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Estate Planning Essentials For Thoughtful Parents

A lot of us avoid proper estate planning—until we have children. Then, suddenly, it's no longer optional. There are several steps you need to take for your kids' ultimate benefit.

First, if you don't already have a will, get one. If you die without one, state law will determine how your assets are distributed.

Next, consider trusts. The magic number is $2 million, the amount each individual can currently shield from federal estate tax. If your estate exceeds $2 million, you can use a credit shelter trust for asset protection purposes as well as tax savings. (The exemption will stand at $2 million through 2008, then jump to $3.5 million in 2009, though pending congressional action could change these numbers.)

Plotting trust strategies. Consider a couple, Jim and Jane. If Jim dies first, his $2 million exemption can fund the credit shelter trust, and the trust assets can eventually pass to the couple's children without estate taxes. While Jane lives, though, she can take income from the trust and even tap its principal. When Jane dies, her own exemption means that $2 million of the family's remaining assets can also go to the children estate-tax-free.

A second trust, the QTIP (for qualified terminable interest property) is often used in tandem with a credit shelter trust. A flexible tool frequently recommended for blended families, its main purpose isn't tax savings but asset protection.

In this example, the QTIP, created when Jim dies, could hold the assets in excess of the $2 million federal tax exemption that didn't go into the credit shelter trust. Jane gets to use the income from the QTIP any way she likes. But if she remarries, the QTIP can ensure that the assets from Jane's and Jim's estate passes to their children rather than to any she might have in a second marriage. The trust also protects Jane—and the trust assets—from potential creditors.

An Estate-Planning Checklist

As you draw up your estate plan, here are a few considerations:

- ✓ **Draw up a financial durable power of attorney that takes effect if you become incapacitated.**
- ✓ **Get a health care proxy and living will. Through the proxy, you designate an individual who can make heath care choices for you. The living will establishes the parameters for making those decisions.**
- ✓ **It's a good idea to have life insurance, especially if you have minor children. The policy could be owned by an insurance trust to keep the policy proceeds out of your estate.**

Designating a trustee. The trustee who manages your trusts can be anyone you designate—a family member, a friend, or an institutional trustee associated with a bank or other financial institution. If a trust has significant liquid assets—cash or

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Walking To And Through Those Golden Gates

Many of you are approaching or are in your retirement phase of life. With a plan in place and following that plan, you will have enough in savings to hopefully live comfortably for the rest of those years. Poor planning leaves many blindsided to risks that could change lives in the blink of an eye. This newsletter has a couple of articles on this topic, explaining how others are protecting themselves.

Another milestone in this phase of your life maybe that of a Grandparent. Read about some financial strategies that are geared for grandparents wanting to help their grandchildren. I know that this is of special importance for my parents since their first grandchild was born last year, my daughter Jenna.

Over the years we have received many great suggestions from you, our clients. We want you to continue sharing ideas with us. In the future we will be asking more questions of you, gathering that feedback to make your experience with FSA the best it can be. These ideas can be regarding our website or Schwab's, how you prefer your statements; email or paper, what you think of this newsletter (we are glad you are reading it!) and many others. Please let us know what works for you and is helpful and tell us what isn't working as well.

We hope you all have the happiest of holidays!

Jim Joseph
Client Relations Manager

Reality Blindsides Many Retirement Plans

Paul, 60, and Mara, 59, thought they were finally going to be able to save aggressively for retirement. Their kids were now out on their own and all their savings would go toward their needs. Then, tragedy struck. Paul was diagnosed with cancer. The couple's retirement plan was suddenly in peril.

While Paul and Mara are fictional characters, such tragic scenarios wreak real havoc on people's lives all the time. Job loss, divorce, the death of a spouse as well as a serious illness turn lives upside down.

Making matters worse, many people wait until later in life to earnestly save for retirement. Pre-retirees are thus often blindsided by life's harsh realities. In fact, there is new evidence that these blind-siding events happen far more frequently than you might think, and that they are causing severe financial distress.

In a recently-published study that tracked adults in their 50s and early 60s from 1992 to 2002, one in three suffered a medical problem that limited their ability to work. More than 10% became either severely disabled or entered a nursing home. About one-quarter had to care for a frail parent or in-law. And almost 10% of the married participants became widowed over the course of the study by the Center for Retirement Research at Boston College. In the study, 69% of the single participants and 87% of the couples experienced at least one "shock," such as loss of job or spouse.

What's even more worrisome is the decimating effect on wealth wrought by these personal disasters. (See accompanying table.) The damage is greater for unmarried individuals because they lack the benefit of a partner's resources, CRR researchers say.

The Cost of Unforeseen Risks

Estimated Decrease In Household Net Worth Caused By	Married Couples	Singles
Major Health Problem	17%	23%
Disability	16%	42%
Loss Of Job	21%	33%
Divorce	44%	
Death Of Spouse	13%	

Source: Boston College Center for Retirement Research, 2006.

Among study participants, 41% suffered a major medical condition such as cancer, stroke, or lung or heart disease, with men falling ill more than women and singles more than married individuals. Making matters worse, the cost of health care has been inflating 30% faster in recent years than prices generally. Even if you stay healthy, premiums for insurance rise with age. When a medical crisis arises, however, disposable income is often reduced sharply, leaving less cash to stash for retirement.

Job loss can also wreck a savings plan. Many middle-aged employees enjoy career-high salaries. Those who get laid-off (18.7%, in the study) are frequently forced to accept lower-paying positions. In addition, married individuals' wealth can be eroded when divorce or widowhood suddenly eliminates a second paycheck, other benefits, or the cost advantage of shared living expenses.

What can you do to shield yourself and your loved ones from being blindsided by life's harshest blows? Whether you are 22 or 52, it is important to save as much as you can, while you can—before circumstances rock your world. Yes, life is full of surprises, and they're not always pleasant. But by saving early and often, along with getting proper insurance coverage and creating an estate plan, you can be ready for the curveballs that are likely to come your way.●

Working Long Into Your Retirement Sounds Good In Theory,

It's the fail-safe option for people worried about their retirement nest eggs. A little short on savings? Just work a few years longer. That way, you not only get extra years to save, but you've also shortened the time you'll have to depend on the funds you've salted away. Yet according to a recent study, the reality for many retirees is exactly the opposite. Forced to leave work earlier than planned, they've been left to tap their savings for considerably longer than anticipated.

The survey, by consulting firm McKinsey & Company, found workers approaching retirement increasingly anxious about their prospects. These pre-retirees said they were "very concerned" about a broad range of issues. And their worries had risen sharply in just two years.

- In 2004, 28% said they were very concerned they would have insufficient guaranteed income during retirement; by 2006, that percentage had almost doubled, to 53%.
- In 2004, 15% worried about future cuts to Social Security; in 2006, 44% fretted about impending cuts.
- In 2004, 35% were very concerned they'd outlive their savings; in 2006, that worry plagued 46%.

The likelihood of working longer. Facing these concerns, almost half of those in the 2006 McKinsey survey said they planned to keep working past age 65. But that's more than triple the 13% of current retirees who have actually done that. On average, current retirees left the work force at age 59, while the average preretiree expects to stay on the job until 67.

Other surveys have found many baby boomers plan to work during retirement out of choice rather than economic necessity. Yet many retirees didn't choose to stop working, according to McKinsey. Some 40% were forced out, mostly because of health reasons (afflicting 47% of

Five Financial Ideas For Grandparents

Spoiling your grandchildren with extravagant gifts may be fun, but you're not really doing them—or yourself—any favors. Instead, it may be wise to look for ways that help grandchildren but that also make financial sense for all of you.

Your long experience handling money matters is one invaluable gift you can pass along. Sharing your savvy not only helps grandkids develop healthy financial habits but also to understand family and cultural values. So tell them about your first job, how you started a business, and financial goofs you've made, such as spending too much or getting suckered into bad investments. "There's a big legacy gap," says Nathan Dungan, author of *Prodigal Sons and Material Girls: How Not to Be Your Child's ATM*. "Grandparents aren't having these conversations with the grandkids."

But don't leave your own children out of the loop. Make sure your advice and giving strategies don't conflict with their plans or guidance for your grandchildren. Here are several ways you might help:

Leverage your gifts. A grandparent can now give as much as $12,000 a year tax-free to each child and grandchild. If you have a large family and make such gifts for several years, you could substantially reduce your taxable estate. But rather than simply putting cash in the grandchildren's pockets, consider creative alternatives. For example, you might open a custodial savings account for a grandson and match what he saves. Or you could establish a brokerage account and use your contributions to help your granddaughter learn about investing. But stick to broad mutual funds rather than individual stocks. Choosing the wrong stock could lead to deep losses and discourage your would-be Warren Buffett.

Take care of college. Setting up a state-sponsored 529 college savings plan for your grandchild brings benefits for both of you. Start early and kick in the annual gift-tax-free maximum, and your grandson or granddaughter should be in fine shape when tuition comes due. Money in 529 plans grows tax free and withdrawals for qualified college expenses aren't taxed, either. And if you want to accelerate giving, you can make five years' gifts—a maximum of $60,000—all at once. Moreover, because you control the plan, you don't have to worry about a spendthrift scion squandering the money. And if you didn't get around to starting a 529? Consider sending a tuition check directly to your grandchild's college. It won't count against your $12,000 annual gift-tax exemption.

Put a roof over their heads. First-time homebuyers often earn enough to qualify for a mortgage but lack cash for a down payment and closing costs. Your gift could make up the shortfall. But there are other options, too. You could make a low-interest or interest-free loan, though that may raise complicated tax issues. Or, if qualifying for a home loan is a problem for your grandchildren, you could co-sign a mortgage. Some financial companies offer programs allowing grandparents to pledge securities as collateral for a grandchild's mortgage, so you can lend a helping hand without the expense and taxes of liquidating personal holdings.

Guide with your gifts. One alternative to direct giving is to fund one or more type of trusts, which can be customized to fit many financial and personal situations. An incentive trust, for example, could be instructed to distribute funds to your grandchildren in installments, at specified points in their lives, and may tie payouts to your grandchild's accomplishments—reaching a certain income level, for example, or getting a college or graduate degree. But tread carefully, warns Dungan. "You need to help a grandchild develop healthy financial habits before trust distributions start," he says. And be careful about the kinds of hurdles you set up. "You want your grandchildren to be connected to their life passions, not yours, so don't strive for too much control," he suggests.

Encourage philanthropy. There are several options for helping your grandchildren learn the value of charitable giving, and many of these vehicles also offer estate tax advantages. For example, you could transfer assets from your estate into your own family foundation, though to be effective, a family foundation needs an initial commitment of as much as $1 million. Your grandkids could get involved by helping screen grant applications or serving on the foundation's board. A less expensive alternative is a donor-advised fund, which also lets grandparents and grandchildren confer about what charities to support. "This is like having your own foundation to support causes you believe in, but without the hassles and paperwork that go along with operating one," Dungan says. ●

But It May Not Always Be Very Realistic

those who quit early) or corporate downsizing (44%).

Other unrealistic expectations. If future retirees can't count on employment earnings, they could reduce spending, and that's what a third of pretirees questioned in the McKinsey survey said they planned to do. But just 10% of current retirees have been able to cut outlays significantly. And while 31% of those approaching retirement expect to improve their financial situation by moving to a smaller home or a cheaper area, only 7% of retirees have downsized. The one area in which expectations matched reality is in the use of home equity; 13% of future retirees expect to take a reverse mortgage or home equity loan, and 13% of current retirees have done just that. However, with savings dwindling, another 25% of retirees are thinking about borrowing against their homes.

The upshot of all this may be a simple if inconvenient truth: the best way to ensure a comfortable retirement remains prudent saving and investing. If you're concerned about whether your retirement plan is on track, call our office and we'll be happy to review your situation with you. ●

401(k) Diversification Is Now Easier

Today, many 401(k) retirement plans offer two distinctly different investment approaches. The first is the traditional method, by which you build a portfolio from a menu of relatively narrow mutual funds—specializing, say, in large-cap growth stocks, foreign stocks or government bonds. With the second, newer approach, you direct your 401(k) money into just one very broad fund whose managers handle all of the investment choices.

Which works better? According to a recent study conducted by Burgess Associates for John Hancock Retirement Plan Service, the all-in-one fund—often known as a lifecycle fund—is worth considering. From 2000 through 2004, Hancock retirement fund participants in lifecycle funds came out ahead of those with do-it-yourself portfolios by 3 to 4 percentage points. On average, the survey found, participants who didn't use the lifecycle funds would have had 17% more in their nest eggs at the end of the period if they'd adopted the single-fund approach.

Past performance is no guarantee of your results, but this new approach to 401(k) investing appears promising not only because it is easier but it also eliminates a major threat to your investment success: you.

A chief virtue of lifecycle funds is that they shift the burden of creating a well-diversified portfolio from you to the funds' professional managers. Professionals—not you—make asset allocation decisions based on your time horizon.

If you're 30 years from retirement, for example, you could invest in a fund designed for someone your age. At first, the fund's manager may invest a large proportion of assets in stocks, with just enough bonds and cash to keep volatility at a manageable level. But as you and the fund's other shareholders age and near retirement, the manager will adjust the investment mix, increasing the fixed-income allocations to lower volatility.

Leaving asset allocation decisions to the manager of such a fund can save you from your own worst investing instincts—the tendency to load up on stocks at the height of a market surge, say, or to move everything into bonds when equities are slumping. These portfolio managers can also make tough rebalancing decisions for you, moving a portfolio back to its target allocations when, again, that means selling hot assets or buying cold ones.

In another study, of participants in Vanguard retirement plans, the mutual fund giant found that while about 70% of plan assets were invested in stocks—a reasonable allocation, given retirement savers' long-term goals—some plan participants had less than optimum investment mixes. Some 13% had all of their money in bonds and other fixed-income securities, while 21% had all-stock portfolios.

Keep in mind, though, that lifecycle funds are intended to serve as all-in-one portfolios. The Vanguard study found that fewer than one in three investors had a lifecycle fund as the sole holding in a 401(k), which is the way these funds are meant to be used. Mixing the broadly diversified lifecycle fund with traditional funds that are more narrowly focused could lead to too big a bet in a particular area of the market, thus defeating one of the main reasons for holding lifecycle funds in the first place.●

Estate Planning Essentials

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securities worth $1 million or more—an institutional trustee may be the best choice. It's an institutional trustee's profession and duty to monitor the needs of the trust and its beneficiaries. While fees for an institutional trustee are often higher than an individual trustee, an institutional trustee offers the long-term stability of a corporate fiduciary.

If assets are less liquid—a family business, say, or real estate holdings—it's fine to appoint a family member or friend as trustee. Or you could name two trustees, perhaps a friend and an institutional trustee. That way, you take advantage of the institutional trustee's experience and expertise while the friend adds a valuable personal element when making distribution decisions.

If you have children under 18, you should also appoint a guardian who agrees to raise the children if you and your spouse both die.

Making distributions. We've all heard horror stories about trust fund babies and squandered assets. But there are ways you can help ensure a bright financial future for your children.

First, with the help of an estate planning attorney, spell out a distribution strategy that makes sense for your child. Usually, distributions are based on age, with a child receiving his or her full share of the estate at age 21, 25, or 30.

Increasingly, though, parents are considering another option: leaving the assets in the trust for the child's lifetime. This can protect the assets from worst-case scenarios such as a child's contentious divorce or a bankruptcy battle. With a lifetime trust, the child typically has a measure of control and can decide to replace the trustee. But requests for distributions normally must be made to the trustee. With minor children, the request comes from the guardian.

This setup also brings other tax and asset protection advantages. For example, instead of distributing $1 million from the trust to buy a new house, the trust can buy the house and let the child live in it. If the child is sued or divorces, no one can touch that asset. ●