



**Charlene K. Dolan**  
CERTIFIED FINANCIAL PLANNER™  
978.388.3468

www.focusonfinancialfreedom.com  
plan@dolanfinancialservices.com  
108 Main Street, Amesbury, MA 01913-2809



## FOCUS ON FINANCIAL FREEDOM® SEPTEMBER 2009

# What Happens If You Become Disabled?

**F**or many people, a long-term disability would be financially devastating. Although no one likes to think about this possibility, you should consider your options now so you can obtain disability income insurance if needed.

When considering a long-term disability, assess your income needs until age 65, when presumably retirement benefits would begin. During

this analysis, consider the following items:

- **Estimate your monthly expenses following a disability.** Typically, some of your disability benefits would be free of income taxes (if you paid the premiums) and you won't incur work-related expenses. However, don't underestimate your expenses, since your medical and rehabilitation expenses might

be much higher after a disability. Find out if you would continue to be covered under your employer's health insurance plan. If not, you'll need to make provisions for that expense.

- **Review your annual Social Security statement for an estimate of disability benefits.** However, keep in mind that the eligibility requirements are quite stringent — you must be totally disabled, have little or no chance of recovery, and wait six months or longer for your first check. Even if you do qualify, benefits tend to be modest.
- **Decide what personal resources you would want to use.** You can access funds from individual retirement accounts, annuities, or 401(k) plans without penalty if you are disabled. But first consider whether you want to risk depleting your retirement fund or children's college funds due to a long-term disability.
- **Investigate any long-term disability benefits provided by your employer.** Long-term group disability plans are less common and typically less common than short-term plans. The policies frequently have strict definitions of disability, pay up to 60% of your base salary (bonuses and commissions generally aren't included),

### A Time of Transition

**T**he leaves have begun to change color, and each day seems shorter than the last. The evenings are much cooler now, and the air seems so different. September is a time of transition.

As children, September marked the end of summer and the beginning of a new school year. Parents and teachers reminded us to organize and prepare so we could focus on the important work ahead. There were many back-to-school preparations — picking out new clothes, selecting the book bag, and purchasing the list of supplies.

Much time has passed since our school years. However, September is still the perfect time to organize and prepare for the year ahead. After all, the holidays are just around the corner. Soon, our time and attention will be focused on holiday preparations and celebrations — as they should be.

It is tempting to wait until January to organize our files and tax records for the year. Life is quieter in January, and taxes are not due until April anyway. Unfortunately, it is too late to take advantage of any real tax planning for 2009 once January has arrived. There are many questions that must be answered before year-end to assure that you do not miss any planning opportunities.

Is a Roth conversion right for you? Are you eligible for additional tax credits or deductions? Should you change your withholdings? Would it make sense to take a tax loss? Make plans now to talk with your financial and tax professionals.

Yes, much time has passed since our school days, and life has changed. However, the message from our parents and teachers is still relevant, "Organize and prepare so you can focus on the important work ahead." 2010 will be here before we know it!

*Charlene K. Dolan*

*Continued on page 2*

## What Happens?

*Continued from page 1*

pay two to five years of benefits, and don't provide cost-of-living increases. Also factor in income taxes that must be paid on any benefits your employer paid for. Check to see if your employer-sponsored retirement plan offers an option for early retirement in case of disability.

- **Consider purchasing disability income insurance to fill any gaps.** However, you might not be able to replace more than 60% to 80% of your income through insurance, since insurers want you to have an incentive to return to work. Any benefits from policies you paid the premiums for are received income tax free. Coordinate your employer-provided insurance and your own policy so that the maximum benefits do not exceed the amount the insurance companies will pay. Otherwise, you may pay for coverage you won't receive.

If you decide to purchase disability income insurance, make sure to consider these things:

- **Pay special attention to the definition of disability.** There are three basic types of coverage: own occupation, any occupation, and income replacement. Own occupation pays benefits when you can't work at your specific occupation. Many professionals, such as doctors and lawyers, opt for this coverage. However, due to substantial claims, this coverage is now more difficult to obtain. You may be able to find own occupation coverage for a specified period, with the policy then converting to any occupation coverage. Any occupation means you must be unable to work at any occupation that your training and education would be suited for. Income replacement policies pay the difference between what you were earning before the disability and what you are earning now.

For most individuals, income replacement policies will provide the best balance between cost and benefits.

- **Opt for a long waiting period before benefits start.** This is a good way to reduce premiums, provided you have other resources to rely on for the short term, such as sick leave, personal savings and investments, and short-term disability coverage. Waiting periods can range from one week to two years, but the most common option is a 90-day delay in benefits.
- **Consider coverage that pays benefits until age 65.** Disability insurance is designed to protect your financial situation from a serious disability, so you should obtain coverage for the long term. Policies for lifetime benefits are rare and expensive. It's probably not needed, however, since you will probably be eligible for Social

Security and other retirement benefits once you turn 65.

- **Look for a policy that provides residual benefits.** This allows you to return to work on a part-time basis and still receive partial benefits.
- **Make sure the policy is either noncancelable or guaranteed renewable.** Noncancelable means you can renew the policy every year at the same premium. Guaranteed renewable means you can renew the policy every year, but the premium can increase as long as it is not done so in a discriminatory manner. Either provision will ensure that the policy can't be canceled due to medical problems.

Please call if you'd like to discuss your need for disability income insurance in more detail. ○○○

## A Budget for Your College Student

Many students will first handle money without parental supervision during college. To help keep expenses down and avoid conflicts, you might want to develop a budget to guide your child's spending. As you go through the process, consider the following:

- First consider all potential expenses, including food, travel, clothing, entertainment, phone, periodicals, computer expenses, medical and dental expenses, and insurance.
- Develop a preliminary budget for the first couple of months of college. After your child has lived on his/her own for a couple of months, you can develop a more realistic budget.
- If your child has trouble sticking with the budget or can't account for large sums, have him/her keep a journal for a

couple of weeks that details all expenditures.

- Consider providing your child with a debit card rather than a credit card. Since your child's spending will be limited to the amount on deposit, it is harder to overspend.
- Explain the basics of credit cards. Make sure your child doesn't use a credit card as a means to overspend. Go over which types of items your child can use the credit card for and which items should not be charged. Make sure your child understands that if the balance isn't paid in full each month, a significant amount of interest will be paid on the outstanding balance.
- Have your child provide you with a written monthly comparison of his/her actual expenses to budgeted amounts. ○○○

## Assisting Your Parents with Their Finances

**D**iscussing financial matters with your parents can be difficult. You don't want to seem concerned about how much money they may eventually leave you, while they may fear you are interfering in their lives. Yet, without discussing these matters beforehand, you may have trouble finding financial records or determining their wishes if you need to take over their finances. Consider discussing financial matters with your parents when they are in their early 60s, making sure to cover the following:

- **Where are personal records kept?** You don't need to know specifics, but you should find out where important records are located.
- **Who are their advisers?** Ask for a list with names, addresses, and phone numbers of all advisers and physicians. Get details about medical conditions and medications being taken.
- **What are their monthly income and expenses?** This will help you determine whether they have sufficient income to pay bills. If they don't, you may be able to help them change investment selections or find ways to increase income.
- **Do they have adequate insurance?** Make sure your parents have adequate insurance coverage and have made provisions for long-term-care needs. Have them investigate long-term-care insurance when they are still healthy and young enough to qualify for reasonable premiums.
- **Do they have up-to-date estate planning documents?** Don't ask for specifics, just make sure documents are in place so their wishes can be carried out. Find out if they have a durable power of attorney and health care proxy. With a durable power of attorney,

they designate someone to control their financial affairs if they become incapacitated. If your parents are concerned that this person may assume control prematurely, suggest leaving the document with their attorney, who can deliver it to the appropriate person when necessary. A health care proxy delegates health care decisions to a third person when your parent is unable to make those decisions. Usually, this document also outlines procedures to be used to prolong life.

- **What are their preferences for the future?** Find out where your parents would like to live if they're not physically able to live in their current home. Do they want to

move in with relatives or live in an assisted-living facility? Discuss in detail what procedures they want performed to prolong life in the event of a terminal illness. Determine their preferences for funeral arrangements.

While these topics are sometimes not easy to discuss, they are important to know in case you need to help your parents with their financial matters. ○○○



### What's a Reasonable Rate of Return?

**H**ow do you know if you're saving enough for a future goal? You must get three factors right — how much you need, when you need the money, and how much you'll earn on your investments. You can then calculate how much you should save on an annual basis. The typical approach to estimating a rate of return is to look at average annual returns for some historical period.

It's tempting to use the highest return possible, since that results in the lowest savings amount. But consider using a conservative estimate. If you save too much, you can always reduce savings in later years or spend more in retirement. Consider the following points:

- **Your investing time frame will probably encompass decades.** Thus, consider using a historical rate of return that covers a very long time frame.
- **Factor in inflation.** When

estimating inflation, factor in a long time period. For instance, inflation, as measured by the consumer price index, averaged 3.1% since 1926 (Source: Bureau of Labor Statistics, 2008).

- **Watch your pattern of returns.** Even if you get the average rate of return exactly right, your portfolio's balance will depend on the pattern of actual returns during that period. If you experience higher returns in the early years, your portfolio will be lower than if those returns occurred in the later years. If you encounter negative returns in the early years, you will have a higher balance than if those negative returns came in the later years. Assess your portfolio's progress on a regular basis, at least annually, so you can make adjustments.

Please call to discuss this in more detail. ○○○

## Should You Contribute to a Roth 401(k)?

Although Roth 401(k) plans became effective on January 1, 2006, they are just now starting to gain momentum. Originally, Roth 401(k)s were scheduled to expire after 2010, so companies were not willing to start a plan that would expire after a few years. However, the Pension Protection Act of 2006 made Roth 401(k)s permanent.

The Roth 401(k) is patterned after the Roth individual retirement account (IRA) — contributions are made from after-tax earnings that grow tax free, and qualified distributions are withdrawn tax free. Here are the basics, including how Roth 401(k)s differ from Roth IRAs:

- **Eligibility** — Employees eligible for their employer's 401(k) plan are also eligible for the Roth 401(k). There are no income limi-



tations for contributions to a Roth 401(k). With a Roth IRA, single taxpayers with modified adjusted gross income (AGI) less than \$105,000 and married taxpayers filing jointly with modified AGI less than \$166,000 in 2009 can make contributions, regardless of their participation in a qualified retirement plan. Contributions are phased out for single taxpayers with modified AGI between \$105,000 and \$120,000 and for married taxpayers filing jointly with modified AGI between \$166,000 and \$176,000 in 2009.

- **Contributions** — The contribution limits for the Roth 401(k) are the same as for the regular 401(k) plan. In 2009, you can contribute a maximum of \$16,500 plus a \$5,500 catch-up contribution for those age 50 and over, if permitted by the plan. However, your employer may set lower limits to comply with nondiscrimination rules. Contributions can be split between a regular and Roth 401(k), as long as total contributions do not exceed the maximum. Funds contributed to each type must be held in separate accounts. Any matching contributions made by the employer must be held in the regular 401(k) account, so they will be taxable when withdrawn. In 2009, the contribution limits for

a Roth IRA are \$5,000 plus an additional \$1,000 catch-up contribution for individuals age 50 and over. You can make contributions to both a Roth 401(k) and a Roth IRA, as long as you meet the income eligibility rules for the Roth IRA.

- **Required distributions** — With a Roth IRA, you are not required to take distributions during your lifetime. With a Roth 401(k), annual distributions must be taken after age 70 1/2, unless you are still working and are not a 5% or more owner in the company. However, funds in the Roth 401(k) can be rolled over to a Roth IRA, which would not require distributions.
- **Conversions** — Individuals under certain income levels can convert a regular IRA to a Roth IRA, as long as income taxes are paid on the amount that would have been taxable if withdrawn. Starting in 2010, all taxpayers, regardless of income level, can convert a regular IRA to a Roth IRA. There is no provision to convert a regular 401(k) to a Roth 401(k).

Please call if you'd like to discuss the Roth 401(k) in more detail. ○○○

FR2009-0226-0005

In a recent survey, consumers indicated that they are making lifestyle adjustments to deal with the current economic downturn. Approximately 60% were delaying vacations, 52% were postponing either buying a car or purchasing or selling a home, and 35% of those approaching retirement age were delaying retirement (Source: American Institute of Certified Public Accountants, 2009).

Approximately 45% of 61-year-olds expect to start Social Security benefits when they turn 62, most doing so in order to pay for basic

## Did You Know?

needs (Source: *Journal of Financial Planning*, February 2009).

From 1996 to 2006, homeowner income increased 36%, but utilities rose 43%, mortgage payments rose 46%, property taxes rose 66%, and property insurance rose 83% (Source: Center for Housing Policy, 2009).

In a recent survey, 41% of the respondents indicated that they had lowered their contributions to

their children's education savings accounts during the past six months (Source: *InvestmentNews*, January 26, 2009).

Approximately 17 million individuals had out-of-pocket medical expenses in 2007 that equaled 10% or more of their family income (Source: *Journal of Financial Planning*, September 2008).

There is a 23% chance that at least one member of a 65-year-old couple will live to age 95 (Source: *InvestmentNews*, October 20, 2008). ○○○