

Case 5

The Butterfield Case

AN INSURANCE PLANNING MINI-CASE

John Butterfield, 49, and his wife Haley Butterfield, 44, live in a relatively new home on the outskirts of Anycity, Anystate. They have been married for 23 years and have three children. Both John and Haley are in excellent health. Their son Troy, age 20, is a baseball player on scholarship at the University of Anystate. Daughter Holly, age 17, hopes to attend State University next fall as a cadet to begin pursuing a career in the Marine Corps.

The choices of their first two children have allowed the Butterfields to concentrate their college saving goals on Naomi, the youngest, at age 13. John and Haley have come to you for help in addressing several insurance planning questions and concerns. Use the following information to conduct a review of their financial situation and use your analyses to answer the questions that follow the case narrative.

Global Assumptions (Valid unless otherwise Specified in Certain Instances)

- Inflation: 3.5%
- All income and expense figures are given in today's dollars.
- Federal marginal tax bracket: 25%
- State marginal tax bracket: 5.75%
- Any qualified plan or IRA contribution growth rates are assumed to stop at the federally mandated limit unless otherwise restricted.
- All nominal rates of return are pretax returns.

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Income Issues

John has worked for the last 14 years as an engineer for CNS Design. He has an \$81,000 salary. He would like to retire at age 67.

Haley has worked as a CPA for 17 years, the last 14 of which have been out of their home. Though her earnings vary from month to month, she estimates that she will earn \$65,000 this year. She wants to retire at the same time as John.

They also assume that their salaries will increase, on average, by 3.5% per year over their working lives. This year they anticipate earning \$600 in interest and non-qualified mutual fund dividend distributions, which will be reinvested.

Expense Issues

Table VI.5 provides a summary of the Butterfields' fixed (non-discretionary) and variable (discretionary) expenses.

Table VI.5 Summary of Expenses

Expense	Amount	Frequency
Pretax health care premiums	\$200	Monthly
401(k) contributions	\$540	Monthly
Keogh contributions	\$7,800	Annually
Mortgage	\$1,600	Monthly
Home equity loan	\$625	Monthly
Auto loan #1	\$310	Monthly
Auto loan #2	\$500	Monthly
Credit cards and installment debt	\$2,100	Annual
Auto insurance	\$1,100	Semiannual
Homeowner's insurance	\$825	Annual
Disability insurance (pretax)	\$200	Monthly
Life insurance	\$400	Annual
IRA contributions (Haley)	\$750	Quarterly
IRA contributions (John)	\$750	Quarterly
Subscriptions	\$650	Annual
Telephone	\$1,560	Annual
Digital cable television	\$125	Monthly
Hobbies	\$750	Annual
Entertainment	\$1,500	Annual
Education payments (spending money Troy)	\$5,000	Annual
Travel costs for first child while in college	\$1,200	Annual
Groceries	\$75	Weekly
Food away from home	\$3,400	Annual

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Real estate taxes	\$1,300	Annual
Household maintenance	\$2,700	Annual
Utilities	\$175	Month
Clothing	\$1,500	Annual
Dry cleaning	\$50	Month
Personal care	\$500	Annual
Furnishing	\$1,000	Annual
Allowances	\$2,000	Annual
Medical copayments	\$700	Annual
Prescriptions	\$250	Annual
Gas	\$2,500	Annual
Personal property tax	\$400	Semiannual
Banking fees	\$75	Annual
IRA fees	\$80	Annual
Travel	\$100	Monthly
Contributions to church	\$125	Monthly
Vacations	\$3,000	Annual
Christmas gifts	\$2,400	Annual

Home mortgage. They are eight years into a 30-year 7.5% mortgage that had an original balance of \$228,850, with a current outstanding balance of \$206,602.

Home equity loan. The loan balance was used to pay off credit cards and purchase a vehicle for Troy to use at college. Since the loan was first taken, they have accumulated additional credit card debt. The monthly payment is approximately 2% of the outstanding balance. The credit line expires and will be due and payable in seven years. They have paid \$3,000 in interest over the past year.

Auto Payments.

Auto 1: Balance is \$8,500 with 2.5 years remaining.

Auto 2: Balance is \$25,000 with 57 months remaining.

Tax Issues

After reviewing their pay stubs, John and Haley calculated that their total annual federal withholdings and/or estimated tax payments totaled \$20,250. Their state withholdings amounted to \$8,000. Social Security withheld was \$10,985. The Butterfields file taxes as "married filing jointly" and have \$30,241 in itemized deductions for the year.

The Butterfields are eligible for a \$5,000 state income tax deduction, and five \$1,000-personal exemptions for John, Haley, and the children. The marginal tax bracket for their state is 5.75%.

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Specific Client Goals

- Under any circumstance, they want to provide 50% of the cost of Holly's and Naomi's college education costs, and all of Troy's education costs that are not covered by scholarships.
- They want to maintain their current standard of living in retirement or in the event of either spouse's premature death.
- They want to protect their income and assets in the event of a catastrophic accident or illness, so that they can pass on their assets to their children.
- They both want to continue funding their IRAs to the current maximum limit.

See Table VI.6 for information on the Butterfields' assets and liabilities.

Table VI.6 The Butterfields' Assets and Liabilities

Asset	Amount	Ownership
Checking account	\$950	Client
Large-cap mutual fund	\$9,000	Client
Checking account	\$1,200	Co-client
Small-cap mutual fund	\$17,250	Co-client
Life insurance cash value	\$3,800	Co-client
Checking account	\$2,800	Joint
Savings account	\$7,500	Joint
Money market account	\$10,050	Joint
Mid-cap mutual fund	\$40,000	Joint
Artwork	\$25,000	Joint
401(k)	\$62,000	Client
Keogh retirement plan	\$125,000	Co-client
Individual retirement account (IRA)	\$38,000	Client
Individual retirement account (IRA)	\$41,500	Co-client
Home	\$315,000	Joint
Honda	\$17,500	Joint
Toyota	\$38,000	Joint
Collectibles	\$13,000	Co-client
Furniture	\$17,500	Client
Other assets	\$69,000	Joint
Misc. assets	\$39,000	Joint
Liabilities	Amount	Ownership
Visa credit card	\$2,500	Co-client
MasterCard	\$4,900	Joint
Mortgage	\$206,602	Joint
Home equity loan	\$32,000	Joint
Honda	\$8,500	Joint
Toyota	\$25,000	Joint
Short-term installment debt	\$21,000	Client

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Current Insurance Data

Property and Casualty

Auto. All vehicles

Liability: \$300,000 single limit (including uninsured motorist)

Medical payments coverage: \$1,000 limit per person

Deductible: \$250 collision; \$100 comprehensive

Premium: \$1,100 every six months

Auto 1: 20XX Honda Accord LX Sedan

Mileage: 30,000

Color: light blue

Engine: 6-cylinder

Transmission: manual

Payment: \$310/month

Balance: \$8,500 with 2.5 years remaining

Worth: \$17,500

Auto 2: 20XX Toyota Sequoia Limited (4×4)

Mileage: 5,500

Color: silver

Engine: 8-cylinder

Transmission: automatic

Payment: \$500/month

Balance: \$25,000 with 57 months remaining

Worth: \$38,000

Home. Single-family dwelling

Insured value: \$245,000

Replacement value: \$315,000

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Deductible: \$500

Personal property: 50% of dwelling

Bodily injury: \$100,000

Personal injury: \$0

Other endorsements: None

Umbrella: None

Professional liability: None

Business: None

Life and Health

Life. Haley has a \$50,000 universal life policy with XYZ Insurance Co. She pays the annual premium of \$400. The policy has a current cash value of \$3,800 (the cash value at the beginning of the period was \$3,600). John is the primary beneficiary and Haley is the owner. At the time of purchase, policy projections were based on after-tax U.S. Treasury rates of 6%.

John has an employer-provided term policy that pays one times his annual salary. The face amount of the policy is reduced by 50%, regardless of his salary, at age 65 and terminates at age 70.

Other life assumptions:

- For planning purposes, the Butterfields would like to use 80% of their combined incomes, before taxes, to represent their total household expenses in the event of a death.
- Final illness and burial expenses are estimated to be \$15,000 each.
- Estate administration expenses are expected to be approximately \$5,200 each.
- Child care expenses will be \$10,000.
- Full retirement age, for insurance purposes, is assumed to be age 67.
- The Butterfields need \$100,000 in annual income per year, before taxes, while retired. They would like to use this assumption for both insurance and retirement planning purposes.
- Social Security benefit while children are still at home is \$32,000 if John dies, and \$29,000 if Haley dies, in today's dollars.
- At age 60, Haley is eligible for a \$13,000 annual Social Security survivor benefit, while John is entitled to a \$10,000 annual survivor benefit (in today's dollars).

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- In the event of either spouse's death, the other spouse plans to stop working at age 60 and begin taking early retirement survivor benefits (if available).
- For conservative planning purposes, the Butterfields do not plan on using interest and/or dividends as an income source when planning insurance needs.
- At full retirement (i.e., at age 67) John will receive \$18,000 per year in Social Security benefits; Haley will receive \$16,500 in benefits (in today's dollars).
- Assumed ages at death for John and Haley are 90 and 92, respectively.
- The assumed gross rate of return on insurance assets, in the event of death, is 9%.

Health. The Butterfields' health insurance is provided by Blue Cross/Blue Shield. The monthly premium of \$600 is paid 66% by John's employer, with the remainder paid out of pocket. The plan has a deductible of \$250 per person and a family copayment of 20%. The out-of-pocket per-family cap on copayments is \$1,000 per year. The lifetime maximum on major medical is \$500,000 per person.

Long-term care. None.

Disability. John's disability coverage is a group disability contract provided by his employer. It pays a \$5,000 monthly benefit until age 65. The contract has a liberal "own occupation" definition. The elimination period is 120 days. Haley does not have a disability policy. In the event of a disability, the Butterfields would like to continue saving for other goals; however, they do not want to rely on Social Security disability benefits when estimating disability income needs.

Vacation/medical leave. John has accumulated 30 sick days, which is the maximum he is allowed to carry. He could accrue one week per year if he fell below the maximum. He also is eligible for three weeks of vacation per year. He can carry over one week, but this has not previously been done.

Education Funding Goals

The Butterfields would like to assume that education expenses will increase 6.50% per year. They are comfortable assuming a growth rate of 9.00% per year for educational assets and savings in a tax-advantaged account before and after college begins (6.75% if assets are held in a taxable account). Each of the children is talented academically (GPA > 3.0) and in terms of extracurricular activities.

Troy is currently enrolled at University of Anystate. Current cost: \$14,700/year (waiver).

- He is on a $\frac{3}{4}$ baseball scholarship. His parents budget \$5,000 per year in extra support; they pay tuition not covered in the scholarship and give Troy what is left from their \$5,000 budget as a spending allowance.

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- The Butterfields have also allocated \$1,200 per year to help pay for Troy's travel expenses.
- He has completed one year of college.
- His health insurance is provided under his father's group health plan.

Holly wants to attend State University; current cost: \$10,500/year (possible tuition waiver).

- Wants to go to school on an ROTC scholarship and fund any additional expenses out of pocket from money earned during summers.

Naomi's college funding goals are unknown, but her parents want to plan for college costs of \$16,500 per year (in today's dollars).

- They prefer to use tax-advantaged savings plans to fund any expenses.

Retirement Information

The Butterfields would like to retire when John turns age 67. Based on today's dollars, they are willing to reduce their income by 80% of current income while retired. At full retirement (i.e., age 67) John will receive \$18,000 per year in Social Security benefits; Haley will receive \$16,500 in benefits (in today's dollars) at age 67. When planning, they are comfortable assuming a 9.00% rate of return before retirement, and a 5.75% return after retirement. Contributions to their defined contribution plans are anticipated to increase 3% annually. They anticipate being in a combined 25% marginal tax bracket in retirement. Inflation before and after retirement will be 3.50%; their incomes should keep pace with inflation. John's employer matches 401(k) contributions \$0.50 cents on the dollar. IRA assets are held in Roth accounts. Assumed age at death for John is age 90 and age 92 for Haley.

Estate Information

They both have simple wills. John leaves his estate to Haley and Haley leaves her estate to John. They believe that, on average, their estate will grow by 4% after the first spouse's death. Other assumptions include:

- Funeral expenses are expected to be approximately \$12,000 each.
- Estate administrative expenses will be \$5,200 each.
- The Butterfield do not expect to pay any executor fees.