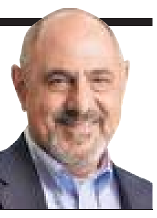
RETIREMENT

FLAVOR OF THE MONTH: FIXED INCOME ANNUITIES

If you can avoid the 'agent games' and a few other pitfalls, they can play a tasty role in your long-term plan

Robert Powell
Special to USA TODAY



Forget stocks, bonds, ETFs and non-traded real estate investment trusts. The new flavor of the month these days for those hawking retirement products is something called a fixed index annuity or FIA.

Consider: Sales of FIAs rose 14% to $38.7 billion in 2013 and another 24% to $48 billion in 2014, or about 21% of all annuity sales, according to a survey out last month by the Insured Retirement Institute (IRI), a Washington, D.C.-based lobbying group for the annuities.

"Fixed index annuities are the current flavor and will remain so while consumers perceive the market indexes potentially rising," says William Byrnes, an associate dean at Texas A&M University School of Law in Fort Worth.

What gives? Here's what experts say about yet another acronym in the alphabet soup of retirement products.

WHAT ARE FIAS?

An FIA is a fixed annuity that, according to the Insured Retirement Institute's report, credits a minimum guaranteed rate of interest over a fixed number of years, plus additional interest that may be credited based on the percentage change in the value of a broad market index.

Insurers use participation rates, caps and spreads to limit the amount of interest that can be credited based on the change in value of the underlying stock market index, which is typically the Standard & Poor's 500-stock index.

So, for example, if an FIA has a participation rate of 50% of the change in the value of the S&P 500 index, and the index returns 10% in a policy year, 5% is credited to the account, according to the IRI.

By limiting the upside, the IRI says the insurance company is able to purchase index options with the portion of the premium that is not invested at interest to support the minimum guaranteed interest rate. What's more, FIAs now offer guaranteed lifetime withdrawal benefits which, the IRI says, makes them useful for saving for retirement as well as for income in retirement.

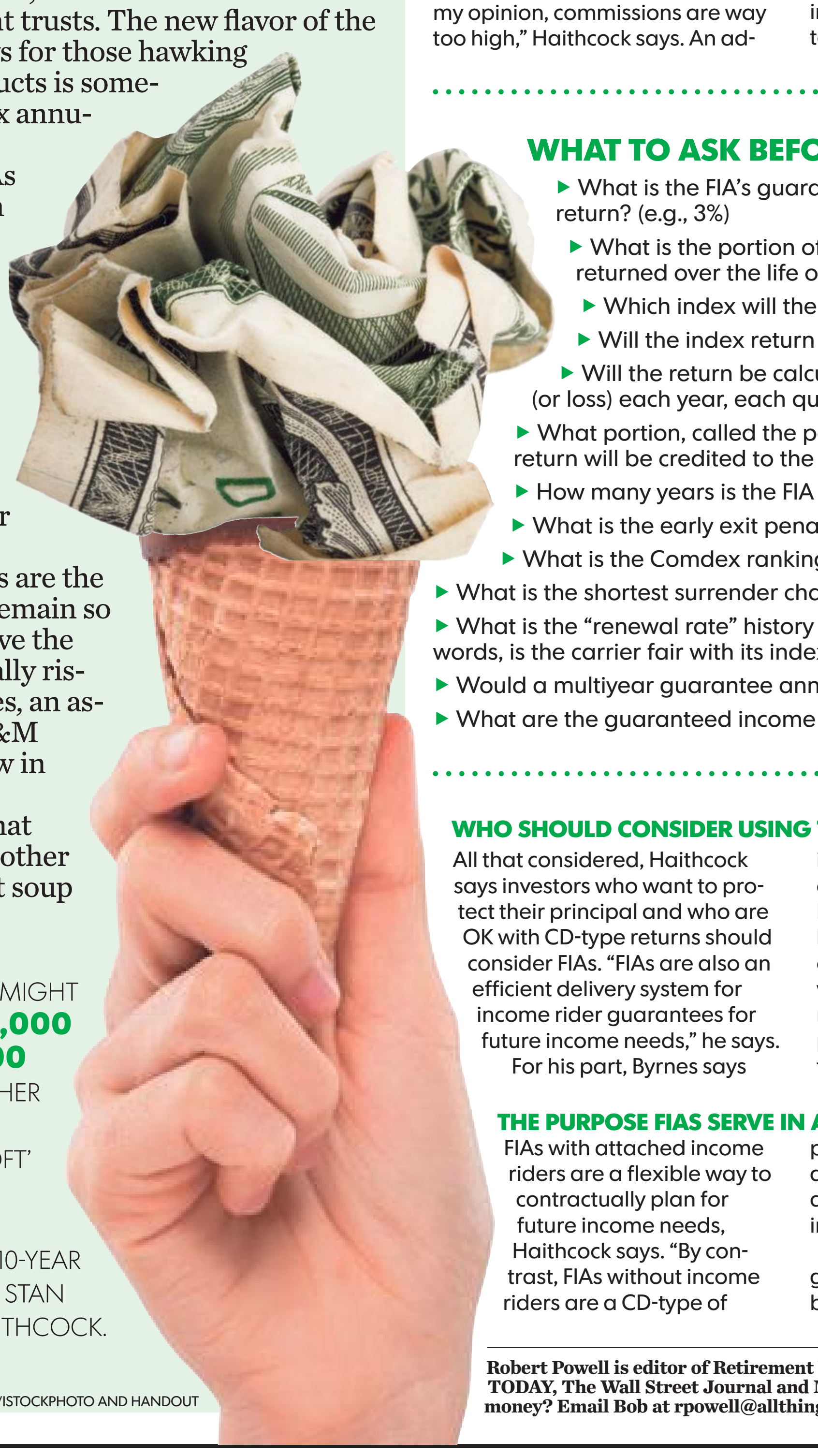
But even though FIAs provide buyers with upside potential, these products are not securities, says Stan Haithcock, author of "The Annuity Stanifesto." FIAs are an insurance product. "The unregulated sales pitch that is too often used is 'market upside with no downside.' Only half of that is true," he says. "There is no downside, because it is a fixed annuity."

According to Haithcock, FIA buyers are told they will participate in the upside. But that upside can be limited. Worse yet, the issuing carrier, in most cases, gets to change the rules of the FIA contract at their discretion.

"That's a key fact that is never disclosed," Haithcock says.

Haithcock also says that most FIAs today are sold with an attached income rider, which is a separate calculation that can only be used for income. "You can't peel off the interest, transfer or get to the lump sum of the income rider total," he says. "This is where the 'agent games' are played. Too many people think that they own a 7% or 8% annuity. They don't. What they own is an income rider that can only be used for a lifetime income stream."

That's OK if the FIA buyer's goal is target-date income, Haithcock says. "But the sales lines are blurred with uninformed or uneducated annuity buyers to falsely believe they are getting real yield," he says.



AN ADVISER MIGHT RECEIVE **$6,000 TO $9,000** PLUS ANOTHER $1,000 TO $2,000 IN 'SOFT' MONEY WHEN SOMEONE BUYS A **$100,000 FIA** WITH A 10-YEAR SURRENDER CHARGE, SAYS STAN **'THE ANNUITY MAN'** HAITHCOCK.

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THE PROS OF FIAS.

Of course, that doesn't mean there aren't good points to FIAs. According to Haithcock, the pros are: full protection of principal; index gains are permanently locked in when the index option expires; can potentially provide better rates than CDs; with attached income riders, FIAs are an efficient way to contractually plan for future income needs; and some income riders also offer confinement-care benefits, which can supplement traditional long-term care coverage.

THE CONS OF FIAS.

Still, there's plenty wrong with FIAs, too. Haithcock says buyers won't get stock market returns, because FIAs were never designed to do that; income rider growth percentages don't generate yields and act more like "Monopoly money" unless used for income; most FIAs have long-term surrender charge time periods; and upfront bonuses to buyers are pitched as free money, which they are not. "Buying an FIA for the upfront bonus is like buying a car for the stereo system."

And if all that weren't bad enough, the compensation that insurance salesmen receive for selling FIAs might be excessive. "In my opinion, commissions are way too high," Haithcock says. An adviser might receive $6,000 to $9,000 plus another $1,000 to $2,000 in "soft" money when someone buys a $100,000 FIA with a 10-year surrender charge, he says.

The fees associated with FIAs can be high, too. "The more administration and management any product requires, the greater that product's built-in fees," Byrnes says. "Because an FIA has more 'moving pieces' than a standard interest-based annuity, the internal fees of an FIA are more. If the market they are indexed to does not keep growing in value, then after fees, the minimum interest return may be nil, depending on the product's contractual terms, of course."

WHAT TO ASK BEFORE BUYING

- What is the FIA's guaranteed minimum investment return? (e.g., 3%)
- What is the portion of my investment that will be returned over the life of the FIA? (e.g., 90%)
- Which index will the FIA track? (e.g., S&P 500)
- Will the index return include or exclude dividends?
- Will the return be calculated upon the index's growth (or loss) each year, each quarter or some other period?
- What portion, called the participation rate, of the index's return will be credited to the FIA investor?
- How many years is the FIA investment for?
- What is the early exit penalty?
- What is the Comdex ranking of the carrier?
- What is the shortest surrender charge FIA available?
- What is the "renewal rate" history of the issuing carrier? (In other words, is the carrier fair with its index option pricing?)
- Would a multiyear guarantee annuity be a better alternative?
- What are the guaranteed income rider contractual details?

WHO SHOULD CONSIDER USING THEM?

All that considered, Haithcock says investors who want to protect their principal and who are OK with CD-type returns should consider FIAs. "FIAs are also an efficient delivery system for income rider guarantees for future income needs," he says.

For his part, Byrnes says investors should ask themselves a question before deciding to buy an FIA. "Is (your) risk averseness to losing a portion of the underlying capital of an investment, over time, worth more than the potential return of purchasing an index product without the capital protection wrapper of this ... product?"

THE PURPOSE FIAS SERVE IN A RETIREMENT-INCOME PLAN.

FIAs with attached income riders are a flexible way to contractually plan for future income needs, Haithcock says. "By contrast, FIAs without income riders are a CD-type of product from a return standpoint and allow you to annuitize that asset at the exact time you need income.

"The bottom line is that FIAs are good products but not too good to be true."

Robert Powell is editor of Retirement Weekly, contributes regularly to USA TODAY, The Wall Street Journal and MarketWatch. Got questions about money? Email Bob at rpowell@allthingsretirement.com.

BOOKS

Teaching kids the ABCs of personal finance

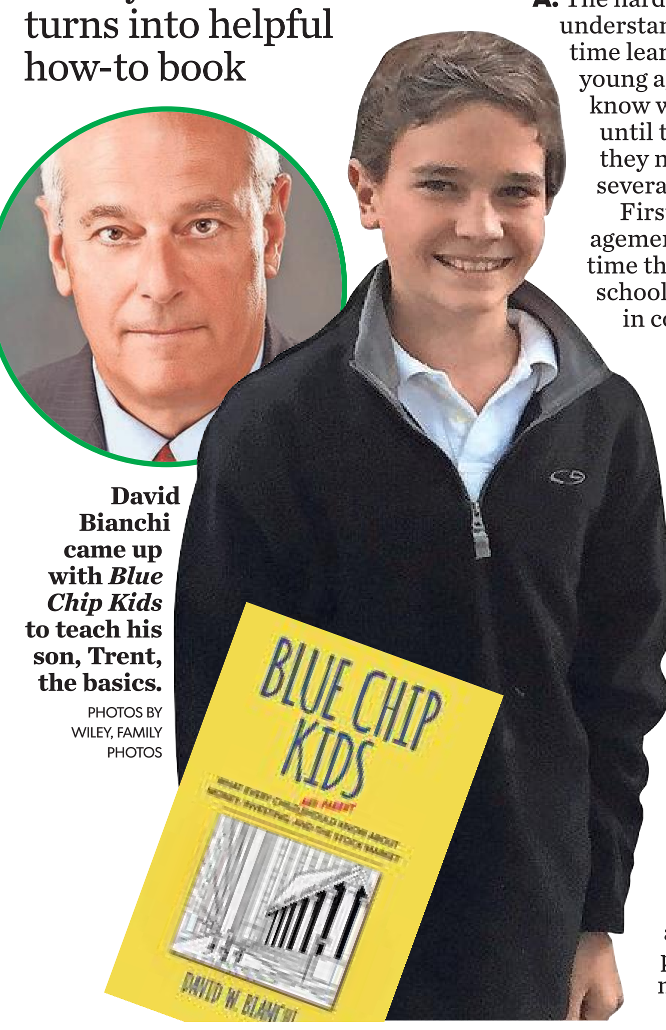
Parents' goal to pass along their money know-how turns into helpful how-to book

Nanci Hellmich
Special to USA TODAY

When Miami attorney David Bianchi and his wife realized their 13-year-old son, Trent, was not learning anything about money, personal finance or investing in school, they thought about buying him some books on the topic. But most of the ones they found seemed too textbook-like for a teen.

So Bianchi, who has invested in start-up companies and has an undergraduate degree in economics from Tufts University, decided to write down some basic information about finances to share with his son. What began as 10 pages turned into 100 topics with illustrations that have been published in his new book *Blue Chip Kids: What Every Child (and Parent) Should Know About Money, Investing, and the Stock Market.*

USA TODAY talked to Bianchi about his book:



David Bianchi came up with *Blue Chip Kids* to teach his son, Trent, the basics.

PHOTOS BY WILEY, FAMILY PHOTOS

Q YOU RECOMMEND KIDS BE DISCIPLINED SAVERS AND CONSERVATIVE SPENDERS. HOW DO YOU GET THAT MESSAGE ACROSS TO THEM?

A: The most important lesson from the entire book is teaching kids that they must live within their means, to save some of what they earn and to avoid the temptations of having to buy every new thing they see or everything their friends may have.

I tell kids about the satisfaction they will have from building up a savings and investment account and knowing that they have a financial cushion in life. Even at a young age they get it.

Q WHAT IS THE HARDEST CONCEPT TO GET ACROSS TO KIDS?

A: The hardest thing is getting them to understand why they need to spend time learning about money at a young age. They often want to know why they can't just wait until they are older. I tell them they need to learn it now for several reasons.

First, the better money management skills they have by the time they graduate from high school the better off they will be in college and later on.

There is over $1 trillion of student debt outstanding in the country, and most of it was taken out by teenagers. If kids were better educated about money, they would be more careful about taking on student debt.

Second, they need to understand the power of compounding investment returns at a young age. The book talks about the power of compounded returns over time and has examples of that.

I explain to them that they will have much more money over their lifetimes if they learn to save, invest and watch what compounding can do to their money from day 1.

Third, I tell them that we live in an increasingly competitive world, and for them to get ahead and compete they need to know how to earn, manage and invest money sooner rather than later. Kids from around the world are learning about money right this minute, and America's kids need to be money smart as soon as possible.

Q WHAT IS YOUR POSITION ON ALLOWANCES FOR KIDS?

A: An allowance is fine if two things happen. First, there should be an understanding that they don't get the money for doing nothing. Requiring some work in exchange for an allowance helps show kids that when they work they will get paid, but money does not grow on trees. They have to earn it.

Second, they need to either save part of their allowance and have a plan to ultimately invest what they save or at least be required to spend some time talking to their parents about the benefits of saving and investing in exchange for getting the allowance.

Q WHAT ARE SOME PRACTICAL WAYS TO TEACH KIDS ABOUT MONEY?

A: Learn from everyday experiences and expand on what you already know. When the restaurant bill comes, play "guess the check" before looking at it. It quickly becomes competitive and teaches kids what things cost, and they soon get quite good at it.

Tell your kids you want to leave a 15% tip and have them calculate the number in their head.

When credit card bills come in, show the bills to the kids so that they can see the relationship between handing the card to a store clerk and actually having to pay for what was charged. We do it, and our son is now cautious about spending money. He has no problem telling me, "Dad, don't spend your money on that."

When a "20% sale" sign is in a storefront window, ask your child what an item would cost if it had been $200 and is now 20% off. It helps them think on their feet and perform quick calculations.

Q ANY OTHER IMPORTANT POINTS YOU THINK KIDS SHOULD LEARN?

A: I have spoken to my son about the fact that the only money we have to spend is "after-tax" dollars, and boy does he get that now. Whatever I may be buying he knows that I had to earn about 30% more than what we are spending in order to have the money to pay for what we just bought.