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in this issue:

Life Insurance Solutions for Unmarried Couples

Unmarried couples face some unique financial and estate planning issues. While married couples typically use **life insurance** to provide funds to help replace income upon the death of a spouse, unmarried couples may have an even greater need for replacement income, since the surviving partner is ineligible for spousal benefits from Social Security and many **defined benefit pension plans**. In addition, both partners' estates may have a greater need for cash to help pay estate taxes because unmarried couples are not entitled to the **unlimited marital deduction** for property bequeathed to one another.

With proper planning, life insurance can provide cash to help meet both your needs as an unmarried couple. It also offers a way to provide for your partner beyond a **will**, which could be contested by family members.

Income Replacement

There are two ways to structure life insurance to help provide replacement income. You can either ***cross-own*** policies or own ***individual*** policies with the other partner named as the **beneficiary**.

Cross-Owning Policies. You each own a policy on your partner's life. When one partner dies, the surviving partner uses the death benefit proceeds to help provide income. Since the policy is owned by the surviving partner, not the deceased, it is not included in the deceased's estate and therefore, is not subject to Federal estate taxes.

To cross-own policies, you may need to demonstrate an **insurable interest**. Spouses are automatically assumed to have an insurable interest on one another. As an unmarried couple, be prepared to prove insurable interest with evidence of jointly owned assets and, possibly, copies of wills or **trust** documents.

Individual Policies with Partner as Beneficiary. You each own a policy on your own life, naming your partner as beneficiary. The surviving partner uses the death benefit proceeds to help provide income. However, since you each own your own policy, the proceeds are included in the deceased partner's estate and may be subject to estate taxes.

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The Basics of Financing Your New Home

If you are in the market for a new home, interest rates are favorable, and good deals are not difficult to find in many areas of the country. Buying a home is the single largest purchase most people will ever make, and for first-time homebuyers especially, the financing process can appear complicated. The following information provides you with some preliminary information to help understand how mortgages work.

The two basic mortgage types are **fixed rate mortgages** and **adjustable rate mortgages (ARMs)**. Deciding which is right for *you* depends on a number of factors, including the spread between the prevailing fixed and variable mortgage rates, the length of time you expect to own your home, the current inflation rate, and the tax savings you expect to receive from the home mortgage interest deduction.

Fixed Rate Mortgages

A fixed rate mortgage is characterized by an interest rate that remains the *same* for the life of the loan, consistent monthly payments, and a principal that will be fully repaid at the end of the loan. The total amount of interest you will pay on a fixed rate mortgage increases with the term, which generally ranges from 15 to 30 years.

One major advantage of a fixed rate mortgage is the certainty of knowing your monthly payments will not increase over the life of the loan, even if interest rates rise. On the other hand, the major disadvantage is that if interest rates drop, your monthly payment will not decrease. The only way you will be able to take advantage of a drop in interest rates is to **refinance** the loan, which may or may not be costly, depending on rates at the time.

Adjustable Rate Mortgages (ARMs)

An adjustable rate mortgage carries an interest rate that a lender can *vary* during the loan term. ARMs are designed to shift the risk of rising interest rates from the lender to the borrower. To offset the increased interest rate risk, ARMs usually offer borrowers a lower rate—compared to a fixed rate mortgage—during the first year. If you are considering an ARM, you will probably encounter the following terms:

- **Index.** An index is a benchmark used by a lender to adjust an ARM's interest rate. Commonly used indexes include the rate on U.S. Treasury securities and the average cost of Federally-insured savings and loan funds.
- **Margin.** Also called the "spread," which is the amount a lender can add to the value of the index specified in the loan agreement.
- **Initial Rate and Adjusted Effective Rate.** The initial rate is the interest rate at the start of the mortgage. It is typically lower than the amount you would owe on a fixed rate mortgage. Very low initial rates called "teasers" are designed to persuade you to enter into the loan.

  The adjusted effective rate is the rate you pay when the adjustments kick in. It is calculated as the value of the index specified in the loan agreement plus the margin. For example, if the index value rises to 8% and the margin is 2%, the adjusted effective rate is 10%. (The adjusted effective rate is not the same as the **annual percentage rate (APR)**, which includes the points levied on the mortgage.)
- **Adjustment Period.** Mortgage payments or interest rates may change every six months, annually, or every three years, according to the length of the adjustment period.

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Saving Tips for Younger Adults

Today, younger adults face a variety of challenges in their pursuit of financial independence. Some of these challenges are similar to those faced by previous generations, while others are unique to the times. Here are five financial tips to help you manage your personal finances and prepare for your future:

1) **Invest in your future.** Rapidly changing technology used in various fields may require continuing education. You may wish to make ongoing education a priority to enhance your skills and increase your professional potential. The more varied and flexible your skills, the more you will have to offer to prospective employers.

2) **Open an emergency savings account.** The uncertainty of the workplace may mean that your professional life will be interrupted by career changes. If you need to return to school to change career paths, you may experience periods of time without steady income. Creating an emergency fund to cover at least six months' worth of living expenses can help you manage work-related transitions. This savings fund may also be used for other endeavors, such as starting your own business.

3) **Save early and continuously for retirement.** Saving for retirement is *your* responsibility. The more disciplined and diligent you are, the better off you may be. Social Security provides only a base level of income, and many employers no longer offer traditional pension plans. With employer-sponsored **401(k) plans**, the responsibility of saving rests on your shoulders. Although you may be years away from retirement, the key is to make *time* and *compound interest* your allies.

4) **Let retirement funds accumulate.** If you change jobs early or often, consider rolling over your employer-sponsored retirement plan funds into an **Individual Retirement Account (IRA)** or new company retirement plan. It may be tempting to cash in the account, especially if you have accumulated only a small amount, but doing so would make it immediately taxable, and you may also incur an early withdrawal tax penalty. Perhaps a greater concern, however, is that you may be unable to make up for time already spent to accrue these savings.

5) **Use credit wisely.** Credit card companies frequently target young adults with the lure of "easy money." While credit cards offer convenience (it is virtually impossible to conduct some transactions, such as reserving airline tickets, without one), they also have the potential to create debt problems. Because payments can be extended far into the future, overspending on credit can create an illusion of wealth. Paying off the full balance each month is the best way to manage your use of credit.

Plan Now for the Future

Remember, the funds you accumulate during your working years may be your *primary* source of retirement income. Although inflation can erode your savings over time, a little discipline and common sense may help you better manage your current and future personal finances.

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- **Caps.** ARMs may include several kinds of caps. A **payment cap** limits the increase in monthly payments at each adjustment period. An **interest adjustment cap** limits the amount by which the interest rate can rise or fall at each adjustment period. A **lifetime interest cap** limits the maximum interest the lender can charge during the loan term. A **lifetime payment cap** limits the percentage by which principal and interest payments can increase during the loan term.
- **Negative Amortization.** Negative amortization occurs when your mortgage payment is less than the amount necessary to cover the interest on the loan. As a result, the unpaid interest is added to the loan principal. The loan agreement may cap the amount of negative amortization allowable.

Understand Your Options

There is no "right" way to finance a home. All financing arrangements involve trade-offs. The more informed you are about your options, the better equipped you will be to arrange a mortgage that suits your needs.

Liquidity and Your Estate

One important goal of estate planning is the proper preparation to help minimize the financial burden and emotional stress on loved ones who may be responsible for and reliant upon the administration of your estate. Building **liquidity** into your estate plan can help to ensure that resources will be available to cover estate settlement costs, as well as any tax due.

Liquidity refers to the ability to quickly and easily convert assets into cash without incurring a significant loss. Funds in a checking account are considered liquid assets, while real estate would be considered relatively illiquid. If your estate must sell illiquid assets to meet immediate cash needs, it may be forced to do so at a significant loss. In addition to the financial consequences, such forced sales are often difficult for heirs, particularly if it means the loss of a family business, heirloom, or home.

Anticipating and planning for the following expenses can help ease the estate settlement process:

- Final medical expenses
- Funeral costs
- Outstanding bills
- Existing debts
- Income taxes (and any accounting fees)
- Appraisal fees
- Federal and state estate taxes
- Attorney fees

Be sure to consult an estate planning team comprised of an attorney, tax advisor, and financial professional to help you develop the appropriate strategies for your situation.

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Cash to Pay Estate Taxes

Married couples qualify for a special tax break—the unlimited marital deduction—that allows them to transfer unlimited assets to each other during their lifetime, or at death, free of gift and estate taxes. Since unmarried couples are not eligible for this deduction, the value of any property you leave each other above the applicable exclusion amount may be subject to Federal estate taxes. Some states also levy estate taxes. Life insurance provides cash that can be used to help pay estate taxes. You can either cross-own policies or create an **irrevocable life insurance trust**.

Cross-Owning Policies. With cross-owned policies, you each purchase insurance in the amount of the estimated taxes. As already mentioned, one advantage of this approach is that you each own the policy on your partner's life. Consequently, the proceeds are not included in your partner's estate.

Irrevocable Life Insurance Trusts. With irrevocable life insurance trusts, a **trust** buys and owns the life insurance policy, and each insured furnishes the trust with the funds to pay the premiums. However, irrevocable trusts must be structured properly to avoid adverse tax consequences. They are costly to set up, and as the name implies, they cannot be revoked if circumstances change in the future.

Life insurance has long provided a valuable solution for married couples who may need cash to help replace income and pay estate taxes at the death of a spouse. As an unmarried couple without the legal protections of marriage, your need for cash at the death of a partner may be even greater. As with all estate planning concerns, be sure to work with an estate planning team, including your personal legal or tax counsel, to discuss your particular needs and to help ensure all arrangements are structured properly.