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Retirement Insecurity: Guaranteed Income May Raise Readiness

Study after study tells the tale. Americans of all ages are becoming increasingly concerned about their ability to afford retirement. A 2024 study from the National Institute on Retirement Security (NIRS) revealed that 79% of respondents agreed that a retirement crisis exists and high retirement anxiety results. Of those surveyed, 55% are concerned that they won't be able to achieve financial security in retirement.[1] Another survey, conducted by Nationwide of consumers ages 60-65, found their biggest threats to retirement security include inflation (90%), cuts to Social Security benefits (84%), and the rising cost of long-term care (73%).[2]

Periods of stagnant wage growth have hindered some individuals' ability to save sufficiently for retirement because income has failed to keep pace with the escalating cost of living. Rising healthcare expenses, housing costs, and everyday outlays are placing additional strain on household budgets, leaving little room for retirement savings.

Moreover, economic uncertainty, exacerbated by market volatility and geopolitical tensions, further unsettles Americans' confidence in their retirement prospects. The unpredictability of financial markets has left many individuals feeling vulnerable and uncertain about the viability of their retirement savings strategies.

Dependable Income Translates to Clarity and Confidence

Despite these common concerns across surveys, a positive outlook emerged among those with reliable lifetime income. The Nationwide survey found that 78% of those with pensions were more likely to be on track for retirement, vs. 59% of those without a pension. In all physical, mental, and emotional health categories, those with pensions reported being happier than those without. The NIRS survey echoed similar findings: more than 80% of Americans with pensions are confident their pension will be there in retirement. Authors of the NIRS survey stated that this is likely because "pensions provide a dependable retirement income that won't run out and isn't subject to market fluctuations."[3]

The challenge is that pensions largely have been replaced in the private sector by defined contribution plans such as 401(k)s over the last four decades. This shift requires employees to determine how much to save, how to invest the assets, and how much to spend in retirement to avoid outliving their income.

Acknowledging the challenges employees often face in understanding how 401(k) account balances translate into tangible monthly income, the SECURE Act requires that defined contribution participants be provided with an estimate of the monthly lifetime income their current account balance would provide.[4] This change and others made under the SECURE Act recognize the importance of lifetime income as a critical ingredient in retirement confidence and readiness.

Social Security is the Primary Pension

For 90% of American retirees, Social Security provides the foundation of their retirement income. On average, Social Security is designed to replace roughly 40% of pre-retirement earnings. Yet, among beneficiaries age 65 or older, 37% of men and 42% of women rely on it for 50% or more of their income.[5]

Growing concerns among consumers over the potential cutbacks to future benefits have led to 77% of those retired and 71% of non-retired individuals saying such cuts would significantly impact their finances. The 2024 OASDI [Social Security] Board of Trustees report projects that the Old Age and Survivor Insurance trust funds will be able to pay full benefits until 2033; subsequently, the program will be able to pay only 79% of benefits if Congress does not act before then to support 100% payouts.[6]

In the NIRS survey, 87% of respondents said the program must remain a top priority for Congress now rather than waiting to address the issue when benefit cuts are imminent. Also, 58% of respondents agreed that the federal government should increase the payroll taxes that employees and employers contribute to Social Security to help avoid benefit reductions.[7] The message is clear. Americans rely on Social Security income and expect it to be a promised source of income in retirement.

The last thirteen OASDI Board of Trustees Reports have asserted that trust fund reserves would deplete between 2033 and 2035 unless Congress enacts legislative change. So far, changes have yet to occur, although policymakers have developed proposals to address the long-range solvency issue. To view these proposals and their effect on the long-term shortfall, visit **www.ssa.gov/OACT/solvency/provisions/summary.pdf.** It may be a small solace, but the OASDI Trust Funds were on the brink of reserve depletion in the 1980s, and changes were made to avoid benefit cutbacks. A repeat performance is a possibility.

No Surprises

Why do retirees especially value employment-related pensions and Social Security retirement benefits? The stability and predictability of such sources of post-career cash flow are often what retirees enjoy most about these monthly income streams. Such stability can help retirees budget and plan for expenses confidently, knowing they will receive regular payments regardless of market fluctuations or economic conditions. Other benefits include:

Guaranteed income: Many people appreciate guaranteed income for life, which provides financial security throughout their retirement years. This assurance of continued income can alleviate concerns about outliving one's savings and struggling to maintain a familiar standard of living.

Inflation protection: Some pensions and Social Security benefits are indexed to inflation to keep pace with rising living costs. Such inflation protection helps retirees preserve their purchasing power over time, ensuring that their income remains sufficient to cover essential expenses as prices increase.

Reduced exposure to market risk: Unlike other retirement income sources such as 401(k)s or IRAs, pensions and Social Security do not expose retirees to investment risk. Retirees do not need to worry about market volatility or managing investment portfolios to ensure a steady income stream, which can be particularly appealing for those with low risk tolerance or limited investment knowledge.

Lifelong benefits: Pensions and Social Security benefits are typically paid out for the duration of retirees' lives and may even continue to a surviving spouse, providing financial support even in advanced age or in the event of longevity beyond initial retirement expectations. This is particularly crucial as life expectancies continue to increase.

Studies, such as those cited above, have shown that the stability, predictability, and guaranteed income that employment-related pensions and Social Security provide all lead to higher confidence and retirement readiness levels. They also mitigate many common risks associated with retirement, including market volatility, inflation, and longevity risk. However, the challenge is that defined benefit pension plans have been replaced in the private sector by defined contribution plans. According to the Department of Labor, 15% of private industry workers had access to a traditional defined benefit pension plan in 2023, while 67% had access to a defined contribution plan.[8]

The proverbial 3-legged stool of pensions, Social Security, and savings has been teetering on two legs for decades for many private sector workers. Now, even the Social Security leg is potentially on shaky ground. It is imperative for those approaching retirement to prepare for alternative scenarios to augment Social Security should a benefit cut occur. Even if Congress takes action to avoid a cutback, as has happened in the past, near-retirees should explore options to create their own pension. A Fixed Index Annuity (FIA) is a potential option that mitigates critical retirement risks while providing the same stability and predictability that may give many retirees peace of mind.

Guaranteed, Plus Upside

An FIA is an annuity contract that many insurance companies offer. It provides a guaranteed minimum return combined with the opportunity to earn an additional return based on the performance of a specific market index, such as the S&P 500. FIAs offer protection of principal, meaning that the initial premium is not subject to market risk, although potential earnings may fluctuate based on the performance of the chosen index.

FIAs may have a participation rate determining how much of the index's gains will be credited to the annuity's value. For example, if an FIA's participation rate is 70% and the designated index returns 10%, the FIA return would be 7%.

(Note that some FIAs also have a spread that reduces the index return before participation. A 2% spread, for example, would reduce a 10% return to 8%, so the 70% participation rate would deliver only 5.6% [70% of 8%] on the FIA.)

There also might be a cap rate. In the above example, a 5% cap would reduce the above return from 5.6% to 5%.

FIAs may also feature a floor, ensuring the annuity value does not decline even if the index performs poorly. These features make FIAs popular among individuals seeking a balance between growth potential and downside protection for their retirement savings.

Additionally, FIAs provide various payout options, including guaranteed lifetime income streams, which can help retirees secure a reliable source of income throughout their retirement years. Additional features, such as inflation protection on monthly income or a long-term care rider, may be available depending on the contract. Additional fees may apply.

For many seniors, Social Security income provides the foundation for retirement income. FIAs can be a valuable tool for retirees looking to secure another reliable source of income to cover basic living expenses while protecting principal and offering the potential for growth over time to keep pace with inflation.

The FIA Bridge to More From Social Security

Deciding when to claim Social Security benefits is a crucial decision for retirees, and it should be made with the assistance of an experienced financial professional. Benefits can be claimed as early as 62. Still, it may make sense to delay until the retiree reaches full retirement age (now 67) or even as late as age 70, particularly if that individual is married and is the higher-earning spouse. Delaying the claim boosts monthly cash flow from Social Security and provides higher income for the surviving spouse. Using an FIA for income during the early years of retirement may allow the eventual Social Security benefit to grow by as much as 8% per year and also provide larger annual cost-of-living adjustments if they are announced.

As mentioned, FIAs can offer peace of mind by providing survivor income protection for spouses. After the death of one spouse, the widow(er) can continue to receive guaranteed income from the FIA, ensuring financial stability and security during a challenging time. This survivor benefit provides reassurance that the surviving spouse can maintain his or her living standard and meet ongoing expenses without interruption.

Using an FIA to Cover Care

Some FIAs may offer a Long-Term Care (LTC) rider that allows the annuity owner to access a portion of the annuity's value to pay for LTC expenses if he or she cannot perform activities of daily living. This provides an additional layer of financial security in case of health-related needs during retirement.

Many people mistakenly believe that Medicare covers the cost of LTC, but that's not the case, so having a plan to cover the potential for an LTC need is important.[9] It is estimated that 70% of people 65 or older will need LTC during their lifetime.[10] Standalone LTC policies may be more costly than a hybrid LTC feature added to an annuity or a life insurance policy. Check each contract for terms and fees for LTC benefits.

Dynamic Planning

Many retirees appreciate how guaranteed lifetime income can help provide financial stability, predictability, and peace of mind. Pensions are generally widely available only to governmental employees, so private sector employees usually must determine how much their 401(k) account balances can convert to income in retirement. FIAs may offer a solution by creating a reliable retirement income stream with many protections against retirement risks and a greater sense of retirement confidence. Working with a financial professional specializing in retirement income planning is important to determine what makes sense for those nearing retirement.

[1]https://www.nirsonline.org/reports/retirementinsecurity2024/
[2]https://news.nationwide.com/download/38d66f4d-9b2e-45fa-aaac-b591b7a803e7/nationwide-peakretirementinsights1.2024.pdf
[3]https://www.nirsonline.org/wp-content/uploads/2024/02/FINAL-2024-Public-Opinion-Research.pdf pg 5 & 11
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[7]https://www.nirsonline.org/wp-content/uploads/2024/02/FINAL-2024-Public-Opinion-Research.pdfp 21-22
[8]https://www.bls.gov/opub/ted/2024/15-percent-of-private-industry-workers-had-access-to-a-defined-benefit-retirement-plan.htm#
[9]https://www.medicare.gov/coverage/long-term-care
[10]https://www.morningstar.com/personal-finance/100-must-know-statistics-about-long-term-care-2023-edition

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