The Financial Navigator - May Newsletter

Welcome to the May edition of the Financial Navigator. Since it is commencement season I wanted to touch on a few topics relevant to financing a college education. In this issue we discuss:

1. College 529 Plans.
2. Financial Aid Basics.
3. Is Life Insurance a Sensible Education Savings Vehicle?

As always, please feel free to forward this newsletter, or to unsubscribe follow the link at the end of this email.

Sincerely,
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College 529 Plans

Recent developments in the 529 plan market caught my eye so I thought it would be timely to discuss these college savings vehicles. The state of Oregon is suing Oppenheimer Funds charging the NY money manager with understating the risk of the bond fund it provides in the state's 529 plan which suffered significant losses in 2008. In a related matter, investors in other state's 529 plans experienced considerable account decreases in purportedly conservative 'age-based' 529 plans.

What is a Section 529 plan? These are investment plans that allow individuals to invest funds for college. The investments grow tax-free and can be withdrawn tax-free to pay for qualified education expenses; generally tuition, fees, and on campus room & board. Age-based 529 plans allocate your investments to US stocks, international stocks, bonds, cash, and real estate to create a more aggressive, or riskier, portfolio the further away the student is from starting college. As the child ages the fund manager reduces the risk profile by moving funds from riskier assets to conservative assets classes such as bonds and cash. For example, a child 1-5 years old may be invested in 100% stocks, while a child 16-18 might have a portfolio consisting of 20% stocks with the remainder in cash and bonds.

The problem is that many age-based 529 plans were invested much more aggressively than was probably prudent, and certainly more so than many parents of children near college age expected. Nationwide there are 3,506 plan options, 93% of them decreased in the past year with 1,100 losing 40%. The stock market was down 43% over the same period, so this is not unexpected, but some age-based plans suffered significant losses in accounts designed for children nearing, or in college. For example, the North Carolina plan had up to 43% of a college student's account in stocks. Rhode Island's aggressive age-based plan had a college age student's portfolio invested up to 40% in stocks with only 5% in cash.

Concerning the Oregon 529 plan, Oppenheimer provided a Core Bond Fund that was promoted as a conservative bond investment when in reality it invested in risky derivative securities and bonds. As a result the fund lost 36% in 2008 while its comparable bond index gained 5.2%.

What you should do - understand how your child's 529 plan is invested. These plans can be a great way to save tax-free funds for college, but you need to assess whether the plan is invested appropriately for your child's age, your risk tolerance and financial situation. Information on your 529 plan's holdings

can be found at the plan's website. Another good resource is www.savingforcollege.com, where you can get information and plan ratings on all the available 529 plans.

Financial Aid Basics

I recently met with a college planner that works with parents and students to navigate the college application and financial aid process. He mentioned how difficult it is to help parents plan, from a financial aid perspective, when they come visit him for the first time in December of the student's junior year. By then it is too late to do much planning to maximize financial aid as institutions and the Federal Government look back at your finances the year before the student starts college (some private institutions look back two years). Therefore, when applying for financial aid the student's junior year is critical in terms of your income and how your assets are titled.

How financial aid is determined - to obtain financial aid from either the government, or the institution, you will need to fill out the FAFSA (Free Application for Federal Student Aid) form each year. It is used by almost all entities that give out student aid. A term that you will encounter in the FAFSA is the **EFC – Expected Family Contribution**. This is basically the amount the family is expected to pay before financial aid is available. In general, the formula for computing EFC counts the following financial resources as being available to pay for college:

- **35%** of a student's assets.
- **50%** of a student's income.
- **2.6% - 5.6%** of a parent's assets.
- **22% - 47%** of a parent's income.

It is important to note that certain assets have a more favorable status in that they are not included, or are minimally included, in the EFC calculation. Some of these assets are:

- Retirement plans, IRAs, 401(k)/403(b) plans, whether owned by parent or child are generally not counted.
- The equity in your home (at most public institutions and some private), insurance policies, and annuities, do not count towards the EFC.
- Only up to 5.6% of a 529 plan or Coverdell Education Savings Account (ESA) value is included in the EFC.
- Grandparent owned Section 529s and ESAs, in general, do not count towards EFC.

What you should do - early planning is critical, so start serious planning in the student's sophomore year if college is likely. If your child's grandparents are planning on contributing to a college fund have them keep any assets they want to contribute in their name so the funds won't be counted in the EFC.

Is Life Insurance a Sensible Education Savings Vehicle?

It has become evident that many insurance companies promote Variable Life (VL) and Variable Universal Life (VUL) insurance as a college savings plan because the value of the policy is sheltered from the financial aid analysis, i.e. kept out of the EFC calculation. In fact many insurance firms push life insurance as preferable to 529 plans because 5.6% of 529 plans can be included in the EFC.

For a minority of the population there may be benefits to VL and VUL policies such as; the funds are sheltered from the EFC, funds grow tax free, there are no limits to the amounts you can invest, and one can withdraw or borrow contributions tax-free without penalty.

The disadvantages - for most people, the benefits are far outweighed by the disadvantages of these policies, especially when it comes to college savings and when compared to other college savings plans. These include high commissions, high ongoing insurance expenses, high investment expenses, reduced death benefit from any withdrawals, and surrender charges may penalize early withdrawals.

The bottom-line - 529 plans and Education Savings Accounts provide the best return for the buck for the vast majority of investors. So if an insurance salesman promotes life insurance as a college savings strategy, take a step back and consider whether he is doing it for the hefty commission, or if it really is the right solution for you. A more detailed discussion can be found at www.finaid.org, under the Savings link.

For more information on these topics and more contact Azimuth Financial Planning at (603) 373-8793. Ask about our Rapid Assessment, a financial plan targeted specifically at your retirement and investment goals and focused to get you back on track.