Johnston Investment Counsel
Trusted Fiduciaries & Fee-Only Advisors

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The Impact of Health-Care Costs on Social Security

For many retirees and their families, Social Security provides a dependable source of income. In fact, for the majority of retirees, Social Security accounts for at least half of their income (Source: Fast Facts & Figures About Social Security, 2013). However, more of that income is being spent on health-related costs each year, leaving less available for other retirement expenses.

The importance of Social Security

Social Security is important because it provides a retirement income you can't outlive. In addition, benefits are available for your spouse based on your benefit amount during your lifetime, and at your death in the form of survivor's benefits. And, these benefits typically are adjusted for inflation (but not always; there was no cost-of-living increase for the years 2010 and 2011). That's why for many people, Social Security is an especially important source of retirement income.

Rising health-care costs

You might assume that when you reach age 65, Medicare will cover most of your health-care costs. But in reality, Medicare pays for only a portion of the cost for most health-care services, leaving a potentially large amount of uninsured medical expenses.

How much you'll ultimately spend on health care generally depends on when you retire, how long you live, your health status, and the cost of medical care in your area. Nevertheless, insurance premiums for Medicare Part B (doctor's visits) and Part D (drug benefit), along with Medigap insurance, could cost hundreds of dollars each month for a married couple. In addition, there are co-pays and deductibles to consider (e.g., after paying the first $162 in Part B expenses per year, you pay 20% of the Medicare-approved amount for services thereafter). Your out-of-pocket yearly costs for medical care, medications, and insurance could easily exceed thousands of dollars.

Medicare's impact on Social Security

Most people age 65 and older receive Medicare. Part A is generally free, but Parts B and D have monthly premiums. The Part B premium generally is deducted from your Social Security check, while Part D has several payment alternatives. In 2013, the premium for Part B was $104.90 per month. The cost for Part D coverage varies, but usually averages between $30 and $60 per month (unless participants qualify for low-income assistance). Part B premiums have increased each year and are expected to continue to do so, while Part D premiums vary by plan, benefits provided, deductibles, and coinsurance amounts. And, if you enroll late for either Part B or D, your cost may be permanently increased.

In addition, Medicare Parts B and D are means tested, meaning that if your income exceeds a predetermined income cap, a surcharge is added to the basic premium. For example, an individual with a modified adjusted gross income between $85,000 and $170,000 may pay an additional 40% for Part B and an additional $11.60 per month for Part D.

Note: *Part C, Medicare Advantage plans, are offered by private companies that contract with Medicare to provide you with all your Part A and Part B benefits, often including drug coverage. While the premiums for these plans are not subtracted from Social Security income, they are increasing annually as well.*

The bottom line

The combination of rising Medicare premiums and out-of-pocket health-care costs can use up more of your fixed income, such as Social Security. As a result, you may need to spend more of your retirement savings than you expected for health-related costs, leaving you unable to afford large, unanticipated expenses. Depending on your circumstances, spending more on health-care costs, including Medicare, may leave you with less available for other everyday expenditures and reduce your nest egg, which can impact the quality of your retirement.

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Should You Roll Your 401(k) to an IRA?

Certain investments may not be right for everyone, and some may have adverse tax consequences, so be sure to consult your financial professional.

If you're entitled to a distribution from your 401(k) plan (for example, because you've left your job, or you've reached age 59½), and it's rollover-eligible, you may be faced with a choice. Should you take the distribution and roll the funds over to an IRA, or should you leave your money where it is?

Across the universe

In contrast to a 401(k) plan, where your investment options are limited to those selected by your employer (typically mutual funds or employer stock), the universe of IRA investments is virtually unlimited. For example, in addition to the usual IRA mainstays (stocks, bonds, mutual funds, and CDs), an IRA can invest in real estate, options, limited partnership interests, or anything else the law (and your IRA trustee/custodian) allows.*

You can move your money among the various investments offered by your IRA trustee, and divide up your balance among as many of those investments as you want. You can also freely move your IRA dollars among different IRA trustees/custodians--there's no limit on how many direct, trustee-to-trustee IRA transfers you can do in a year. This gives you the flexibility to change trustees as often as you like if you're dissatisfied with investment performance or customer service. It also allows you to have IRA accounts with more than one institution for added diversification.

However, while IRAs typically provide more investment choices than a 401(k) plan, there may be certain investment opportunities in your employer's plan that you cannot replicate with an IRA. And also be sure to compare any fees and expenses.

Take it easy

The distribution options available to you and your beneficiaries in a 401(k) plan are typically limited. And some plans require that distributions start if you've reached the plan's normal retirement age (often age 65), even if you don't yet need the funds.

With an IRA, the timing and amount of distributions is generally at your discretion. While you'll need to start taking required minimum distributions (RMDs) from your IRA after you reach age 70½ (and your beneficiary will need to take RMDs after you die), those payments can generally be spread over your (and your beneficiary's) lifetime. (You aren't required to take any distributions from a Roth IRA during your lifetime, but your beneficiary must take RMDs after your death.) A rollover to an IRA may let you and your beneficiary stretch distributions out over the maximum period the law permits, letting your nest egg enjoy the benefits of tax deferral as long as possible.

The RMD rules also apply to 401(k) plans--but a special rule allows you to postpone taking distributions until you retire if you work beyond age 70½. (You also must own no more than 5% of the company.) This deferral opportunity is not available for IRAs.

Note: *Distributions from 401(k)s and IRAs may be subject to federal income tax, and a 10% early distribution penalty (unless an exception applies). (Special rules apply to Roth 401(k)s and Roth IRAs.)*

Gimme shelter

Your 401(k) plan may offer better creditor protection than an IRA. Assets in most 401(k) plans receive virtually unlimited protection from creditors under a federal law known as ERISA. Your creditors cannot attach your plan funds to satisfy any of your debts and obligations, regardless of whether you've declared bankruptcy. (Note: individual (solo) 401(k) plans and certain church plans are not covered by ERISA.)

In contrast, traditional and Roth IRAs are generally protected under federal law only if you declare bankruptcy. Federal law currently protects your total IRA assets up to $1,245,475 (as of April 1, 2013)--plus any amount you roll over from your 401(k) plan. Any creditor protection your IRA may receive in cases outside of bankruptcy will generally depend on the laws of your particular state. If you're concerned about asset protection, be sure to seek the assistance of a qualified professional.

Let's stay together

Another reason to roll your 401(k) funds over to an IRA is to consolidate your retirement assets. This may make it easier for you to monitor your investments and your beneficiary designations, and to make desired changes. However, make sure you understand how Federal Deposit Insurance Corporation (FDIC) and Securities Investor Protection Corporation (SIPC) limits apply if you keep all your IRA funds in one financial institution.

Fools rush in

- While some 401(k) plans provide an annuity option, most still don't. By rolling your 401(k) assets over to an IRA annuity, you can annuitize all or part of your 401(k) dollars.
- Many 401(k) plans have loan provisions, but you can't borrow from an IRA. You can only access the money in an IRA by taking a distribution, which may be subject to income tax and penalties.

If you have questions about how long to keep copies of your federal tax returns and related records, see IRS Publication 17, Your Federal Income Tax. And because states may have different rules, check with your state's tax authority to find out how long to keep state tax returns and records.

Think Outside the Shoe Box When Organizing Financial Records

If you've ever had trouble finding an important financial document, you know why it's necessary to keep your financial records organized. Less clutter means less stress, and though you'll need to commit a bit of time up front to organize your files, you can save time and money over the long term when you can find what you need when you need it.

What records do you need to keep?

If you keep paperwork because you "might need it someday," your files are likely overflowing with nonessential documents. One key to organizing your financial records is to ask yourself "Why do I need to keep this?" Documents that you should retain are likely to be those that are related to tax returns, legal contracts, insurance claims, and proof of identity. On the other hand, documents that you can easily duplicate elsewhere are good candidates for the shredder. For example, if you bank online and can view or print copies of your monthly statements and cleared checks, you may not need paper copies of the same information.

How long should you keep them?

A good rule of thumb is to keep financial records only as long as necessary. For example, you may want to keep ATM receipts only temporarily, until you've reconciled them with your bank statement. If a document provides legal support and/or is hard to replace, you'll want to keep it for a longer period or even indefinitely.

Records that you may want to keep for a year or less include:

- Bank or credit union statements
- Credit card statements
- Utility bills
- Annual insurance policies

Records that you may want to keep for more than a year include:

- Tax returns and supporting documentation
- Mortgage contracts and supporting documents
- Receipts for home improvements
- Property appraisals
- Annual retirement and investment statements
- Receipts for major purchases

Records that you may want to keep indefinitely include:

- Birth, death, and marriage certificates
- Adoption papers
- Citizenship papers
- Military discharge papers
- Social Security card

Of course, this list is not all-inclusive and these are just broad guidelines; you may have a good reason for keeping some records for a shorter or longer period of time.

Where should you keep them?

Where you should keep your records and documents depends on how easily you want to be able to access them, how long you plan to keep them, and how many records you have. A simple set of labeled folders in a file cabinet works fine for many people, but electronic storage is another option if space is tight.

For example, one easy way to cut down on clutter and still keep everything you need is to store some of your files on your computer. You can save copies of online documents or purchase a scanner that you can use to convert your documents to electronic form. But make sure you keep backup copies on a portable storage drive or hard drive, and make sure that your files are secure.

Another option to consider is cloud storage. Despite its lofty name, cloud storage is simply an online backup service that allows you to upload and store your files over the Internet, giving you easy access to information without the clutter. Information you upload is encrypted for security. If you're interested, look for a company with a reliable reputation that offers automatic backup and good technical support, at a reasonable subscription cost.

Staying organized

Keeping your financial records in order can be even more challenging than organizing them in the first place. One easy way to prevent paperwork from piling up is to remember the phrase "out with the old, in with the new." For example, when you get this year's auto policy, discard last year's. When you get an annual investment statement, discard the monthly or quarterly statements you've been keeping. It's a good idea to do a sweep of your files at least once a year to keep your filing system on track (doing this at the same time each year may be helpful).

But don't just throw your financial paperwork in the trash. To protect sensitive information, invest in a good quality shredder that will destroy any document that contains account numbers, Social Security numbers, or other personal information.

Whatever system you choose, keep it simple. You'll be much more likely to keep your records organized if your system is easy to follow.

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What unique challenges do women face in achieving a financially secure retirement?

Women can face special challenges when saving for retirement. Generally speaking, women tend to spend less time in the workforce, and when they do work, they typically earn less than men in comparable jobs. As a result, women's retirement plan balances, Social Security benefits, and pension benefits are often lower than their male counterparts. In addition, women generally live longer than men, so they typically have to stretch their retirement savings and benefits over a longer period of time.

What can you do to maximize your chances of achieving a financially secure retirement? Start saving as soon as possible. The best time to start saving for retirement is in your 20s; the second best time is right now. At every stage of your life, there will always be other financial needs competing with the need to save for retirement. Don't make the mistake of assuming it will be easier to save for retirement in 5, 10, or 15 years. It won't. Start small, with whatever amount you can afford, and contribute regularly, adding to your contribution when you can.

If you're in the workforce, an employer retirement plan like a 401(k) plan can be a convenient, no hassle way to get started and build your retirement nest egg--contributions are deducted automatically from your paycheck and may qualify you for employer matching funds. If you're out of the workforce and married, you can contribute to an IRA (traditional or Roth), provided your spouse earns enough to cover the contributions.

In many cases, your job is your lifeline to being able to save for retirement. Before leaving the workforce for family obligations, consider exploring with your employer the possibility of flexible work arrangements, including telecommuting and part-time work, that might enable you to continue to earn a paycheck as you balance your family obligations.

Start planning now by taking the following steps: (1) set a retirement savings goal; (2) start saving as much as you can on a regular basis, and track your progress at least twice per year; and (3) find out how much you can expect to receive from Social Security at www.socialsecurity.gov.

My teenage daughter just got her driver's license. Will my auto insurance rates go up?

The short answer is: yes. Anytime you add an extra driver to your policy, your rates will increase. However, you may end up paying even more when you add your daughter to your policy, since teenage drivers are some of the highest-risk drivers on the road. According to the most recent statistics from the National Transportation Safety Board, teen drivers have represented less than 7% of the driving population but have accounted for more than 13% of drivers involved in all deadly crashes. (Source: National Transportation Safety Board, October 2013)

Fortunately, there are some steps you can take to help make insuring your teen a bit more affordable.

- **Take advantage of policy discounts:** Your first step should be to ask your insurer if your teen qualifies for any policy discounts that are specifically designed for teens. For example, many insurance companies offer discounts (usually around 10% to 15% off of premiums) for teens who complete a driver's education course, obtain a certain grade point average, or participate in a safe driver program.
- **Consider the type of car your teen will be driving:** Typically, new cars are more expensive to insure than older ones. As a result, you may want to consider purchasing an older, less expensive car for your daughter to drive. You may even be able to save more money by forgoing collision coverage on an older vehicle.
- **Consider whether an individual policy makes sense:** In the future, circumstances may arise where it may be more affordable to insure a teen under his or her own individual policy as opposed to listing him or her as an insured on your policy (e.g., he or she gets into an accident or has numerous motor vehicle infractions). When the time comes, ask your insurance agent to help you run the numbers to see which option is more affordable.
- **Be sure to shop around:** You'll want to take the time to compare the rates offered by different insurers. Insurance company rates vary widely, so it often pays off in the end to do your homework.

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Bitcoins: Investment or Bust?

Bitcoins are a relatively new type of alternative digital currency. The actual coins are, of course, not coins at all; they are essentially records in a digital archive stored on servers throughout the web, in the form of digital signatures, timestamps, wallets and public keys, all created in open-source computer code in a way that is designed to foil hackers. Because a Bitcoin transaction doesn't involve banking or transaction fees, some economists think that they represent an early version of what all currencies will look like in the future.

Libertarians and drug dealers like bitcoins because they allow you to buy and sell (with those few business who will accept them in payment) without the government being able to assess taxes or track your activities. People who are suspicious of central bank policies like them because bitcoins are not tied to any traditional banking system. The total number of bitcoins that will ever be in circulation is fixed at 21 million (estimated to happen in the year 2140), and no government can print more of them and debase the currency. Hackers are also fond of bitcoins. If they can manage to steal bitcoins out of your electronic wallet, there is no way to recover your losses or trace the thieves.

When they were introduced in 2009, bitcoins were often given away as cheap curiosities, but the conversion price to dollars has risen above $1,000 this year. So are bitcoins a good potential alternative investment?

The answer is almost certainly no, for a variety of reasons. First, there is the volatility. Earlier this month, bitcoins suddenly lost more than half their value, dropping from $1,200 per "coin" to less than $600, on news that the Chinese central bank would not allow Chinese citizens to use them as legal tender. A graph of bitcoin values looks like the roller coaster of death, with prices soaring and plunging in ways that would give a hardened options trader a case of vertigo.

Second, what can you buy with bitcoins? Mainstream businesses will not accept bitcoins. Try holiday shopping with bitcoins, online or elsewhere, and you'll quickly discover that your options are limited--unless your holiday spirit involves porn, narcotics or gambling stakes.

But most importantly, many economists believe that it is inevitable that bitcoins will eventually wind up worthless. Why? First of all, there is nothing backing the bitcoins in your digital wallet. Unlike dollars, pesos, euros or yen, no government guarantees that bitcoins will have value in the marketplace. For bitcoins to become a stable reservoir of value, they would have to be accepted by the mainstream business community--which, in turn, would have to have confidence that the currency they receive will have value in the future.

Bitcoins have a built-in recipe for severe deflation. Since the global supply can never exceed 21 million, each bitcoin would have to dramatically rise in value to “lubricate” the U.S. and global economies. That means as the price of bitcoins increase the cost of your iPhone decreases from 1 bitcoin to one-half a bitcoin, to a quarter bitcoin. Just like consumers during the Great

Depression, you (and millions of other bitcoin holders) would have little or no incentive to actually do any transactions with your bitcoins.

Currencies are not supposed to be terrific investments, and bitcoins are no exception. You want them circulating into the economy, rather than hiding in the mattress or an encrypted digital wallet. Those who invest thousands of dollars in bitcoins will likely get two rewards: a lot of heartburn as bitcoin values bounce around like a kangaroo on steroids, and then heartbreak when the music stops and their investment isn't worth the pixels and bytes they're printed on.