

ARE FLEXIBLE CERTIFICATES OF DEPOSIT RIGHT FOR YOU?

Rising interest rates have made certificates of deposit attractive again, but some investors have a concern: being locked into a long-term traditional fixed-rate CD should interest rates continue to climb. To counter this concern, banks are offering flexible, interest-sensitive CDs that allow investors to take advantage of rising traditional rates. But as with all investment products, you need to investigate these CDs carefully before buying.

The most common of the new variations of CDs is called the bump-up or step-up CD, or a similar name such as “opt up.” Say you buy a 24-month bump-up CD with a rate of 2.55 percent. Interest rates rise, and ten months into the term of the CD you tell the bank you want to bump the rate up. The new rate would equal the rate the bank is paying on its latest 24-month bump-up CDs. Say that’s 2.85 percent. You would earn 2.85 percent for the remaining 14 months of your CD’s term.

Usually you are limited to a one-time bump during the CD’s term, though some banks allow two bump-ups. You may or may not be limited as to how soon you can exercise your bump after buying the CD. It might be within a few days or it might be six months. Some bump-ups allow you to invest additional money in the CD at the time you bump, but this is usually limited to 20 percent of the initial investment.

Another twist is the “liquid” CD. This pays a fixed rate its entire term, but it allows you to withdraw without penalty a limited portion of the original investment—perhaps 20 percent—before the CD matures. This provides the flexibility, should interest rates rise, of withdrawing some money to use or to reinvest at the higher rates. As with the bump-up CD, withdrawals are limited to a single time.

Some CDs allow all three components: bump-up, additional funds during the bump-up, and a one-time withdrawal.

While all this flexibility can help you avoid being locked into fixed CD rates, be aware of the trade-offs and cautions.

Read the terms and compare. The interest rates, terms, and restrictions of bump-ups and similar CDs vary widely from bank to bank, so evaluate several before deciding if one is right for you. For example, be sure when you bump up that it doesn’t extend the original term. Also compare minimums. Bump-up CDs often have higher minimum investments than a comparable-term fixed-rate CD.

Interest rates usually are lower. The initial interest rate for a bump-up or liquid CD is usually lower than a comparable standard CD: around a quarter to half a percentage point lower is common. Yet sometimes the difference is smaller, making the bump-up more attractive.

The risk is that should you guess wrong, and rates don't rise or rise very little during the bump-up CD's term, you might have done better sticking with a comparable fixed-rate CD.

Easy on the term. Bump-up CDs tend to be longer-term, though there are exceptions. Many bump-ups are 18 months, with 24-month and 30-month common. Some banks only offer five-year bump-ups. The risk here is that in a fast-rising interest-rate environment, even with the opportunity to bump up or make a withdrawal, you won't be able to keep up with rising rates. Usually the advice in a rising interest-rate environment is to stay short term.

Consider laddering CDs. Many financial planners recommend laddering CDs instead of buying the more flexible CDs. With this strategy, you buy CDs at staggered maturities: three months, six months, one year, two years, three years, and five years, for example. When the three-month CD matures, reinvest at a longer term that matches your investment needs. Eventually, all your CDs are at the longer and higher-earning term, but because their maturities are staggered you don't have all your money locked up for long periods of time.

Compare with money market funds. While taxable money market mutual funds usually pay lower interest rates than CDs (insured bank money market pay even less), you may find rates close to short-term CDs, especially online. The advantage is that money markets raise their rates often to keep up with overall interest rate increases – you're not locked in for long periods. But keep in mind that money market mutual funds are not federally insured, unlike CDs.

April 2005- This column is produced by the San Diego Chapter of the Financial Planning Association™. We can be a continued resource for your personal finance coverage. If you use this column in whole or part, please credit the chapter or one of our CERTIFIED FINANCIAL PLANNER™ members.

The Financial Planning Association is the owner of trademark, service mark and collective membership mark rights in: FPA, FPA/Logo and FINANCIAL PLANNING ASSOCIATION. The marks may not be used without written permission from the Financial Planning Association.

FINANCIAL PLANNING FOR AGING PARENTS

Just as your parents took care of you when you were growing up, there's a good chance that at some point you'll need to help take care of them when they grow old. But you can avoid some of the emotional and financial stress associated with their potential care by taking these financial planning steps well in advance.

Talk with your parents. This is the first – and probably the most difficult – step. If you're going to assist your parents as they age, you will need a general idea of their wishes and what financial resources they have to see them through the rest of their lives: dependable monthly income such as pensions and Social Security, retirement assets, investment assets, bank accounts, medical and long-term care insurance, and so on.

What do they envision for their money? Have they even thought about it? Do they want to spend it all while they're alive or pass some of it on to family heirs or charity? Answers to such questions have a profound impact on financial decisions such as gifting, budgeting, where to invest, and whether or how to buy long-term care insurance.

Yet your parents may not want to discuss their personal finances or issues associated with their own mortality, such as wills and long-term care. Or *they* may be fine talking about it while *you're* the reluctant one.

You might broach sensitive money subjects by first discussing nonfinancial issues such as a living will or funeral planning, then getting to the larger financial areas. Involving all family members may help, too.

Discuss their future living arrangements. Will your parents be able to care for themselves where they now live, perhaps with outside assistance? Would moving to a smaller home, a retirement center, a continuing care community, or one of their family member's homes be a better idea, and if so, how soon? What if health problems force them out of their home into assisted living or a nursing home? Would they want to stay in the area where they now live, or move closer to family?

Get durable powers of attorney. A durable power of attorney designates a person to make certain decisions on behalf of someone else if that person is unable to make decisions, usually due to some type of incapacity. Having the power of attorney in advance avoids the costly delay of going through the court system to obtain these powers.

You need two types of durable powers of attorney. A financial power of attorney, depending on how it's drafted, would allow you to step in for your parents to pay their

bills, make investment decisions, even sell their home. The health care power of attorney, sometimes called a health care proxy, would authorize you to make medical decisions on behalf of your physically or mentally incapacitated parent.

Put other legal documents in place. Be sure your parents have an up-to-date will that reflects their wishes and is in line with current tax laws. Each should also have a living will that expresses what life-sustaining medical treatment they would want or not want should they become incapacitated.

Know where their financial records are. Know where they keep their financial records and be sure you have access to them should you need to step in.

Pay special attention to health-related insurance. What medical insurance do your aging parents have? Besides Medicare, do they have any retiree health care benefits or Medigap coverage? Do they have long-term care insurance in the event they need at-home health care or to move to an assisted living facility or nursing home? If they don't have LTC insurance, would they still qualify for it based on their health and their finances?

Monitor their finances. Frankly, you have to be nosy here. You need to watch for telltale signs that your parents are failing to properly manage their finances and that you or an outside service, such as a CERTIFIED FINANCIAL PLANNER™ or a bill-paying service, need to step in.

For example, are income checks undeposited and bills piling up unpaid? Are they sending money to dubious contests or charitable requests? Is the IRS sending them notices about improperly calculated income-tax returns? Are financial institutions selling them investment products that are unwise for their financial circumstances? For example, regulators have been after financial institutions for inappropriately selling variable annuities to the elderly.

April 2005- This column is produced by the San Diego Chapter of the Financial Planning Association™. We can be a continued resource for your personal finance coverage. If you use this column in whole or part, please credit the chapter or one of our CERTIFIED FINANCIAL PLANNER™ members.

The Financial Planning Association is the owner of trademark, service mark and collective membership mark rights in: FPA, FPA/Logo and FINANCIAL PLANNING ASSOCIATION. The marks may not be used without written permission from the Financial Planning Association.

CFP®, CERTIFIED FINANCIAL PLANNER™ and the federally registered CFP (with flame logo) are certification marks owned by the Certified Financial Planner Board of Standards, Inc. These marks are awarded to individuals who successfully complete CFP Board's initial and ongoing certification requirements.

THE NEW RULES OF RETIREMENT

As the national debate over Social Security illustrates, retirement in the 21st century won't look like our parents' or grandparents' retirement. New rules are coming into play, and the sooner you understand those rules, the more comfortable your retirement will be.

You'll live longer. Average life expectancy – how long one lives from birth to death – rose to 77.6 years (80.1 years for women, 74.8 for men) for people born in the United States in 2003, according to the latest figures from the Centers for Disease Control and Prevention.

Longevity – the average number of years of life expectancy based on your current age – is also increasing. According to the National Center for Health Statistics, a 65-year-old person can expect to live another 18 years, to age 83 (20 years for women, 17 for men). And each year you live beyond age 65, longevity stretches a little bit more.

This increased life expectancy has profound implications for retirement, and more than any single factor is changing the rules of retirement.

Retirement is a whole new stage of life. Not all that long ago, people worked late into their life, retired to a rocking chair for a few years, and died. Today, not only are people living longer, many are retiring earlier. Retirement has become a stage of life that can easily last 20 to 30 years – or more! What you “envision” for your retirement and how to pay for it is something you must plan and work for.

A secure retirement is on your dime. Like it or not, most of us will have to fund an ever-increasing portion of our retirement – or try to scrape by primarily on Social Security.

Employer-paid pension plans that pay out defined monthly benefits based on salary and years of service are going the way of the dodo bird. Of the 112,000 corporate pension plans in 1985, only 32,000 are left today, according to a *U.S. News & World Report* article. Most of those pension plans have been replaced by retirement plans such as 401(k)s funded primarily by employees.

Social Security will be there, but... Social Security is not likely to go away, but it is very likely to change. Most financial planners have been advising their clients for some time not to base much of their retirement plans on income from Social Security, which was never designed to be anything more than a safety net. Yet for 22 percent of people over age 65 today, Social Security is their sole source of retirement income, according to the Social Security Administration. And it provides over 50 percent of retirement income for two-thirds of the elderly.

You'll need to work in retirement. That may sound like an oxymoron, but even current retirees are returning to the workforce. Sometimes it's for the money, but often it's because retirees are looking for emotional and intellectual stimulation they're not finding in retirement. A good approach is to "phase" into retirement by reducing full-time work to part-time or seasonal work, or even change careers.

Stretching out retirement funds is as important as accumulating them. Because people live longer in retirement, they need to be more careful in how they keep their retirement portfolio invested and at what rate they withdraw funds from the portfolio. Ground-breaking research in the financial planning profession suggests limiting annual withdrawals to four to five percent of a retirement portfolio's value – perhaps a bit more if you follow certain rules and review your portfolio regularly. Your financial planner can help you here.

Health care costs could kill you. A huge but often unrecognized cost of retirement is health care. The Employee Benefits Research Institute says that medical costs for retirees is actually five times higher than what near-retirees believe they will be. Meanwhile, employer-funded retiree health plans are disappearing or raising costs for their retirees, and Medicare pays only roughly 55 percent of the average retiree's health care costs. Future retirees need to think carefully about medical insurance for retirement and save more for rising out-of-pocket expenses.

You need to prepare for long-term care. With people living longer, chances increase that you'll need long-term care at some point, either at home, in a nursing home, or assisted-living facility. That takes a lot of money you may not have or don't want to drain from retirement savings. Your retirement plan should consider long-term care insurance.

April 2005- This column is produced by the San Diego Chapter of the Financial Planning Association™. We can be a continued resource for your personal finance coverage. If you use this column in whole or part, please credit the chapter or one of our CERTIFIED FINANCIAL PLANNER™ members.

The Financial Planning Association is the owner of trademark, service mark and collective membership mark rights in: FPA, FPA/Logo and FINANCIAL PLANNING ASSOCIATION. The marks may not be used without written permission from the Financial Planning Association.