Emerald Spectrum Advisory

The September Newsletter

Emerald Spectrum Advisory
Malissia Johnson, CFP®,AAMS,CMFC
Brian Johnson, CFP®
100 Winners Cir N, Ste 210
Brentwood, TN 37027
615-369-0690
esateam@emeraldspectrum.com
www.emeraldspectrum.com

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Do Millennials Need Life Insurance?

The financial challenges millennials face can be overwhelming. Many young adults have to figure out how to pay off college loans, save to buy a home or start a family, and sock away money for retirement. Given these hurdles, it's no wonder that life insurance as a financial asset gets little to no attention. But it should. There are many reasons to have life insurance at a relatively young age, but here are some common ones.

Leaving your debts for others to pay

As a young adult, you become more independent and self-sufficient. While you no longer depend on others for your financial well-being, your death might still create a financial hardship for those you leave behind.

You may have debts such as a mortgage or student loans that are jointly held with another person. Or you may be paying your parents for loans they took out (e.g., PLUS loans) to help pay for your education. Your untimely death would leave others responsible for some or all of these debts. You might consider purchasing enough life insurance to cover your financial obligations so others don't have to.

Funeral expenses can also be a burden for those you leave behind. Life insurance could ease the financial burden of paying for your uninsured medical bills (if any) and for costs associated with your funeral and burial.

It's less expensive

Premiums for life insurance are based on many factors, including age and health. Certainly, the younger and presumably healthier you are, the less your coverage will cost. This is especially true if you are at a high risk for developing a medical condition later in life.

Replacing lost income

Someone may be relying on your income for financial support. For instance, you may be providing for a family member such as a parent, grandparent, or sibling. In each of these instances, how would your income be replaced if you died? The death benefit from life insurance can help replace your income after you're gone.

Providing for your family

As your family grows, so do your financial responsibilities. There is likely a hefty mortgage to pay. And there are costs associated with young children. If you died without life insurance, how would the mortgage get paid? Could your surviving spouse or partner cover the costs of day care and housekeeping?

And there are events you should plan for now that won't happen until several years in the future. Maybe you'll begin saving for your kids' college education while trying to save as much as you can for your retirement. Over the next several decades, think about how much you could set aside for these expenses. If you are no longer around to make these contributions, life insurance can help fund these future accumulations.

Work coverage may not be enough

You may have a job with an employer that sponsors group life insurance. Hopefully, you take advantage of that program, but is it enough coverage to meet your needs now and in the future? Your insurance needs may change with time, although your employer's coverage may not. Also, most employer-sponsored life insurance programs are effective only while you remain an employee. If you change jobs or are unable to work due to illness or disability, you may lose your employer's coverage. That's why it's a good idea to consider buying your own life insurance.

The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased. As with most financial decisions, there are expenses associated with the purchase of life insurance. Policies commonly have mortality and expense charges. In addition, if a policy is surrendered prematurely, there may be surrender charges and income tax implications.

See disclaimer on final page

Social Security: Shoring Up America's Safety Net

Future projections

In 2019, the trustees of Social Security reported that the Old-Age and Survivors Insurance (OASI) trust fund is projected to run out in 2034. At that time, payroll tax revenue alone would be sufficient to pay 77% of scheduled benefits.

Ever since a legal secretary named Ida May Fuller received the first Social Security retirement check in 1940, Americans have been counting on Social Security to provide much-needed retirement income. For many older Americans, Social Security is their main source of guaranteed retirement income — income that continues throughout their lifetimes and is indexed for inflation every year (in 2019, the cost-of-living adjustment, or COLA, was 2.8%).

Social Security provides more than just retirement income, though. It also provides disability and survivor insurance benefits. About 62 million people — more than one in six U.S. residents — collected some type of Social Security benefit in 2018, with approximately 80% of these recipients receiving Social Security retirement or survivor benefits.[1]

How Social Security works

Social Security is a pay-as-you-go system, which means that payments from current workers (in the form of payroll taxes) fund benefits for current beneficiaries. The payroll tax rate for Social Security is 12.4%, with 6.2% paid by the employee and 6.2% paid by the employer (self-employed individuals pay the entire 12.4%). These payroll taxes are deposited into the Old-Age and Survivors Insurance (OASI) trust fund (for retirement and survivor benefits) and the Disability Insurance (DI) trust fund (for disability payments).

Because of demographic and economic factors, including higher retirement rates and lower birth rates, there will be fewer workers per beneficiary over the long term, worsening the strain on the trust funds. This year, the trustees of Social Security reported that the OASI trust fund is projected to run out in 2034. After that, payroll tax revenue alone would be sufficient to pay 77% of scheduled benefits.

Ideas for reform

There has been little national consensus by policymakers on how to deal with Social Security's looming demographic challenges. Meaningful reform will require broad bipartisan support, and the trustees have urged Congress to address Social Security's challenges sooner rather than later, so that solutions will be less drastic and can be implemented gradually, lessening the impact on the public.

Some Social Security reform proposals on the table include:

- Raising the current Social Security payroll tax rate — according to the 2019 trustees report, an immediate and permanent payroll tax increase to 15.1% (up from the current 12.4%) would be necessary to address the long-range revenue shortfall (16.05% if the increase started in 2035)
- Raising or eliminating the ceiling on wages currently subject to Social Security payroll taxes ($132,900 in 2019)
- Raising the full retirement age beyond the currently scheduled age of 67 (for anyone born in 1960 or later)
- Reducing future benefits — to address the long-term revenue shortfall, the trustees have noted that scheduled benefits would have to be immediately and permanently reduced by about 17% for all current and future beneficiaries, or by approximately 20% if reductions were applied only to those who initially become eligible for benefits in 2019 or later
- Changing the formula that is used to calculate benefits
- Changing the formula that is used to calculate the annual cost-of-living adjustment for benefits

Understand your retirement benefits

The amount you'll receive from Social Security is based on the number of years you've worked, the amount you've earned over your lifetime, and the age when you file for benefits. Your benefit is calculated using a formula that takes into account your 35 highest earnings years, but you don't need to work for that long to qualify for retirement benefits. Generally, you need to have earned a minimum of 40 work credits, which is about 10 years of work in a job covered by Social Security. If you haven't worked long enough to qualify on your own, you may qualify for spousal benefits based on your spouse's work record. A spousal benefit claimed at your full retirement age is generally equal to 50% of the primary worker's full benefit.

You can get an estimate of your future Social Security retirement benefits by visiting the Social Security website at ssa.gov and using the Retirement Estimator tool or by viewing your Social Security Statement. Your personalized statement contains a detailed record of your earnings history, as well as estimates of the retirement, survivor, and disability benefits you can expect at different ages. To view your statement online, you'll first need to register. If you haven't registered online, you'll receive your Social Security Statement in the mail every year if you are age 60 or older and not yet receiving benefits.

[1] Top Ten Facts About Social Security, Center on Budget and Policy Priorities, August 14, 2018

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Balancing 401(k) and HSA Contributions

For more information on qualified medical expenses, review IRS Publication 502. For help with your specific situation, consult a tax professional.

Asset allocation is a method used to help manage investment risk; it does not guarantee a profit or protect against investment loss.

All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.

[1] Survey of Adults with Employer-Sponsored Insurance, Kaiser Family Foundation/LA Times, May 2, 2019

[2] 2019 HSA Survey, Plan Sponsor Council of America, June 4, 2019

If you have the opportunity to contribute to both a 401(k) and a health savings account (HSA), you may wonder how best to take advantage of them. Determining how much to contribute to each type of plan will require some careful thought and strategic planning.

Understand the tax benefits

A traditional, non-Roth 401(k) allows you to save for retirement on a pre-tax basis, which means the money is deducted from your paycheck before taxes are assessed. The account then grows on a tax-deferred basis; you don't pay taxes on any contributions or earnings until you withdraw the money. Withdrawals are subject to ordinary income tax and a possible 10% penalty tax if made before you reach age 59½, unless an exception applies.

You can open and contribute to an HSA only if you are enrolled in a qualifying high-deductible health plan (HDHP), are not covered by someone else's plan, and cannot be claimed as a dependent by someone else. Although HDHP premiums are generally lower than other types of health insurance, the out-of-pocket costs could be much higher (until you reach the deductible). That's where HSAs come in. Similar to 401(k)s, they allow you to set aside money on a pre-tax or tax-deductible basis, and the money grows tax deferred.

However, HSAs offer an extra tax advantage: Funds used to pay qualified medical expenses can be withdrawn from the account *tax-free.* And you don't have to wait until a certain age to do so. That may be one reason why 68% of individuals in one survey viewed HSAs as a way to pay current medical bills rather than save for the future.[1] However, a closer look at HSAs reveals why they can add a new dimension to your retirement strategy.

HSAs: A deeper dive

Following are some of the reasons an HSA could be a good long-term, asset-building tool.

- With an HSA, there is no "use it or lose it" requirement, as there is with a flexible spending account (FSA); you can carry an HSA balance from one year to the next, allowing it to potentially grow over time.
- HSAs are portable. If you leave your employer for any reason, you can roll the money into another HSA.
- You typically have the opportunity to invest your HSA money in a variety of asset classes, similar to a 401(k) plan. (According to the Plan Sponsor Council of America, most HSAs require you to have at least $1,000 in the account before you can invest beyond cash alternatives.[2])
- HSAs don't impose required minimum distributions at age 70½, unlike 401(k)s.
- You can use your HSA money to pay for certain health insurance costs in retirement, including Medicare premiums and copays, as well as long-term care insurance premiums (subject to certain limits).
- Prior to age 65, withdrawals used for nonqualified expenses are subject to income tax and a 20% penalty tax; however, after age 65, money used for nonqualified expenses will not be subject to the penalty [i.e., HSA dollars used for nonqualified expenses after age 65 receive the same tax treatment as traditional 401(k) withdrawals].

The bottom line is that if you don't need all of your HSA money to cover immediate health-care costs, it may provide an ideal opportunity to build a separate nest egg for your retirement health-care expenses. (It might be wise to keep any money needed to cover immediate or short-term medical expenses in relatively conservative investments.)

Additional points to consider

If you have the option to save in both a 401(k) and an HSA, ideally you would set aside the maximum amount in each type of account: in 2019, the limits are $19,000 (plus an additional $6,000 if you're 50 or older) in your 401(k) plan; $3,500 for individual coverage (or $7,000 for families, plus an additional $1,000 if you're 55 or older) in your HSA. Realistically, however, those amounts may be unattainable. So here are some important points to consider.

1) Estimate how much you spend out of pocket on your family's health care annually and set aside at least that much in your HSA.

2) If either your 401(k) or HSA — or both — offers an employer match, try to contribute at least enough to take full advantage of it. Not doing so is turning down free money.

3) Understand all HSA rules, both now and down the road. For example, you'll need to save receipts for all your medical expenses. And once you're enrolled in Medicare, you can no longer contribute to an HSA. Nor can you pay Medigap premiums with HSA dollars.

4) Compare investment options in both types of accounts. Examine the objectives, risk/return potential, and fees and expenses of all options before determining amounts to invest.

5) If your 401(k) offers a Roth account, you may want to factor its pros and cons into the equation as well.

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Emerald Spectrum Advisory
Malissia Johnson, CFP®,AAMS,CMFC
Brian Johnson, CFP®
100 Winners Cir N, Ste 210
Brentwood, TN 37027
615-369-0690
esateam@emeraldspectrum.com
www.emeraldspectrum.com

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When should I file the FAFSA?

The FAFSA, which stands for Free Application for Federal Student Aid, is the federal government's financial aid application. The FAFSA is a prerequisite for federal student loans, grants, and work-study. In addition, colleges typically require the FAFSA before distributing their own need-based aid and, in some cases, merit-based aid.

For the 2020-2021 school year, the FAFSA can be filed as early as October 1, 2019. Whether you have a senior in high school or a returning college student, it's a good idea to file the FAFSA as early as possible to increase your child's chances of getting financial aid, because some aid programs operate on a first-come, first-served basis. (For high school seniors who haven't yet been accepted at a particular college, you can list all the schools your child has applied to on the form.)

The 2020-2021 FAFSA relies on your family's current asset information and two-year-old income information from your 2018 tax return. The form is available online at [fafsa.ed.gov.](https://fafsa.ed.gov)

In order to file the form, you'll need to create an FSA ID if you haven't done so already (be sure to follow the online instructions). You can save time and minimize errors on the FAFSA by using the built-in IRS Data Retrieval Tool, which electronically imports your tax data.

Even if you don't expect your child to qualify for need-based aid, you still might consider submitting the FAFSA. All students attending college at least half-time are eligible for federal unsubsidized Direct Loans regardless of financial need. So if you want your child to take out a loan (or your child needs to do so), you'll need to file the FAFSA. (Unsubsidized Direct Loan amounts are capped each year: $5,500 freshman year, $6,500 sophomore year, and $7,500 junior and senior years.)

Keep in mind that you'll need to resubmit the FAFSA each year that you want your child to be considered for aid. Fortunately, renewal FAFSAs take less time to complete.

I THINK I FINALLY UNDERSTAND THE MEANING OF HIGHER EDUCATION.