormal returns is by analyzing the investment style pf the portfolio. You can decompose returns by attributing allocation to style, and style tilts and rotation are important active portfolio strategies.

Subordinated bond. Bond that will be paid after the other loan obligations of the issuer are paid.

Subsidized Loans. Loans where another party pays the interest while the student is in school. Interest begins 6 months after the student graduates or drops below half-time enrollment.

Subsidized University Loans. These are loans offered by the university to students attending school.

Successor Trustee. This is the person to succeed the trustee should the trustee not be able to manage the trust.

Supplemental medical insurance. The SMI portion of the Medicare program (Part B) is financed by premiums paid by participants and by federal government funding. Participation in Part B is voluntary.

Survivor Benefits. Deceased worker must had had fully insured status; other survivor benefit (mother's or fathers' child's lump sum) will be paid to eligible survivors of a fully or currently insured worker

Target Benefit Plan. These are defined contribution plans that establish a required contribution level to meet a specific target level of benefits at retirement.

Tax Considerations. These are how taxes will impact your investment decisions, including your tax position, specifically your marginal and average tax rate; and how tax-free investments may fit into your plan, i.e. municipal versus corporate bonds.

Tax Cost Ratio. This is the percent of nominal Fund return attributable to taxes, assuming the fund is taxed at the highest rate. If a fund had an 8.0% return, and the tax cost ratio was 2.0%, the fund took home (1 + return) * (1 – tax cost ratio) -1 or (1.08*.98)-1 or 6.00%.

Tax Efficiency. Invest in taxable funds with an eye to obtaining high returns while keeping taxes low. Taxes reduce the amount of money you can use for your personal and family goals. Watch the historical impact of taxes, for it will likely continue. Remember it is not what you earn, but what you keep after taxes that makes you wealthy.

Tax Freedom Day. This is the day you stop working for the government and begin working for yourself.

Tax Tables. These are tables to help you calculate how much taxes you owe.

Taxable accounts. There are investment vehicles without tax advantages.

Taxable bonds. Taxable bonds include U.S. Treasuries, corporate bonds and agency issues (bonds issued by U.S. government agencies, like Ginnie Mae).

Taxable Estate. This is equal to the gross value of your estate, less estimated funeral and administrative expenses, debts, liabilities, taxes and any marital or charitable deductions.

Tax-adjusted Return. This is your return after taxes

Tax-advantaged money. This is the process of using investment vehicles that have specific advantages. There are two types: Tax deferred and tax-eliminated vehicles.

Tax-deferred money. This money has the ability to be invested before-tax, with principle and earnings taxed only at retirement (IRA, SEP IRA, etc.). This money converts long-term capital gains into short-term income for tax purposes.

Tax-efficient and wise investments. This is money that is invested tax-efficiently and wisely, consistent with the principles of successful investing discussed earlier.

Tax-eliminated money. This money can be used at retirement (or for education) without penalty and without taxes, i.e., a Roth IRA/410k/403b for retirement, and 529 Funds and Education IRA for education. You pay the taxes upfront, and then pay no taxes on earnings or capital gains when you take it out at retirement.

Taxes (automobile) (also called government costs). It is the tax on the usage and interest in a lease. It is calculated as (Usage + Interest) times your tax rate.

Taxes on Distributions. These are taxes on your distributions which must be taken into account to get the true return of your portfolio but which are not noted on your monthly reports.

Taxes on mutual funds. Mutual funds are pass through vehicles, which means that taxes are not paid at the Fund level but are passed through to the individual shareholders who must pay the taxes. Mutual fund taxes are mainly capital gains, stock dividends and interest/coupon payments. They are handled the exact same way as the taxes for stocks and bonds discussed earlier.

Taxes. These generally are your largest single annual expense. These may include personal, income, business, transportation and other taxes. Taxes can further be divided into Federal taxes, or taxes we pay the Federal government; State taxes, or taxes we pay the state government, and local taxes, which are taxes we pay the local government.

Tax-free bonds. Tax-free bonds include revenue or general obligation bonds issued by local or state governments and agencies. Such bonds are generally free from federal and state taxes.

Teaser Rates: Very low introductory interest rates used to attract new customers to a certain credit card. They increase soon after the card is in the user's hands.

Temporal goals. These are goals that relate to the temporal measures of success. It could be money, title, fame, positions at work or in industry, include influence, rank or power, or assets, investments, or possessions.

Tenancy by the entirety. Ownership is shared equally and limited to spouses, lifetime control is shared by both spouses, consent from both is required to sell, income is shared between owners, testamentary control is absent, and the right of survivorship is key.

Tenancy in Common. Ownership is shared, with each owning an undivided fractional interest that may be unequal, lifetime control is unlimited, income is shared between owners in relation to fractional interest, and testamentary control is unlimited.

Term Insurance. Term insurance is insurance protection for the insured over a specific term or time period. They may be renewable or non-renewable policies. It is the least expensive form of insurance and the death benefit coverage is only for a specific term.

Term or Bond Maturity. The maturity of the bond.

Testamentary transfers. Methods by which property is transferred at death.

Testamentary Trust. The process where assets are placed in trust after you die. The trust is created after probate according to your will.

Thrift /Savings Plans (TSP). These are defined contribution plans where the employer matches a percentage of employee contributions to a specific amount (i.e., free money). This program is for employees of federal civil service.

Total Costs Analysis. This is a form of loan analysis that does not take into account the time value of money, but is simple to calculate. To do this, calculate your total new costs and fees from the loan until it is paid off, your total current monthly principal and interest costs remaining without refinancing, your total refinance monthly principal and interest costs. If you will be paying less overall, think about it, if it is equal or less, it likely does not make finance sense.

Total expense ratio. This is the total percentage of assets that are spent each year to manage the fund including management fee, overhead costs, and 12b-1 fees.

Tracking Error. This is the return on the fund less the return on the benchmark. This tracking error should be small versus your benchmark. Tracking error is the historical difference between the return of a fund (i.e. a mutual fund) and its specific market/sector benchmark or index. The smaller the tracking error, the better the performance of the Index fund relative to the benchmark. However, you won't complain if the tracking error is positive (i.e., your fund had higher returns than the index or benchmark).

Traditional IRA. An individual retirement account in which an individual can contribute up to a specific amount annually which is tax-deferred. Eligibility and amounts depend on the contributor's income level and whether they have other retirement plans. The contribution is tax deductible and earnings grow tax-deferred.

Transaction costs. These are costs of the fund buying and selling securities, which are not included in other costs. Mutual funds which turn over the portfolio often, i.e. buy and sell a lot, will have higher transactions costs. A good proxy for this is the turnover ratio.

Treasury Bills. A short-term debt obligation issued

at a discount and redeemed at face value upon maturity in 3, 6, or 12 months.

Treasury Bonds. A long-term debt obligation issued at or near par and interest is paid semiannually.

Treasury Notes. An intermediate-term debt obligation issued at or near par and interest paid semiannually.

Treynor Measure. This is a risk-adjusted performance measure. This is similar to Sharpe but it uses the portfolio beta instead of the portfolio standard deviation, or (rp – rf)/ ßp where rp = average return on the portfolio, rf = average risk free rate, and ßp = weighted average b for portfolio. It is the portfolio risk premium divided by portfolio risk as measured by beta.

Trust Grantor. The person who created the trust.

Trustee. The person who will manage the trust.

Trusts. A trust is a legal contract. When you create a trust you are simply creating another legal entity. Trusts avoid probate and are more difficult to challenge than wills. They may reduce estate taxes, allow for professional management, provide for confidentiality, can be used to provide for children with special needs, can be used to hold money until a child reaches maturity, and can assure that children from a previous marriage will receive some inheritance in the future.

Turnover ratio. This is a measure of trading activity during the period divided by the fund's average net assets. A turnover ratio of 50% means half the fund was bought and sold during the period. Turnover costs money and incurs taxes.

Turnover. This is the amount of the portfolio that is bought and sold during a specific period. Keep turnover low, as turnover is a proxy for fund expenses and taxes. The costs associated with turnover are hard to quantify and may not be disclosed in the prospectus. These costs include commissions, bid-ask spreads, and market impact.

Types of Mutual funds. The types of mutual funds generally follow the major asset classes, i.e., money market, stock, and bond mutual funds.

Underwriting. Underwriting is the process whereby the borrower fulfills the requirement of the lender and the lender funds the loan. It also includes the lender selling the loan and the loan being syndicated and sold to investors.

Un-invested Cash. This is the amount of cash in the portfolio. High cash levels in the portfolio are drags on performance so keep un-invested cash low.

Unique Needs. Unique needs are special needs that may impact your investing decisions.

Unlimited Marital Deduction. There is no limit on the value of an estate that can be passed tax-free to a U.S. citizen spouse. This does not apply to non-U.S. citizen spouses. The tax-free maximum gift per year to non-citizen spouses is specified.

Unsecured corporate debts. Bonds not secured by collateral, and pay a higher return.

Unsecured loans. Unsecured loans require no collateral, are generally offered to only borrowers with excellent credit histories, and have higher rates of interest – 12% to 28% (and higher) annually.

Unsubsidized Federal Loans. These are loans for both grads and undergrads where the student responsible for interest during school, repayment begins six months after student graduates, discontinues, or drops below half-time enrollment for a continuous 6 months. The interest is not subsidized.

Upfront costs. These are cost due at the signing of the loan which include closing costs and points, down payment (3-20 percent of the loan amount), and other closing costs including points (3-7 percent).

Upgrade. A situation where a bond rating company improves the bond rating of a bond due generally to an improving financial condition.

Upper Income Filer. These are singles with income above $34,000 and MFJ with income above $44,000. 85% of Social Security benefits are taxable.

US Savings EE Bonds. Savings bonds issued by the US government that pay a fixed rate of interest with is reset every 6 months.

US Savings I bonds. Bonds issued by the U.S. government, and tax deferred until maturity. They are not marketable, but can be redeemed from local banks. Bonds sold at face value, with interest paid at maturity, with the interest rate set to inflation with a fixed component.

Usage (automobile) (also called depreciation). This is the amount of the value of the vehicle that is used over the lease life. It is calculated at the Net capitalized cost – residual value.

VA Loans. These are Veterans Administration (VA)

Guaranteed Loans. These loans are issued by others and guaranteed by the Veterans Administration. They are only for ex-servicemen and women as well as those on active duty. Loans may be for 100% of the home value.

Value stocks. These are inexpensive (in terms of low PE and low P/BV ratios), companies that have potential for good long-term return through both appreciation and dividends.

Values Statement. These are the values you will live by to help you accomplish your vision and mission.

Variable or Adjustable Rate Mortgages (ARMs). These are mortgage loans with a rate of interest that is pegged to a specific index that changes periodically, plus a margin that is set for the life of the loan. Generally the interest rate is lower compared to a fixed rate loan, as the borrower assumes more of the interest rate risk. The may have a fixed rate for a certain period of time, then afterwards adjust on a periodic basis.

Variable-rate loans. Have an interest rate that is tied to a specific index (e.g., prime rate, 6-month Treasury bill rate) plus some margin or spread, i.e. 5%). Can adjust on different intervals such as monthly, semi-annually, or annually, with a lifetime adjustment cap. Normally have a lower initial interest rate because the borrower assumes the interest rate risk and the lender won't lose money if overall interest rates increase

Vesting period. This is the period required before the promised benefits are considered yours.

Vision Statement. This is your vision of what it is you want to become. It is seeing or visualizing with your mind's eye what you will be in the future.

Widow(er)'s Benefits. A benefit of up to 100% of the deceased, fully insured PIA will be paid to the surviving spouse who is at least age 60 and who was married to the worker for 9 months. The surviving spouse is generally eligible if he or she is not remarried and is not entitled to retirement benefits (due to his or her covered employment) of at least the amount of the deceased workers PIA. A widowers benefits terminates at death or at eligibility for an equal or greater retirement benefit.

Will. A legal declaration by which a person provides for the disposition for their property and other assets at death.

Winning by Losing. Sometimes we actively trade stocks instead of buying index funds or ETFs which we know are lower cost and take a lot less time to invest. We know index funds generally outperform the actively managed funds, but we try to invest actively anyway.

Workers' Compensation. Workers compensation is state insurance program that insures against work-related accidents and illness. Workers' Compensation provides insurance to workers injured on the job, regardless of whether they have other health insurance or not. It only covers work-related accidents and illnesses, and coverage is determined by state law and varies state by state.

www.charitynavigator.org. a website on information about various charities which file Form 990 with the IRS. However, they do not include religious organizations listed as "church or convention or association of churches" which are exempt from filing Form 990.

Yankee Bonds. Bonds issued by international companies and sold in the U.S. in U.S. dollars.

Yield to Maturity. This is the true yield received if the bond is held to maturity, which assumes that all interest payments can be reinvested at the same rate as the bond itself.

Yield. The annual interest on a bond divided by its price.

Zero-coupon bonds. A discount bond which pays no interest until maturity.

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