The Personal Financial Health Guide

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Financial health is very important – almost as important as your physical health. This guide is an effort to offer important and useful information in an accessible manner. The objective is to get you started on this journey if you haven't really done so, as well as provide an overview that helps you spot areas that you may need to focus on. In short, it is to answer the questions of "How do I begin?" and "What am I not doing?"

It is not meant to be financial advice or a substitute for using professional financial guidance.

We highly recommend that you use the information in this guide as a starting point for your own, thorough, investigation. At minimum it can suggest things you should be doing, and it could potentially lead you toward knowledgeably seeking professional help.

Let's start with the *Personal Finance Checklist*. The items listed here cover the vast majority, if not all, of the categories of personal finance that you should consider.

Personal Finance Checklist

1. Personal Financial Planning

- Importance of planning your financial future

2. Retirement planning

- Example – 401(k)
- What is it, How much to contribute, What is Employer Match, Annual Limits, Investment Options and Pitfalls, Using the Money (When, for what)

3. Educational planning

- Example – 529
- What is it, Variations by State, How much to contribute, Annual Limits, Multiple Children, Investment Options and Pitfalls, Using the Money (When, for what)

4. Insurance

- Life – What, Why, Common Types (Term, Whole, others)
- Health – What, Why, Common Types (Traditional, High Deductible/HSA)
- Home – Importance of periodic reappraisal, using an agent
- Auto – Importance of periodic reappraisal, using an agent

5. Home finance

- Mortgage – 30/15 years, Paying down earlier?
- Refinance – Check interest rate on current mortgage, Use a mortgage consultant
- Line of Credit – Using the equity in your home as a bank
- Home Loan – Borrowing lump sum against equity in your home (consider line of credit instead)

6. Estate planning

- What is it, Where to go, What are some major components?
  (Will, Power of Attorney, Living will, Other)

7. Emergency Fund

- Keep about 6 months of expenses in a liquid account (like savings), for use in case of job loss or other emergencies.

8. Investment

- There are various vehicles to get return on money beyond above categories
  - Individual Stocks Vs Mutual funds, Savings/Bonds/MM, Real estate, Other

9. Financial Literacy/Management for Family

- Teaching the family, Making important information (e.g., passwords) accessible

10. Seeking help

- Importance of trust
- Difference between Financial Advisors, Planners, Brokers, etc.

Let's look at each item in more detail.

1. Personal Financial Planning

Why is this even important as a topic?

Whether we like it or not, in today's world money is very important and most people are not going to become financially independent without some form of planning. To be able to live a comfortable life till death does us in (and beyond, if we are concerned about our partner/offspring), paying attention to money matters.

Second, barring extraordinary situations (e.g., lottery wins), wealth building is a marathon – a long, slow, steady process, built on sound decisions made years or even decades before the effects become apparent. In fact, such decisions often have to be made early in life when one may not have the experience or motivation to do so. But with appropriate guidance it is possible to set a course that will lead in the general direction of increasing your chances for financial security rather than ruin.

Lastly, even if we are currently in mid-life and feel that it is too late to do anything of significance (not true!), we still have a responsibility to guide our children in the right direction. Personal financial literacy can be a great asset to bequeath our children helping them become more secure and independent.

2. Retirement Planning

This may be the most important of the topics addressed here, which is why we are placing it so prominently. One reason why it is important is that people generally don't think about it or do enough about it till it is too late. The best time to think about retirement planning is when getting the first full-time job. Before the first salary check hits the bank account, if we can siphon off enough money toward a retirement account, and keep doing it till retirement in a thoughtful way, we would never have missed that money, while still developing a healthy nest egg. But that opportunity is likely long gone for most of us, though we can certainly educate and encourage our children to do that. For most people in mid-life, the thing to do is to consider how they are dealing with their current retirement savings plan and set a path forward.

Example – 401(k) Retirement Plan

Many private companies have these (and other plans work on similar principles, such as 403(b)). This is a plan where money can be saved before taxes (or after tax as in the Roth IRA plan). It also, usually, has what is known as an employer match, whereby a company adds extra money to an employee's account to encourage savings. If you don't contribute enough to maximize your company's match it is like giving away free money. Yet, the average person often saves too little in this account. At minimum, one should be saving at least as much as the employer is willing to match (say 6%). But it is advisable to save much more than that if possible. Currently, the law allows a person (under 50 years) to save up to $23,000 a year in this account, and an additional $7500 if over 50 years of age. If possible, one should try to hit the maximum limits to secure the financial future.

The money going into this account can usually be invested in a variety of funds so that it can grow over time. While there are complexities with regard to how to make these investments (see Appendix for an explanation of various types of investments), it is not hard to use low cost investments that perform about as well as the general market (i.e.) it is not hard to get the money to grow. Your company should have a default investment option to address this as well (such as a Target Date Fund).

Given the long-time horizons involved with retirement planning, it is best not to keep fiddling with the account. Make a good plan, set it up and check in periodically (e.g., annually) without obsessing about weekly/monthly market movements.

Things to Consider:

Target Date funds – Once a retirement date is set, these automatically rebalance the portfolio to reduce risk as the retirement age draws closer (for example a 2040 Target Date Fund assumes you will retire in 2040). They are intended to be a single vehicle for your retirement investment needs. By reducing their exposure to equities (i.e. stocks), they are intended to mitigate the impact of a sudden market drop near retirement, so that you are not left with an unexpectedly low balance. In some cases they are also built in with an annuity feature which may provide for additional certainty.

Drawing money for expenses – If money is drawn for a non-retirement related expense (such as a home renovation), there will be a penalty assessed on the amount. So, it is advisable not to do that.

Other options:
Roth IRA – A Roth IRA operates similar to a traditional IRA – the key difference is that you contribute through after-tax dollars (as compared to a traditional 401(k) where pre-tax dollars are used). With a traditional 401(k) you get a deduction now and your contributions and earnings grow tax deferred until you withdraw it. For a Roth IRA you make your contributions after tax, but both contributions and earnings are tax free after age 59 ½ generally. If you think you may be in a higher tax bracket at retirement, then you may want to consider a Roth IRA.

Traditional IRA – this is also an option if your company does not offer 401(k). Individuals can contribute a maximum of $7000 (or $8000 if over 50).

Last word:

This should be your top priority above all else including saving for your children's education. People are living longer, cost of living goes up, and long-term care is expensive. If there is one area to focus on, it would be this one.

3. Educational Planning

If you have children, be aware that college education can be expensive. But with some planning it can be manageable. As with retirement planning, it is best to start early. Regardless of how old your children are, start doing this now!

Example – 529 Educational Savings Plan

Every state has its own version of the 529 plan, that allows parents to save for their children's (or their own) education tax free. Each state's plan is a little bit different. In the PA plan, the minimum contribution is very low ($10). So if you have a newborn, you can start saving immediately. The annual limit on savings per child is $18,000, but you can save any amount you want below that.

The funds can be invested in a variety of investment options. For example, the PA 529 has two major plans – called *Investment Plan* and *Guaranteed Savings Plan*. In the Investment Plan there are several investment options from conservative to aggressive (depending on how much risk/growth one would like). The Guaranteed Savings Plan is a way of locking in today's tuition rates.

When used for qualified educational expenses these funds are not taxed. Such expenses include tuition, room, board and certain other expenses. Funds are also transferable from one beneficiary to another, so when one child is done with their education, you can transfer the funds over to another child's account.

Things to Consider:

Coverdell IRA (Educational IRA) – Allows a contribution of up to $2000/year. Can be set up at a bank or investment company. Can be a good place to put in money received as birthday gifts etc. Once the limit is reached the next step could be a 529 plan.

Drawing money for other expenses – If the money is drawn out for other non-qualified purposes, not only will taxes have to be paid, there may also be a penalty. So, it is advisable to not do that.

Other options (e.g. loans) – Educational loans are available from the government and private sources. It would be best to discuss with a financial professional before deciding to take one.

Last Word:

While educational planning is a priority, it should not come at the expense of your retirement planning. Keep in mind that when you retire (and have decreased earning capacity), your children will be entering their prime earning years. With education and planning they can manage without too much help from you, but you are likely to need all the help you can get. So, plan for their educational expenses today, but keep your priorities straight!

4. Insurance

Everybody needs it, but nobody wants to deal with it! Insurance, as the word implies, is protection against future trouble or even catastrophe. Since there isn't much present benefit, human nature is to avoid thinking about it. We are here to tell you that's a big mistake! And that you can do a few things that can make a big difference. Let's consider some major categories of insurance one at a time:

Life Insurance:

When a person takes out a life insurance policy on themselves, the beneficiaries are their dependents (i.e. family). In the case of the person's untimely passing, the insurance policy provides money (the value of the policy) to the beneficiaries. In order to do this, premiums on the policy will have to be paid periodically and regularly over a long period of time.

The simplest is a **term life policy** – one that is taken out for a fixed term and fixed amount (say $100,000 for 30 years). The person taking out the policy is expected to pay a monthly/yearly premium for 30 years. In case the person dies before that 30-year period, the beneficiaries receive $100,000. If the person outlives the policy, then there is no payoff. This is a good base policy to have, and it is best to get it early in life when rates are likely to be low. Term life policy can also be thought of as gap insurance between jobs.

Another one is a **whole life policy** that covers the person for the entirety of their life. If one were to start with a term life policy, it may be useful to convert it to a whole life policy at some point. It is best to talk to a financial professional about these things.

Sometimes companies offer group life insurance policies to employees. These are often worth taking as additional policies. These policies often terminate 30 days after departing a company.

Last word:

If you don't have life insurance, get it. If you have it, make sure you understand what you have and how it may need to be changed.

Health Insurance

This can be a more complicated topic, but the basics don't have to be. Most employed people tend to have group health insurance through their employer. Often these are in the form of **traditional plans** (such as HMO, POS, PPO etc.). A premium is paid for the individual and dependents and in return many health expenses are covered. There are many variations and complexities, but two things are worth keeping in mind. These plans have varying "deductibles". That is, a certain amount of expense has to be incurred before the insurance kicks in. They also usually have "copays". That is, every visit to a doctor will need a small out-of-pocket payment. Taking various factors such as these into account, an employee can choose between the plans offered by the employer (assuming such a choice is available). These are pretty standard plans and hard to go wrong with since the employer has already gone through a selection process.

More recently, another kind of plan called a **High Deductible plan** is becoming popular. Unlike the traditional plan, this one shifts more of the responsibility to the member/consumer. As the name implies, the deductible on these plans (i.e., the point where the insurance coverage kicks in) is much higher than traditional plans. Till that deductible is reached, a person will need to pay for medical expenses out of pocket. In return, the monthly premiums paid for these plans are significantly lower compared to traditional plans. If you are someone who is quite healthy and doesn't use medical facilities often, this can be a good way to reduce your health insurance cost.

High deductible plans are sometimes paired with an investment vehicle called **Health Savings Accounts** (HSA). As with retirement and educational planning accounts, one can put aside money on a monthly basis that can then be invested. When needed for expenses, one can draw from this account. Otherwise, the money can grow there forever (regardless of job switches, etc.). It is a very good benefit that you should consider making use of. It has an annual family contribution limit of $8300. If you are switching from a traditional to a high deductible plan, consider contributing the difference between the premiums into the HSA account. Your company may also provide contributions to your HSA for basic activities (such as an annual physical) – consider taking advantage of that. They can be thought of as a secondary retirement plan for medical needs (tax free).

For individuals who are not employed, self-employed or otherwise not part of a group plan, **Exchange plans** are an option. Set up under the Affordable Care Act, these usually come in three levels – *Gold, Silver* and *Bronze*, with decreasing premiums and benefits. These can be directly purchased from the insurance exchange.

Last word:

Health insurance is very important. Make sure you have some kind of coverage as medical expenses can be very high if you are not covered.

Home and Auto Insurance

Both of these are required by law, so you already have them if you own a home and a vehicle. But there are huge variations in what people pay for these insurance policies. If you haven't changed your policy for a while (say in the last 2-3 years), you should look into having it priced for you. The easiest way to do this is through an insurance agent. The agent can run through a list of options and find the best policy

and rate for you. If you haven't changed policies in the last few years, you will be surprised at how much money you could save by switching (sometimes hundreds of dollars).

Last word:

Look into your home and auto policy now, and annually afterwards! It's best to do the review with your agent to make sure everything is as it should be.

5. Home Finance

Home Mortgage

This section covers all home finance related topics, none more important than the home mortgage. The home is likely to be the biggest purchase that most of us will ever make. Typically, it is a transaction that involves hundred of thousands of dollars and involves a repayment process that runs for decades.

The standard home mortgage is for 30 years. So, if you buy a house today and take a loan for $300,000 you will have till 2050 to pay it off. Since it is a loan provided to you it will have an interest rate on it (as of today a little over 3%). Over a 30-year period you will pay a lot more than $300,000 for that house. In our example, you will pay close to $455,000 for a 3% loan. Much of that payment will be in the form of interest to the loan provider (about $155,000 in our example). In fact, early in the repayment period, most of what you pay will go toward interest (you can see this by taking a look at the amortization schedule i.e., the table that shows a month-by-month breakdown).

Things to Consider:

Increase Monthly Payment – If you can pay more toward your principal each month (beyond the minimum payment), you can substantially reduce the overall amount you pay, and possibly shave off a few years from the life of the loan. Even a small additional amount each month toward the principal can make a significant difference.

15-year Mortgage – This is the second most common mortgage. It compresses the repayment period down to 15 years. The interest rate is lower than for the 30-year mortgage, but the monthly payment is higher. If you are not able to do this, as mentioned previously, you can still make additional monthly payments to cut down the repayment period.

Adjustable Rate Mortgages – The 30 and 15-year mortgages usually have a fixed interest rate (i.e., one that does not change over time). An adjustable-rate mortgage (ARM) will have an interest rate that varies (typically based on how the economy is doing and how the Federal Reserve sets rates). Unless you have a very good reason for taking one of these, you should probably avoid it.

Last Word:

Make some additional payments toward the principal each month. Read the next section.

Refinance

Though you may have a fixed interest rate on your mortgage it is sometimes possible to lower it through a process called refinancing. Let's say you obtained a mortgage with 5% interest a few years ago. Due to prevailing economic conditions, let's say the current rates are significantly lower (say around 4% or less). You can take advantage of that and lower your interest to the prevailing rate. Essentially, you can work with an entity (a bank, or a mortgage company) to pay off the existing loan and take out a new loan at the new interest rate. This will cost some amount of money (typically a few thousand dollars), so it will be worthwhile only under certain conditions. Two of those conditions are that the new rate be clearly lower (at least 1% point less) than your current loan, and that you are planning to stay in the house for at least a few more years. You can easily keep tabs on existing interest rates by visiting sites like www.bankrate.com.

Things to Consider:

You may want to use a mortgage consultant to do a refinance as it does require a significant amount of paperwork. A refinance can also allow you to leverage the equity in your house to take out some money if needed. That is, you are taking out some cash today and rolling that into a low interest, long term loan, which in some circumstances may be desirable.

Last Word:

Look at your mortgage and see if it makes financial sense to refinance. Keep in mind that if you previously had a 30 year mortgage, and have been paying it for the last 10 years, it may make more sense to look at a 15 or 20 year mortgage, so you can put the payments behind you when you retire. Rates have come down significantly, so even if you went through this process recently it's worth looking it over again. Go to www.bankrate.com for prevailing rates.

Home Equity Line of Credit (HELOC)

One way to have a credit line is to access the equity in your home. A "credit line" is the ability to easily borrow money when you need it. "Equity in your home" means that there is a significant difference between the loan value and what you owe. For example, let's say you took out a home mortgage for $200,000 several years ago. Let's say that over the years you have paid down half of it. Roughly speaking that means you have about $100,000 in equity in your home. That is, a lender will be willing to let you borrow money (up to something like 80% of that equity) with your home as collateral. That means you can have a line of credit of say, $80,000. Usually the repayment period is 20 years or more.

Things to Consider:

This is a line of credit not a loan, so it is money that is available for you to borrow and not an obligation. You can choose to borrow all, some, or none of it (at an interest rate that is roughly around the prevailing interest rates). There is usually a modest annual fee ($50-$100) to keep this line open.

Last Word:

This is a good way to have easy access to a significant amount of money in case you need it. If you haven't done so, you should consider getting a home equity line of credit. This works better than taking out a home loan where you will start paying interest immediately. Keep in mind that it's a lot easier to get a home equity line of credit when still employed.

6. Estate Planning

Everyone dies. Yes, you too. What will happen to your assets when you die? What will happen to your children if you die prematurely? What will happen if you end up in a comatose situation and someone else needs to make major financial and health decisions that you would have made? These are tough questions, but ones that need to be addressed in a timely manner when we are still fully in control. Estate planning is a process of getting the required legal paperwork done so that there is no ambiguity if any of the above situations unexpectedly happens.

Will

This is a legal document that specifies (according to your wishes) the distribution of your property and the care of your minor children.

Power of Attorney

This is a legal document that allows someone you designate to make decisions on your behalf. There are various types of these documents, including a financial Power of Attorney and Health Care Power of Attorney.

Living Will

This is a legal document that specifies written instructions for your future health care in the event of any situation in which you can no longer speak for yourself. For example, it outlines your wishes about life-sustaining medical treatment if you are terminally ill or permanently unconscious. An "Advance Health Care Directive" is a document that combines a Health Care Power of Attorney and a Living Will.

Last Word:

This is a topic that most of us don't want to deal with. But it is important to get it done for the sake of our family. It is best to use a specialist to do this (typically an attorney) so that there are no legal issues later. Get it done.

7. Emergency Fund

This is sometimes referred to as a rainy-day fund. All it means is that we set aside some amount of money that is easily accessible and can be used in emergency situations. A common recommendation is to set aside at least 3-6months worth of expenses in an emergency fund. So, if your normal expenses (mortgage, utilities etc.) in a month are $1000, you would want to have something like $3000-$6000 set aside in a place where you can easily access it.

Things to Consider:

Even if you can't put aside the entire amount at one time, you can start building that fund starting today. It is best to have it in a place where it is "liquid" or easily available, such as a savings account. A home equity line of credit can also work as an emergency fund.

Last Word:

It is best to not touch this fund except in cases of real emergency (for example, unexpected job loss).

8. Investment

If after doing everything discussed so far you still have money left over, you may want to consider investing it and allowing it to grow. There are many options available for such investment. The Appendix provides short descriptions of several common options. Even if you are not planning to invest the money by yourself, you may want to familiarize yourself with the options. Be wary of get-rich-quick schemes that promise guaranteed returns and no risk. All investment comes with some level of risk.

Things to Consider:

Do it Yourself – One investment approach that is increasingly popular is the do-it-yourself approach. There are many places online that can allow you to do it yourself (see references at the end). Keep in mind that even if you are using mutual funds there are always some fees included, so it is useful to be aware of them.

Broker – Think of this as a commission-based approach. When you need a product (Mutual Fund, IRA, 529, 401(k)), the broker provides the product and for that you pay a commission. You just have to make sure the product is in your best interest and not that of the broker. Remember that once the sale is made the broker has no fiduciary responsibility to you. You can look into your broker at brokercheck.finra.org.

Financial Advisor – Another approach is to use a financial advisor. Think of this as an asset-based approach. In many cases you pay a management fee (1%-1.5%) of your assets under management (AUM). For example, if you have $100,000 of assets under management, at a 1% fee, you will be paying $250 per quarter in fees, to work with that advisor. Sometimes Advisors will offer consultative services – perhaps a one-time fee for a few tasks (rebalance 401(k), review insurance, look over investments). Or it could be an annual maintenance fee if all assets are tied up in a 401(K), but you still need guidance.

Last Word:

Make sure you ask questions and understand what services you are receiving in these arrangements. Also keep in mind the idea of fiduciary responsibility – they have to do what is in *your* best interest, not theirs.

9. Financial Literacy/Management for the Family

Financial literacy is generally not taught in school (or not covered well) and can be an area of significant ignorance for many people. The word "financial" often gets people to think about investments and

making money in the stock market. But many of the steps discussed in this document are “defensive” (to prevent loss and to set up well for the long term) rather than “offensive” (investing to make money grow fast).

This document is an effort to improve our personal financial literacy. But it is something that should be extended to our family (spouses, if needed, and children for sure).

Speaking of spouses, it appears that it is quite common for one person in a household to manage much of the finances. This usually means that one person has knowledge of various financial choices, investments, accounts etc. A practical problem that arises is that one person has access (through usernames, passwords etc.) to a lot of information that a spouse or significant other may not. In the event that the first person is incapacitated, this can pose significant (and avoidable) hurdles for the other person. People seem to have various ways of dealing with this, though none appear to be systematic and robust. ***Developing a system that meets those standards and sharing that will be a future objective***.

Last Word:

It’s rarely too early to start educating children about finances (with age-appropriate information). For example, teenagers can have bank accounts and debit cards to help understand the flow of money. So, if you haven’t done so already, think about how to educate your family about financial matters.

10. Seeking Help

Finance can be a daunting topic as it combines two important and difficult topics: money and math. This document is a starting point to easily gain an understanding of various personal finance topics. But this is not a journey that one needs to undertake alone. There are a variety of sources that can be accessed.

Things to Consider:

Do it Yourself – To learn more about personal financial management we suggest these sources:

www.nerdwallet.com
www.fool.com

Professional Financial Support – There are many types of finance professionals that you could consider such as financial advisors, brokers, etc. In all cases it will cost you something though the format of the payment may vary (fixed fee, percentage of assets, etc.) and the level of service can vary as well. You will need to make the decision on whether you should use professional financial support (perhaps depending on your financial situation and life stage).

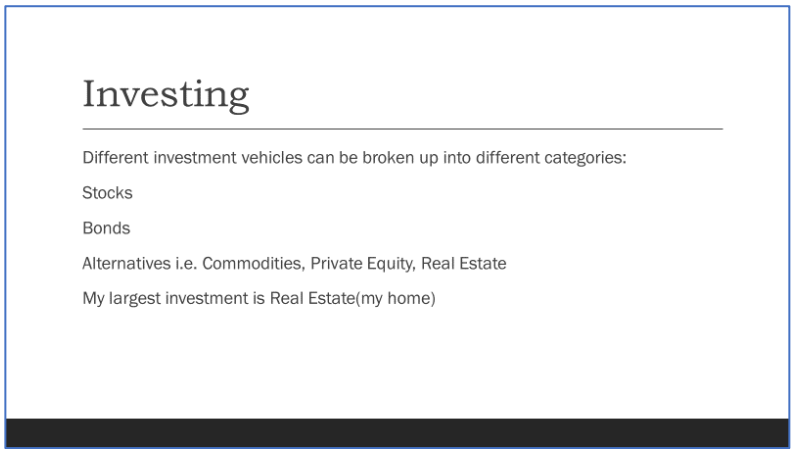
Last Word:

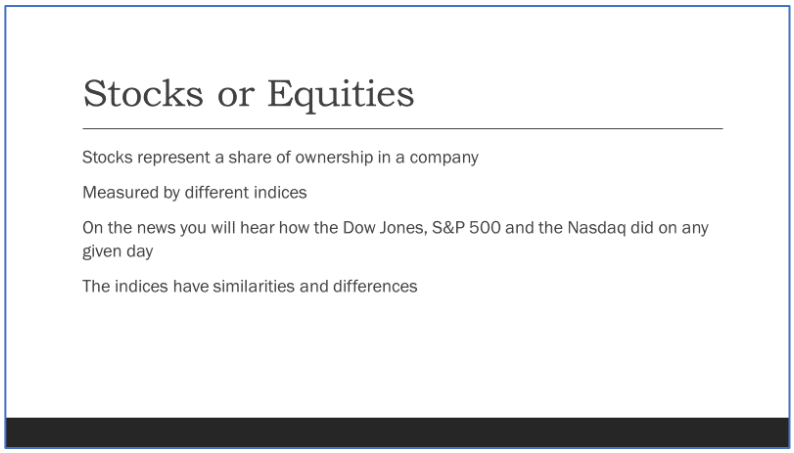
Trust and ***competence*** are two big components of professional financial support. Whoever you choose, you need to be confident that both of those are abundantly present. Ask questions and be an informed buyer.

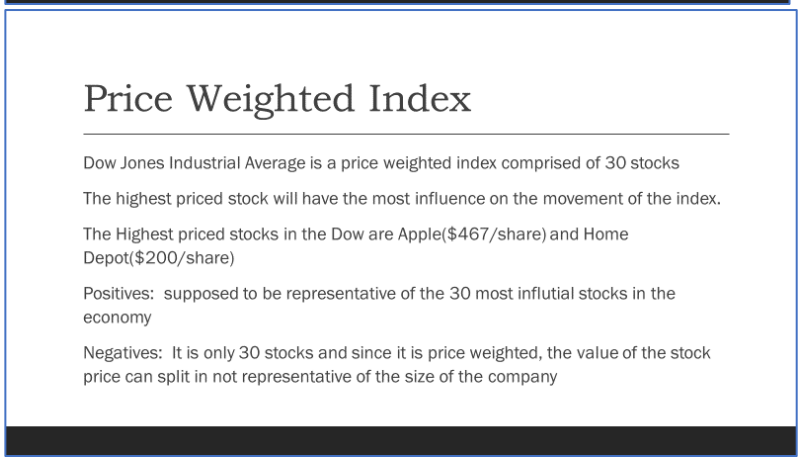
Appendix

Investing Terminology and Vehicles

"Investing is laying out money now to get more money in the future" – Warren Buffett







Market Weighted Indexes: S&P 500 and the Nasdaq

Weighted by market capitalization of the companies which is more indicative of their size

S&P is comprised of 500 of the largest companies traded on US exchanges

Nasdaq is comprised of over 3000 stocks and holds more technology companies

The difference in the performance will differ:

2020 YTD:

Dow -3%

S&P +6%

Nasdaq +26%

Bonds or Fixed Income

IOU to the Government or Corporation with a maturity date and a coupon.

Most popular are Treasury, Municipal, Corporate and Mortgage backed

Used as stream of income and generally less volatile than stocks

Price of bonds are dictated by interest rates

Popular Investment Vehicles

Mutual Funds-pools money to invest in a diversified group of stocks, bonds, ect

-managed by an investment manager

-bought and settled at the end of every trading day

Exchange Traded Fund(ETF)

-usually not managed and represents an index(most popular ETF is one that represents the S&P)

-traded on an exchange so you can buy and sell during market hours

-not professionally managed