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the newsletter of Prentice Yates & Clark

Common Financial Guidelines for Planning Your Retirement

Preparing for retirement can be a very stressful experience, with so many factors that you need to consider. How much money will I need to maintain my standard of living? How much will I want to travel? How long will I live? What if I outlive my money?

There's so much uncertainty, that financial rules of thumb for planning your retirement have become very popular – following them relieves at least some of that uncertainty.It is important to understand the assumptions, and the limitations of these guidelines, so that you understand whether they are relevant for your particular situation.

'You Need 70% of Your Pre-Retirement Income in Retirement'

This popular guideline incorporates the fact that you will not have certain expenses in retirement that you had while employed, like commuting costs and buying clothes for work. You also won't be saving for retirement anymore. However, there are some personal factors that can make this more of a myth than a guideline, including:

- whether you own your home and your mortgage is paid off
- whether your children are financially independent or you are still helping fund their university education
- your own personal goals for retirement – your personal income replacement factor could be significantly lower, or higher, than 70%

A better way to estimate how much retirement income you will need is to track your current expenses and then adjust for the changes in your lifestyle once you retire, such as an increased budget for vacations and hobbies. There are tools and apps that you can use to help you categorize and summarize your current spending. However, check with your bank first, as using third-party tools that automatically download transactions from your bank accounts may violate your online banking agreement and expose you to liability if there are unauthorized transactions in your accounts. Many banks provide their own tools to help you manage your finances, or you can download the transactions and use spreadsheet software to create your own summary.

Once you have your recurring annual budget amount, adjusted for lifestyle changes, you should also budget for expenditures that do not occur annually, such as purchasing a new car or major house renovations. If, for example, you plan on purchasing a new car every eight years, you should factor in an annual "car replacement fund" over that period to give you a more comprehensive budget amount. Similarly, you should budget a certain annual amount as a fund for major home repairs – you might not need that money in every year, but planning for bathroom and kitchen renovations, new furnaces and roofs should still be built into your retirement budget, so that they don't end up being a nasty surprise when they happen! Budgeting a percentage of the purchase price of your home, or a specific dollar amount per square foot, are common ways to do this. As with all rules of thumb, these should be adjusted for the age of your home and how often you want to renovate it.

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Our phone and fax numbers have not changed

Common Financial Guidelines for Planning Your Retirement - continued

The '4% Rule'

One of the most commonly-cited rules for estimating how much income you can withdraw from your investment portfolio without risking running out of money is "the 4% rule." This rule comes from a study conducted by William Bengen and first published in The Journal of Financial Planning in 1994.

Bengen explored the concept of "portfolio longevity" – how long your investment portfolio would last if you withdrew a specific percentage of it in the first year of retirement – and then adjusted that amount for inflation in each successive year. He tested this against the stock market returns for a person retiring in each year from 1926 to 1976, and for initial withdrawal rates from 1% to 8%. With an initial withdrawal rate of 4% the portfolio lasted more than 33 years – even for those worst-case scenarios of retirees who lived through the Great Depression or the 1973–74 recession.

The rule provides a simple answer to how much you need to save for retirement or how much retirement income you can take from an investment portfolio, but there are some important assumptions behind this rule. His sample portfolio in the data above was 50% invested in U.S. common stocks and the remaining 50% invested in intermediate-term Treasury Bills, and it was rebalanced annually. That may be more risk than some retirees are willing to assume.

Bengen did explore this issue in his study, comparing the returns from various portfolio mixes of stocks and fixed income assets. While the 50/50 split seemed to be optimal in terms of maximizing the longevity of the portfolio, increasing equity portion of the portfolio to 75% increased the value of the estate passed on to the heirs, while having minimal impact on the portfolio longevity.

Bengen updated the study in 2006 and concluded that 4.5% was the safe initial withdrawal rate. Whether it is 4% or 4.5%, this can give you a good guideline for how much you will need to have saved by retirement to feel confident that you will not run out of money. Once you have calculated your budget based on the retirement lifestyle that you want, and subtracted what you expect to receive from the Canada Pension Plan, Old Age Security and any defined benefit pension plan, you can divide that net amount by 4% and have a reasonable target for your portfolio at retirement.

The '100 Minus Your Age' Rule

You often hear that our tolerance for risk in our investment portfolios should decrease as we get older, theoretically since you will have less time for your portfolio to recover from a financial catastrophe, which is where the "100 minus your age" rule comes in to play – the proportion of your investments invested in equities should be 100 minus your age, with the remainder invested In safe, fixed income assets, such as bonds. So a 40 year old should have 60% of their portfolio invested in equities, while a 70 year old should have a portfolio with only 30% equities.

However, with the increase in life expectancy since this rule was introduced, and with the historically low returns on fixed income investments, retirees will risk running out of money by following this rule. Some advisors have adjusted the rule to "110 minus your age," or even "120 minus your age," to address the increase in life expectancy, while another study evaluated the minimum and maximum returns for various portfolio mixes against the "100 minus your age" portfolio over a 50-year period. This research found that the "100 minus your age" portfolio consistently underperformed against both the minimum and maximum returns for two constant mix portfolios: 60% equity / 40% bonds and 70% equity / 30% bonds. This is consistent with Bengen's conclusions. While every individual's tolerance for risk is very personal, the link between that risk and the expected return on the portfolio is very clear.

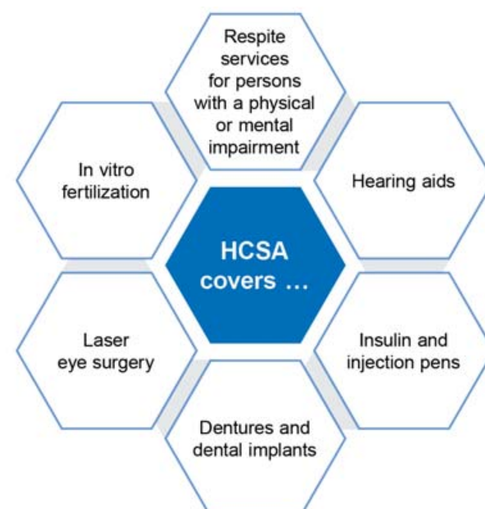
In summary, these common guidelines can be a good starting point for thinking about your retirement, and how prepared you are for it, but each situation is unique and therefore understanding the assumptions and limitations of the guidelines is important.◆

Why Should You Care About Your Health Care Spending Account?

Families may not realize that they have a great opportunity to significantly reduce the cost of medical treatments and therapies through a health care spending account (HCSA). These accounts are not well understood and, if available, are typically underutilized due to a lack of awareness of how they can help.

In essence, the HCSA helps families pay for eligible medical expenses by using pre-tax money. For families who incur medical expenses that are not traditionally covered by their employer's group benefits plan, an HCSA can be a very powerful tax-saving tool. Typically, if you are an employee of a company, you have access to the HCSA as a supplement to your traditional group benefits program. If you do have this access, you may receive a portion of your total compensation in the form of HCSA funding, up to a certain limit.

Eligible expenses that are not traditionally covered by your family's group benefits plan, but are covered through a health care spending account (HCSA), include these:



(Please note that this list is not exhaustive – for a full listing, please see the CRA link at the bottom of this article)

Why Should You Care About Your Health Care Spending Account? continued

Tax savings available

If your family has qualifying medical expenses above $2,302 (2018) or 3% of your income per year and your marginal tax rate is greater than 20%, then the HCSA could be a valuable tool for your family.

To estimate your potential tax savings from using an HCSA, simply take the difference between your combined marginal tax rate and the federal and provincial tax credit (METC) amount on qualifying medical expenses. If you are an individual in the top marginal bracket living in Ontario (53.53%), the tax savings are your qualifying medical expense amount (incurred during the year), multiplied by the tax rate difference between your marginal tax rate (53.53% less HCSA administrative costs of 8%) and the METC credit (15% federal plus 5.05% Ontario resident), which is approximately 25.48%.

For a family with large medical expenses during the year (such as respite services), the resulting tax savings can be significant. For instance, if a family incurs qualifying medical expenses of $15,000 in a year, the resulting tax savings from using an HCSA instead of the METC is close to $3,822! In addition, if qualifying medical expenses are incurred regularly every year, this is an ongoing tax savings to the family.

Business owners can improve both their financial situation and that of their employees by making a health care spending account part of their benefits offering

Implementing an HCSA as part of your benefits offering can be very valuable for you as a business owner. Up front, the business receives a tax deduction on contributions to an HCSA, while the employees do not pay tax on contributions to the HCSA or on eligible expenses. As a result, the employee is farther ahead by avoiding income tax on HCSA eligible expenses. In addition, the business owner has clarity of costs with an HCSA, as it is the employer that elects to contribute and at what amount. This contrasts with a traditional group benefits plan, which can have variable costs due to the group's unpredictable claims experience.

In some circumstances, business owners might just offer an HCSA without a traditional group benefits plan. In this case, the employee has full flexibility to use the HCSA dollars for whatever purpose they prefer, while the business owner doesn't have to worry about escalating benefits costs. If, however, the employee would still like the option of a traditional group benefits plan, they can use their HCSA dollars to purchase a plan for themselves, as premiums are an eligible expense for HCSA purposes.

Navigating the details of a health care spending account program is challenging. Despite the complexity, it is an important planning tool for families and business owners to use, to improve wellbeing and financial outcomes.

Links of interest

Canada Revenue Agency (CRA) – Eligible medical expenses you can claim on your tax return:
www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax-return/completing-a-tax-return/deductions-credits-expenses/lines-330-331-eligible-medical-expenses-you-claim-on-your-tax-return.html

Canadian Broadcasting Corporation (CBC) – HSAs the best health plans you've never heard of:
www.cbc.ca/news/business/hsas-the-best-health-plans-you-ve-never-heard-of-1.990547◆

Antivirus Preparedness: What to Look for in an Antivirus Solution

Finding a good antivirus solution is kind of like searching for insurance coverage. We know we need it, but few of us really understand how it works. Here is a simple discussion outlining what antivirus software is, the threats out there and what to look for in selecting a security solution.

What is antivirus software exactly?

Antivirus software are programs that are specifically designed to deal with various forms of malicious software (often referred to as malware) that can infect your computer and cause data corruption, breach of privacy or many other forms of malintent. Typically, antivirus software is used to both prevent and remove the offending malware. Given that there are constantly new kinds of malware being released, a key aspect of antivirus software is the frequency and completeness with which it is updated.

Inside PYC

The annual Ontario Non-Profit Association (ONPHA) conference will be held November 1st to 3rd in Toronto where J.J. Pauze and Viola Bardhoshi will be at the Trade Show and Viola will also be presenting the Award of Excellence at the opening plenary.

Congratulations to Peter Nham who has recently completed all the requirements for his designation as a chartered professional accountant.

We would like to welcome Pauline Kiondo as a new member of our professional staff.

Antivirus Preparedness: What to Look for in an Antivirus Solution- continued

The term antivirus has become synonymous with protection against a variety of threats, and not just viruses as the name suggests. It is worth understanding, at least at a high level, what the various forms of these threats are.

What threats should you be concerned about?

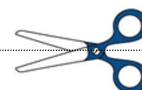
There are several different threats present in our modern environment. These are normally categorized by the method by which they are transmitted and/or by the malicious activity of the offending code and are collectively called "*malware*". A few of the most prominent types of threats are listed below. This is by no means a complete list:

- **Viruses –** usually an executable file that has the capability of replicating itself, causing several different malicious intents. Executing the infected file activates or triggers the virus to act.
- **Worms –** similar to viruses in that they can replicate themselves, however they differ in that they do not require the execution of a file to trigger their activity and are transmitted by taking advantage of gaps in existing security protocols.
- **Trojan horses –** a type of malicious software or code that – as you can probably guess by the name – masquerades as legitimate software, and fools users into downloading it. Once downloaded and activated, a Trojan horse typically will open pathways for other malicious software to enter your PC.
- **Spyware –** malicious programs that, once they have found their way onto your computer, collect various pieces of data about you, your transactions and/or any data that resides on your PC. Once this personal data has been collected, the spyware will transmit it back somewhere to be collected by hackers, who could potentially steal your identity.
- **Ransomware –** probably the scariest of all the threats listed. In this case, the malicious software seeks out your important files – such as photos, documents, and videos – and encrypts them. Once these are all locked up, large sums of money are requested by the hackers to release your own files back to you.
- Considerations when selecting antivirus software
- Here are some important things to consider when evaluating an antivirus solution:
- **Comprehensive coverage –** With the many different threats that are out there, it is vital that you are looking for more than just antivirus coverage, but also for other forms of defence. Things like a firewall, internet browsing protection and even identity protection are key elements to have.
- **Ease of use –** No tool is worth anything if it won't be used. Complicated pieces of software may provide a little better protection, but if it is not easy to understand, frustration will result. Look for easy-to-use screens, good documentation and options around how the product is configured.
- **Performance impact –** This is probably one of the biggest complaints about robust security solutions. They can use a fair amount of your PC's resources to run the checks, scans and updates necessary to keep you protected. If you find that you see consistent slowness in your PC, regardless of the product used, it may be time to upgrade.

- **Reliability –** Reliable security software products have a few common elements. First, they are frequently updated, meaning that the provider is constantly adapting to new threats. Second, they have tools to automate the scanning process, and are highly configurable; so you can customize when they are run, and what files are investigated. They will also have a high malware-detection rate (look for a number higher than 95%). The high detection rate indicates that few viruses are missed, and conversely that most are caught. Lastly, they should guard against being unintentionally uninstalled, as some malware has been known to uninstall the antivirus software that is present. This is easily prevented by adding required confirmations to the uninstall process.

Free versus paid

This is a common debate. There are some good low- or no-cost antivirus products available, however most research does point to the paid product as having a better long-term rate of malware detection. The paid software is updated more frequently, is more robust in terms of functionality and comes with better support. Free solutions, while less feature-rich, may provide less interruption to your PC – however, remember that, at the end of the day, those interruptions are saving you from harm.◆



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