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Welcome to the April, 2016 issue of The Farmers Bank Quarterly Newsletter!We can deliver this newsletter to you directly through your email or we can send a paper version to you directly - just let us know.

The Farmers Bank, Frankfort, Indiana has been serving clients since 1876. Our vision is to provide service levels that continually exceed expectations. We strive to build a strong heritage and it is important to us to continue this legacy to be *your bank for life* . Whether it's saving, investing, retirement planning, estate planning or any other of the services that The Farmers Bank Trust and Asset Management Division offers, we are here to help you.

Enjoy!

-The Farmers Bank Trust and Asset Management Team

April 2016

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The Farmers Bank Quarterly

Planning your Financial Future

Protecting Your Business from Cyber Threats

Risk management is a key component in any successful business plan. In today's world--where data breaches are common occurrences--it's especially important for business owners to understand the digital risks they face. Are you doing all you can to mitigate the risk of a cyber attack?

Understanding the risks

Many small-business owners may think their organizations hold little appeal to hackers due to their small size and limited scope. However, according to the Small Business Administration (SBA), this naivete may actually make them ideal targets. Small businesses are keepers of employee and customer data, financial account information, and intellectual property. Their systems, if not adequately protected, may also inadvertently provide access to larger supplier networks. "Given their role in the nation's supply chain and economy, combined with fewer resources than their larger counterparts to secure their information, systems, and networks, small employers are an attractive target for cybercriminals," reports the SBA on its cybersecurity website.

Consider the following tips compiled from information supplied by the SBA, the Federal Trade Commission (FTC), and the Federal Communications Commission (FCC).

Cybersecurity tips

1. Assess: To protect your organization, you must first understand your vulnerabilities. How are your systems protected? Do you collect and store personal information of customers and employees, such as credit-card information, Social Security numbers, and birth dates? If so, how is this information stored and who may access it? Do you have a Wi-Fi accessible to employees and customers? How do your vendors and other third-party service providers protect their information? It may help to engage a professional to help identify your risks.

2. Protect: Ensure you have firewall and encryption technology protecting your Internet connections and Wi-Fi networks. Make sure your business's computers have antivirus and antispyware software installed and updated automatically. Require employees and others who access your systems to use complex passwords that are changed regularly. Keep only personal data that you actually need and dispose of it securely as soon as it no longer serves a business purpose. Back up critical information and data on a regular basis, and store the backups securely offsite. Assign individual user accounts to employees and permit access to software and systems only as needed. Be especially cautious with laptops and company-assigned smartphones. Question third-party vendors to ensure that their security practices comply with your standards.

3. Document: Establish clear security policies and procedures and put them in writing. Cover such topics as handling sensitive or personal information, appropriate use of Internet and social media, and reporting vulnerabilities. Clearly spell out consequences for failing to follow the policies.

4. Educate: Develop a mandatory employee training program on the importance of cybersecurity. Explain the basics of personal information, as well as what is and isn't acceptable to post on social media. Employees could unknowingly release information that could be used by competitors or, worse, by criminals. Ensure that employees understand the risks associated with phishing emails, as well as "social engineering"--manipulative tactics criminals use to trick employees into divulging confidential information.

For more information

Business owners who want to learn more can find a wealth of helpful information online. In addition to visiting the SBA's cybersecurity website, business owners might want to review "Protecting Personal Information: A Guide for Business" and "Start with Security: A Guide for Business," both available on the FTC's website.

See disclaimer on final page

Can You Get to a Million Dollars?

In trying to accumulate $1 million (or any other amount), you should generally consider how much you have now, how much you can contribute in the future, how much you might earn on your investments, and how long you have to accumulate funds. But remember, there are no guarantees--even when you have a clearly defined goal. For example, the market might not perform as expected, or you may have to reduce your contributions at some point.

All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful. Review your progress periodically and be prepared to make adjustments when necessary.

Often in life, you have investment goals that you hope to reach. Say, for example, you have determined that you would like to have $1 million in your investment portfolio by the time you retire. But will you be able to get there?

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Current balance--your starting point

Of course, the more you have today, the less you may need to contribute to your investment portfolio or earn on your investments over your time horizon.

Time (accumulation period)

In general, the longer your time horizon, the greater the opportunity you have to accumulate $1 million. If you have a sufficiently long time horizon and a sufficiently large current balance, with adequate earnings you may be able to reach your goal without making any additional contributions. With a longer time horizon, you'll also have more time to recover if the value of your investments drops. If additional contributions are required to help you reach your goal, the more time you have to target your goal, the less you may have to contribute.

The sooner you start making contributions, the better. If you wait too long and the time remaining to accumulate funds becomes too short, you may be unable to make the large contributions required to reach your goal. In such a case, you might consider whether you can extend the accumulation period--for example, by delaying retirement.

Rate of return (earnings)

In general, the greater the rate of return that you can earn on your investments, the more likely that you'll reach your investment goal of $1 million. The greater the proportion of the investment portfolio that comes from earnings, the less you may need to contribute to the portfolio. Earnings can benefit from long time horizons and compound rates of return, as returns are earned on any earlier earnings.

However, higher rates of return are generally associated with greater investment risk and the possibility of investment losses. It's important to choose investments that meet your time horizon and tolerance for risk. And be realistic in your assumptions. What rate of return is realistic given your current asset allocation and investment selection?

Amount of contributions

Of course, the more you can regularly contribute to your investment portfolio (e.g., monthly or yearly), the better your chances are of reaching your $1 million investment goal, especially if you start contributing early and have a long time horizon.

Contributions needed

Now that the primary factors that affect your chances of getting to a million dollars have been reviewed, let's consider this question: At a given rate of return, how much do you need to save each year to reach the $1 million target? For example, let's assume you anticipate that you can earn a 6% annual rate of return (ROR) on your investments. If your current balance is $450,000 and you have 15 more years to reach $1 million, you may not need to make any additional contributions (see scenario 1 in the table below); but if you have only 10 more years, you'll need to make annual contributions of $14,728 (see scenario 2). If your current balance is $0 and you have 30 more years to reach $1 million, you'll need to contribute $12,649 annually (see scenario 3); but if you have only 20 more years, you'll need to contribute $27,185 annually (see scenario 4).

Scenario	1	2
Target	$1,000,000	$1,000,000
Current balance	$450,000	$450,000
Years	15	10
ROR	6%	6%
Annual contribution	$0	$14,728

Scenario	3	4
Target	$1,000,000	$1,000,000
Current balance	$0	$0
Years	30	20
ROR	6%	6%
Annual contribution	$12,649	$27,185

Note: *This hypothetical example is not intended to reflect the actual performance of any investment. Actual results may vary. Taxes, fees, expenses, and inflation are not considered and would reduce the performance shown if they were included.*

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Earn Too Much for a Roth IRA? Try the Back Door!

If you have taxable compensation, you can contribute up to $5,500 to an IRA in 2016, or $6,500 if you'll be 50 or older by the end of the year. You can't contribute to a traditional IRA for the year you turn 70½, or thereafter.

To be eligible for tax-free qualified distributions from a Roth IRA, you must satisfy a five-year holding period and, in addition, one of the following must apply: you have reached age 59½ by the time of the withdrawal, the withdrawal is made because of disability, or the withdrawal is made to pay first-time homebuyer expenses ($10,000 lifetime limit from all IRAs).

It's not clear how long the back door is going to remain open. There have been suggestions that this is a loophole that should be legislatively closed.

Background

Roth IRAs, created in 1997 as part of the Taxpayer Relief Act, represented an entirely new savings opportunity--the ability to make after-tax contributions that could, if certain conditions were met, grow entirely free of federal income taxes. These new savings vehicles were essentially the inverse of traditional IRAs, where you could make deductible contributions but distributions would be fully taxable. The law also allowed taxpayers to "convert" traditional IRAs to Roth IRAs by paying income taxes on the amount converted in the year of conversion.

Unfortunately, the law contained two provisions that limited the ability of high-income taxpayers to participate in the Roth revolution. First, the annual contributions an individual could make to a Roth IRA were reduced or eliminated if his or her income exceeded certain levels. Second, individuals with incomes of $100,000 or more, or whose tax filing status was married filing separately, were prohibited from converting a traditional IRA to a Roth IRA.

In 2005, however, Congress passed the Tax Increase Prevention and Reconciliation Act (TIPRA), which repealed the second barrier, allowing anyone to convert a traditional IRA to a Roth IRA--starting in 2010--regardless of income level or marital status. But TIPRA did not repeal the provision that limited the ability to make annual Roth contributions based on income. The current limits are set forth in the chart below:

Phaseout ranges for determining ability to fund a Roth IRA in 2016*	
Single/head of household	$117,000-$132,000
Married filing jointly	$184,000-$194,000
Married filing separately	$0-$10,000
***Applies to modified adjusted gross income (MAGI)**	

Through the back door...

Repeal of the provisions limiting conversions created an obvious opportunity for high-income taxpayers who wanted to make annual Roth contributions but couldn't because of the income limits. Those taxpayers (who would also run afoul of similar income limits that prohibited them from making deductible contributions to traditional IRAs) could simply make nondeductible contributions to a traditional IRA and then immediately convert that traditional IRA to a Roth IRA--a "back door" Roth IRA.

The IRS is always at the front door...

For taxpayers who have no other traditional IRAs, establishment of the back-door Roth IRA is essentially tax free. Income tax is payable on the earnings, if any, that the traditional IRA generates until the Roth conversion is complete. However, assuming the contribution and conversion are done in tandem, the tax impact should be nominal. (The 10% penalty tax for distributions prior to age 59½ generally doesn't apply to taxable conversions.)

But if a taxpayer owns other traditional IRAs at the time of conversion, the tax calculation is a bit more complicated because of the so-called "IRA aggregation rule." When calculating the tax impact of a distribution (including a conversion) from any traditional IRA, all traditional and SEP/SIMPLE IRAs a taxpayer owns (other than inherited IRAs) must be aggregated and treated as a single IRA.

For example, assume Jillian creates a back-door Roth IRA in 2016 by making a $5,500 contribution to a traditional IRA and then converting that IRA to a Roth IRA. She also has another traditional IRA that contains deductible contributions and earnings worth $20,000. Her total traditional IRA balance prior to the conversion is therefore $25,500 ($20,000 taxable and $5,500 nontaxable).

She has a distribution (conversion) of $5,500: 78.4% of that distribution ($20,000/$25,500) is considered taxable ($4,313.73), and 21.6% of that distribution ($5,500/$25,500) is considered nontaxable ($1,186.27).

Note: These tax calculations can be complicated. Fortunately, the IRS has provided a worksheet (Form 8606) for calculating the taxable portion of a conversion.

There's also a side door...

Let's assume Jillian in the example above isn't thrilled about having to pay any income tax on the Roth conversion. Is there anything she can do about it?

One strategy to reduce or eliminate the conversion tax is to transfer the taxable amount in the traditional IRAs ($20,000 in our example) to an employer qualified plan like a 401(k) prior to establishing the back-door Roth IRA, leaving the traditional IRAs holding only after-tax dollars. Many 401(k) plans accept incoming rollovers. Check with your plan administrator.

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Should I loan my child money for a down payment on a house?

For a lot of young people today, it's difficult to purchase a home without at least some financial assistance. As a result, many young adults turn to their parents or other family members for help with a down payment.

If you plan on lending your child money for a down payment on a house, you should try to assume the role of a commercial lender. Setting the terms of the loan in writing will demonstrate to your child that you take both your responsibility as lender and your child's responsibility as borrower seriously.

While having an actual loan contract may seem too businesslike to some parents, doing so can help set expectations between you and your child. The loan contract should spell out the exact loan amount, the interest rate and a repayment schedule. To avoid the uncomfortable situation of having to remind your child that a payment is due, consider asking him or her to set up automatic monthly transfers from his or her bank account to yours.

This type of loan documentation is also important for IRS purposes because there may be potential income and gift tax issues with these types of loans. For example, interest paid by your child will be considered taxable income, and if adequate interest is not charged for the loan, special imputed interest rules may apply.

If you don't feel comfortable lending your child money, you may want to consider making a smaller, no-strings-attached gift that doesn't have to be repaid. Currently, you can gift up to $14,000 annually per person under the gift tax exclusion. However, if you do gift money for a down payment, your child's lender may still require him or her to put up some of his or her own money, depending on the type of mortgage chosen.

Keep in mind that lending money to family members can be a tricky proposition. Before entering into this type of financial arrangement, you should take the time to carefully weigh both the financial and emotional costs.

What information will I need before shopping for an auto insurance policy?

Shopping for auto insurance might sound like a drag, but it's important for you to have appropriate coverage in the event of an accident. Following are some guidelines to consider when purchasing your auto insurance policy.

- **Gather information.** Before you start shopping, compile key information about each vehicle you want to insure. This list should include the year, make, and model of each vehicle. Knowing your Vehicle Identification Number (VIN) may help you get a more accurate quote. Be prepared to answer questions about vehicle usage or special after-market equipment installed in your vehicle.
- **Decide what you need.** Whether you're purchasing auto insurance for a new vehicle or making changes to your existing policy, it's important to be familiar with the different coverages available to you. Maybe what you currently have doesn't meet your needs, or perhaps your premium seems to high.

  Bear in mind that there may be a gap between how much coverage your state requires you to have and how much you may actually need.
- **Shop around.** When selecting an insurer, ask questions. How long has the company been selling auto insurance? Does it have a good reputation? How is the company's customer service and claims handling? Is it able to provide the coverage you need at a price you can afford? Answering these questions could make it easier for you to shop for the policy that's right for you.
- **Ask about discounts.** You could be eligible for several discounts. These vary by state and company but may include discounts for multiple vehicles, anti-theft devices, and low annual mileage.
- **Compare quotes.** Once you have a collection of quotes, you need to compare them. Review each quote for information such as coverage levels, policy length, and price. This will help you attain the best overall value for your money as well as sufficient protection for your vehicle.

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