BACK BAY FINANCIAL GROUP

HELPING CLIENTS BUILD AND MANAGE WEALTH ™

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THE BACK BAY ADVISOR

Protecting Your Earning Power

You probably have life insurance to protect your family's lifestyle in case you die prematurely. But have you considered how your family would cope if you were unable to work for a lengthy period due to illness or injury?

Only 28% of workers have some form of disability insurance (Source: *SmartMoney*, July 2005). Many people ignore disability coverage, hoping they won't be affected by a disabling injury or illness. However, the Society of Actuaries indicates that an adult has a one-in-seven chance of dying before age 65, but a one-in-three chance of being disabled for at least three months.

Consider disability insurance if your current assets won't support you until age 65. To see if this is the case, review your available options. Determine how much you need monthly to pay essential expenses and what income sources you could count on if you couldn't work. Review the following questions to determine if you have adequate coverage in this area:

Will Social Security provide disability benefits? The criteria for benefits are very strict — you must be unable to work at any job, expect to be completely disabled for at least one year, and have contributed to the Social Security system for a sufficient length of time. Approximately 37% of those who apply qualify. Even if you do qualify, benefits tend to be modest. As of June 2006, the average disability benefit was $943 (Source: Social Security Administration, 2006). Your annual Social Security Statement indicates what disability benefits you can expect.

Does your employer provide disability insurance? Many companies provide short-term disability insurance, which covers 100% of your salary for three to six months. Long-term disability insurance is typically less common and less generous than short-term plans. Policies frequently have strict definitions of disability, pay no more than 60% of your base salary (bonuses and profit sharing generally aren't included in benefit calculations),

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Coping with Long-Term-Care Costs

Life expectancies have increased significantly and are expected to continue to increase in the future. As people age, they are more likely to develop conditions that limit their ability to live independently. However, it is estimated that only 5% of people between the ages of 45 and 64 have purchased long-term-care insurance (Source: *Employee Benefit News*, January 1, 2006).

How likely is it that you'll need long-term-care insurance? It is estimated that 69% of individuals age 65 and older will need some type of long-term care, with 37% entering a nursing home (Source: *The Wall Street Journal*, February 22, 2006). Those entering a nursing home face an average stay of 2 1/2 years, with an average annual cost of $74,000 (Source: *Investment News*, October 10, 2005).

Who needs long-term-care insurance? If your assets, not including your home, equal at least $2 million, you can probably fund long-term-care costs with those assets, although you may not want to deplete your assets for this care. Those with very few assets will probably be covered by Medicaid. It is the people between these two extremes who should consider long-term-care insurance. This coverage may be especially important for women, who tend to outlive their husbands.

If you're considering long-term-care insurance, review these points:

- **Purchase the insurance at a relatively young age.** You should probably purchase the insurance by the time you are in your 50s or early 60s. After that, the premiums get much more expensive. Also, if you develop a serious health condition, you may not be able to purchase the insurance.
- **Check for inflation provisions.** Since you may not receive benefits for many years and costs for long-term care have been increasing significantly in recent years,

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Your Earning Power

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pay benefits for only two to five years, and don't provide cost-of-living adjustments.

Do you want to use other personal assets? You can access individual retirement accounts, annuities, or 401(k) plans without penalty if you are disabled. But first decide whether you want to risk depleting your retirement fund or children's college fund due to a disability.

How much of your income should disability insurance replace? You should ensure that your available resources and benefits from disability insurance equal at least 60% of your pretax income. Many insurers limit coverage from all disability policies to 60% to 70% of your salary to provide an incentive to return to work. Make sure the total of your employer-provided insurance and individual coverage does not exceed the maximum that will be paid, or you could end up paying for coverage you won't receive. Insurers typically require documentation of income and may limit the maximum monthly benefit.

Are there any significant differences between employer-provided insurance and individual policies? You typically have no choice regarding the benefits offered by your employer, while an individual policy can be tailored to your needs. The most significant difference, though, is the tax treatment of any benefits. If premiums are paid by your employer, benefits are taxable. If you pay the premiums, benefits are tax free. This will have a significant impact on the amount available to pay your bills. It may make sense to reimburse your employer for the cost of this insurance so any benefits will be tax free.

What provisions should you look for in a disability policy? There are several provisions you should pay special attention to, including:

- **The definition of disability** — There are three basic types of coverage — own occupation, any occupation, and income replacement. Own occupation pays benefits when you can't work at your specific occupation. Many professionals, such as doctors and lawyers, opt for this coverage. However, due to substantial claims, this coverage is now more difficult to obtain. You may only be able to find own-occupation coverage for a specified period, with the policy then converting to any-occupation coverage. Any-occupation coverage means you must be unable to work at any occupation your training and education would be suited for. Income replacement policies pay the difference between what you were earning before the disability and what you are earning now.
- **Noncancelable or guaranteed renewable** — Noncancelable means you can renew the policy every year at the same premium. Guaranteed renewable means you can renew the policy every year, but the premium can increase as long as it is not done so in a discriminatory manner. Either provision will ensure the policy won't be canceled due to medical problems.
- **Waiting period before benefits begin** — If you have other resources to rely on for the short term, such as sick leave, personal savings, or short-term disability coverage, you can increase the waiting period to reduce premiums. Waiting periods can range from one week to two years, but the most common option is a 90-day delay in benefits.
- **Length of benefits** — Disability insurance is designed to protect your financial situation in the event of a serious disability, so coverage should last for the long term. You can obtain lifetime benefits, but you may only need benefits until age 65, when presumably you could collect Social Security and other retirement benefits.

Please call if you'd like to discuss your need for disability insurance in more detail.

Review Your Personal Liability Coverage

A personal liability umbrella policy increases the liability coverage of your homeowners and automobile policies. It also expands coverage to include damages caused by nonowned property in your possession and suits for libel, slander, defamation of character, or invasion of privacy. The policy also pays attorney fees to defend you against claims covered by your policy. Thus, even if you carry high limits on your homeowners and automobile policies, you should consider an umbrella policy.

Your homeowners and automobile policies will typically cover you for personal liability of anywhere from $100,000 to $500,000. However, if a judgment in excess of that amount is awarded against you, the amount in excess of your insurance limits will have to be paid personally, unless you carry personal liability insurance.

You may not consider an umbrella policy because you think your actions would never necessitate the need for this coverage. However, liability can arise from auto-related accidents or accidents on your property. Liability awards are typically based on the severity of the plaintiff's injuries, not on whether you intended to harm the person.

Umbrella policies can be purchases in increments of $1 million. They are designed to kick in once the limits of your homeowners and automobile policies are exceeded, so you'll be required to maintain certain limits on those policies. Umbrella policies don't cover intentional acts or damages resulting from a business, even a home-based business. Separate coverage is required for business risks.

Long-Term-Care Costs

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check inflation protection in your policy. Another option is to make sure your policy contains an annual renewal option, so you can buy additional coverage in the future.

- **Obtain insurance from a stable insurance company.** You want to obtain insurance from a company that is sure to be around for the long term.
- **Make sure the policy terms are reasonable.** Many people choose a benefit period of three years to cover the average nursing home stay. However, due to the substantial costs associated with long-term care, you may want to select a longer period. Benefits should be paid in as many situations as possible, including skilled care, intermediate care, custodial care, home health care, and adult day care. Review the waiting period carefully to ensure a good balance between premium costs and out-of-pocket costs.
- **Review carefully the level of assistance needed to qualify for benefits.** Typically, benefits are paid when you are unable to perform two of six activities of daily living, including bathing, eating, using the bathroom, moving back and forth from a chair to a bed, and remaining continent. Typically, benefits are also triggered when a cognitive impairment, such as Alzheimer's disease, requires substantial supervision.
- **Determine how benefits are paid.** Some policies pay a set daily amount, regardless of your actual costs. Other policies will only pay your actual out-of-pocket expenses up to a daily limit or reasonable and customary costs. Find out how you prove you're entitled to benefits. Some plans require an in-house doctor to review your health, while others allow your own doctor's review.
- **Consider sharing a policy with your spouse.** Some companies now offer policies that allow spouses to share the policy, with a variety of options available.
- **Check the policy's tax status.** A qualified policy allows you to deduct a certain percentage of the premium, depending on your age, as a medical expense on your tax return. Medical expenses are deductible to the extent they exceed 7.5% of your adjusted gross income. Also, payouts from qualified policies are received free from federal income taxes.

Please call if you'd like to discuss your options for dealing with long-term-care costs.

Life Insurance and Estate Planning

One of the more common reasons to own life insurance is to help fund estate taxes after your death. If the policy is properly structured, the proceeds will not be included in your taxable estate and your beneficiaries will not have to pay federal income or estate taxes. However, with the eventual repeal of the estate tax in 2010, you may wonder whether you still need life insurance for estate purposes.

Keep in mind that the estate tax repeal may not be permanent. Due to the sunset provisions of the current tax law, the estate tax will be reinstated in 2011, based on 2001 tax laws, unless further legislation is enacted.

Even if the estate tax repeal becomes permanent, there are situations where the use of life insurance may be an appropriate estate planning strategy:

- **To provide liquidity after your death** — If your estate consists primarily of illiquid assets, such as real estate or a business, you may want to use insurance to provide funds to your family so they won't have to sell or mortgage assets.
- **To equalize inheritances** — Perhaps your primary asset is a family business, which is run by one of your children. You may want to leave the business to that child, but need additional funds to equalize the inheritances of your other children.
- **To transfer wealth to heirs** — Even if the estate tax is permanently repealed, life insurance proceeds still retain their income tax advantage — proceeds are paid to beneficiaries free of federal income taxes.
- **To leave a large contribution to a charity** — You may want to leave a large charitable contribution to a charity without depleting assets left to heirs.
- **To help heirs fund future tax liabilities** — After the estate tax is repealed, inherited assets will no longer receive a step-up in basis to market value at the date of the decedent's death. Instead, inherited property will generally have a basis equal to the lesser of the decedent's adjusted basis or the property's fair market value at the date of the decedent's death, with certain adjustments. If you leave substantial assets with low bases to heirs, they may face significant future tax liabilities. You may want to help them with those tax liabilities through the use of life insurance.

If you'd like to discuss the use of life insurance for estate planning purposes in more detail, please call.

News and Announcements

As we reflect on our accomplishments for 2006, Back Bay Financial Group is pleased to mark its tenth year serving clients. At the 10th Anniversary celebration at the Colonnade Hotel, Bob Siefert and John LeBlanc gave moving and thoughtful presentations about the values of the company and its vision. Our technical consultants created a video entitled *BBFG: The First Ten Years* for the celebration, and highlights of the anniversary are available on our web site.

We enter our eleventh year with more than $300 million in assets under management. In preparation for 2007, the entire staff met for a half-day planning meeting at the end of November to set goals for the upcoming year. As part of our year-end activities, Bob and a team of BBFG employees are visiting selected charities and non-profit organizations for the Back Bay Financial Group Charitable Gift Fund's annual donations.

BBFG will move forward in strengthening systems and operations to streamline client interactions, along with implementing new best practices in our business. Ed Childs continues our efforts with portfolio management, and in October, we mailed investment reports to our retained clients using the new system. He is training Mandy Magee on the trading operations side of the business. Ed is also working with Becky Martz and David Young to develop a secure, client-only area of the web site.

BBFG has been enhancing its office environment and human resource systems. We have finished upgrading both conference rooms with computer access that can be used for remote meetings with clients and internet-based training sessions. The advisors recently used this tool to hear famed author, lecturer, and advisor, Roger C. Gibson, discuss his theories on asset allocation and risk.

Lindsay McDonald, one of our summer interns, has been hired as a full-time Administrative Assistant. John, Mandy, and Emily O'Hara participated in the Financial Planning Association Career Fair at Bentley College to visit with prospective candidates for the position of Financial Planning Assistant.

Our Wealth Managers are available to present financial planning concepts to community, business, and educational groups. Jeanne Gibson Sullivan and Susan Brown gave a seminar on basic financial planning to the Mount Holyoke Alumnae Club of Boston, covering concepts from basic budgeting and saving, estate planning, and investment allocation. Jeanne also did a seminar for a Reading, Massachusetts, elementary school PTA on saving for college.

In addition to its community involvement, BBFG stays current on wealth management trends. Bob spent two days in early December in northern New Jersey with his study group. Bob and three other members of the group also attended a three-day symposium co-sponsored by Boston University and the Federal Reserve Bank of Boston. This meeting drew an international audience of academic researchers, government agencies and practitioners on life-cycle savings and investing. Participants discussed research on financial sustenance during retirement and debated the challenges associated with the demise of the traditional pension plan. This dynamic event was unlike a typical industry conference, allowing attendees to listen, interact, and debate with Boston Federal Reserve Bank CEO Cathy Minehan and Nobel Laureates Paul A. Samuelson and Robert Merton.

John traveled to Chicago in September to join six owners of similarly sized fee-only firms to form a study group that will exchange ideas about their practices, technology, business trends, and personnel needs. These two-day meetings will be held at various locations throughout the country. The next meeting is scheduled for February to coincide with the National Association of Personal Financial Advisors (NAPFA) Advanced Planner Conference.

Philip Lee and Bob attended the annual Schwab IMPACT conference, which brought together the nation's leading independent investment advisory firms. Keynote speaker Alan Greenspan gave his thoughts on economic history of the last few decades. John Cochran, a well-known political journalist, spoke on the outcomes of the historic midterm elections. A major theme of the conference was the design of portfolios during retirement years with an emphasis on income needs diversification. Bob met a number of portfolio managers whose funds we are considering adding to our company's select list.

Phil and Susan attended a NAPFA study group meeting to hear about Social Security benefits and estate planning related to the 2006 Pension Act. Susan and Emily attended the NAPFA Northeast Regional Conference in Bethesda, Maryland, to participate in seminars on topics ranging from Health Savings Accounts and college planning to financial planning trends. Jeanne went to the Financial Planning Association national conference in Nashville, Tennessee, and attended sessions for generating income in retirement while preserving assets.

BBFG employees are just as busy outside of work. David is volunteering at Madison Park High School in Roxbury to teach a 20-week program on economics, jobs, and financial aid for the Junior Achievement program. Phil attended his 20th college reunion at Kalamazoo College in Michigan and a family gathering in Ohio to celebrate the 100th anniversary of the Lee family farm. Mandy hosted Thanksgiving in Melrose for 17 people. She and Emily saw Christina Aylward compete in the New England Irish Dance Championships. Christina also competed in the Federal Reserve Challenge as a member of the Boston College team, placing first in New England and second at the national level in Washington, DC. The purpose of the competition was to build and present recommendations for Federal Reserve monetary policy. Becky traveled to Arkansas and to a wedding in Nashville, Tennessee, that was held in the Country Music Hall of Fame. Francis Sellers and his wife, Marianne, visited Disney World and SeaWorld in Orlando, Florida, and had great fun swimming with dolphins at Discovery Cove with their grandchildren. They also went to North Carolina for their annual Thanksgiving visit.

BBFG is thankful for the relationships we have with our clients. We wish each of you a fulfilling and successful 2007.