February 1997 Volume 2.1

BFAS Money Line

DEBT

Don't Use Negative Equity Loans

There is a great deal of hype these days on solving the nasty problem of too many bills by rolling them into a negative equity home mortgage. The argument is that you can consolidate your bills, many at 18 - 21% interest (non tax deductible), pay less due to a lower interest rate (generally 14%) and a longer pay-back period while making it tax deductible.

This seductive argument, while reducing monthly payments, has people mortgaging their house to 125% of the home's value and paying off their Christmas gifts and restaurant bills over 20 years at 14%.

It does nothing to resolve the basic budgeting problem which led to the problem in the first place. **This seemingly painless solution to living beyond your means leaves you in great danger of foreclosure in the event of a recession/loss of job.** Who wants to write a check to sell your house?

In addition, you cannot deduct mortgage interest on the

portion of a loan greater than the home's fair market value.

Folks, the best advice is to take care of debt the old fashion way. Don't get into debt, pay it off as fast as possible and shop for the lowest interest rates. Negative equity loans are hazardous to your financial health.

PENSION PLANS

Studies show 89% of companies with less than 25 employees have no pension plan. In response to the low rate of pension savings by small businesses, Congress recently enacted new options: SIMPLE IRA and 401(k). At the same time, no new SARSEPs can be started after December 31,1996 (contributions can continue to existing SARSEPs).

While larger companies may have a 401(k) plan, the cost of establishing and maintaining them for many self-employed persons or small businesses made traditional plans too expensive.

Some reports I have read indicate the SIMPLE 401(k) may not be much of an advantage over the regular 401(k), however the SIMPLE IRA seems to be an option well worth considering.

With relatively easy administrative requirements, the SIMPLE IRA requires some matching of employee pension payments (up to 3%), but allows up to $6,000 in pre-tax pension payments.

A sole proprietor making $40,000 per year could put $6,000 into a SIMPLE IRA invested in mutual funds with very limited costs or reporting requirements and no discrimination testing. In addition, the proprietor's spouse could work for the company and also put $6,000 (plus $180 due to 3% match) into the plan on a salary of, say, $8,000. Thus over $12,000 could be put into pension plans! Contributions are not based upon a percentage of income.

Several companies are just now coming out with their plans. Vanguard, a low cost company, expects no fees on SIMPLE IRAs. Fidelity says no charge this year, $350 per year thereafter. Both companies allow purchase of mutual funds with no loads. Beware of other companies with low annual fees and loaded funds.

A 5% load on a $6,000 investment is $300!

HEALTH INSURANCE

Many of you with small businesses will want to evaluate the new Medical Savings Accounts. In MSAs, you purchase a high deductible insurance policy and contribute the deductible amount (before taxes) to an MSA account.

You spend the MSA account on your regular medical bills. What is not used is left to grow tax deferred to be used for future health care costs or withdrawn at age 65 as retirement income.

What should be of significant interest is that you can use MSA account money for non traditional health care costs: dental costs, orthodontics, acupuncture, etc.

Since you are spending your own money, you have a self-interest in shopping for the best deals. This helps you and puts cost pressures on the whole system.

Beware that MSAs are available only on a 3 year trial basis. If 750,000 are set up this year, they may not allow any new MSAs in 1998. I recommend you evaluate the tradeoffs of MSAs versus your current plan now. Waiting could leave you out in the cold.

RETIREMENT

How much can you withdraw?

Most people lock their money in fixed income investments and expenct to live off of the interest or dividends. The problem with this solution is inflation. How quickly we forget just 15 years ago the impact of 10% plus inflation with your investments earning 5 - 6%.

Everyone should have some portion of their retirement funds invested in stock mutual funds (U.S. and international) because these are the only assets which consistently beat inflation.

Even if you have done this, how much can you safely take out (remembering you need more income every year to make up for inflation)? The numbers vary depending upon inflation and portfolio returns, but generally 4% seems to work well to average out the up and down economic cycles.

Everybody's situation is different, but if I wanted to be sure I would not outlive my retirement funds, I would plan on only withdrawing 4% per year. Think about it!

TRAVEL

Planning your summer vacation already? Have you considered whether your health insurance covers you while over seas? many people neglect are those items that don't pass by will.

Sure, you say, I know that my joint checking and savings accounts revert automatically.

But, what about your life insurance (especially the group term at work), your 401k or IRA pension funds. Does your will determine who gets them? NO!

These assets pass according your beneficiary designation, not your will. So those who changed their wills and figured they were done, not so fast! Go back and make sure every beneficiary is the one you want to receive your asset.

For those who inadvertently left an ex-spouse as beneficiary, Virginia has a law

which says ex-spouses would be treated as if they had died before you. In this case, the contingent beneficiary would become the primary beneficiary. Do you know who your contingent beneficiaries are?

Thus, if you really plan to leave some asset to your ex-spouse as a primary beneficiary, you need to consult your attorney to make sure you use the correct language.

LIFE INSURANCE

Secrets of Low-Load Life Insurance

Low-load life insurance is a unique new type of policy that's often less expensive than conventional policies. It's wise for you to know how they work. Low-load policies can take any form, including universal life, variable life,

whole life and term. But what's different about a low-load policy is that it can only be purchased directly from an insurance company or through a fee-only advisor. The insurer pays no sales fees to anyone when you buy this product.

With no sales commissions to be made, low-load life's remained a well kept secret even though it's been around for about 10 years. So here's a brief description of low-load life insurance.

Every life insurance policy carries loads. Loads are fees for the administrative expenses of maintaining a policy, mortality charges and sales commissions paid to whomever sells you the policy. One of the biggest loads on a life insurance policy is the cost of acquiring you as a customer – the cost of brochures, mailings, telemarketing, advertising and, of course, paying commissions to agents.

On a traditional policy, the cost of acquiring you as a customer is greater than your entire first year's premium. But the cost of acquiring your business on a low-load policy is well below a first-year premium.

Think of low-load as buying wholesale, like shopping at a warehouse versus the full-priced retail chain. With no agents to pay, an insurer can make the same profit on a low-load policy as on a traditional one while charging you less.

One important benefit on a low-load policy is that you get a higher immediate cash surrender value. This provides two advantages: First, if tax laws or your personal situation change, surrendering or exchanging your low-load policy is much less painful. Second, a higher immediate cash value on your policy gets the magic of compounding working for you sooner; starting with more cash working for you from the beginning, logically means accumulating more over 20 years.

A report in the April 1995 *Best's Review* examining the five-year performance of 114 universal life policies found that the three best were low-loads.

Another benefit of low-load policies is that they remove the chance that an agent will sell you a policy because it has the best commission pay-out. While the majority of agents are honest and reputable, low-load policies remove conflict of interest problems.

The main drawback with low-load insurance is that it's underutilized. Not enough customers feel comfortable making decisions about life insurance on their own and buying direct. And while fee-only advisors have become the fastest growing segment of the financial advisory industry, as more consumers seek objective advice, we're pretty rare. The result: fewer than 20% of insurance companies offer low-load product.

Another caveat on low-load life: some traditional policies can be less expensive and may perform better over long periods. That's something that has to be analyzed when examining policies. Traditional policies can't always be ruled out because there are times when they are the best solution.

In choosing a fee-only advisor, one of the big benefits you get is objectivity. My goal is to make sure that you buy the best insurance policy for your particular situation at the best price. Whether the policy is low-load or agent-sold isn't that important, as long as it's the best product for you!

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