INSIGHTS

PACIFIC LIFE

A Lifetime of Work Deserves a Lifetime of Income

On Labor Day, we celebrate the achievements of the diverse work force in the United States. As a financial professional, you can help your clients transform their years of work into a plan for lifelong income.

A financial professional asked a recently retired client if she and her husband had plans for Labor Day. The couple had worked hard for many years and were careful savers, so their savings balance should have easily covered a weekend trip. However, the client said, "Well, we thought about taking a trip, but we're worried about spending some of our retirement savings on a flight."

This response might be an indicator of a less-understood retirement-income problem: Spending confidence. The benefits of working hard and saving for retirement should mean an enjoyable retirement lifestyle. Yet these well-prepared clients were still concerned about spending. How can you help clients like these cultivate the confidence to thrive rather than just survive?

Lifetime Income—The Secret Ingredient

The basic idea is pretty simple: When a working person receives his or her paycheck, it is meant to provide for both current expenses and retirement savings. When working years end, a proper retirement-income plan converts those savings into a predictable cadence of retirement income. Lifelong income can ensure the retiree has a paycheck that lasts as long as he or she (and, in many cases, a spouse) are alive—as well as provide funds for discretionary spending like the above example.

But why does lifelong income matter? Recent research by David Blancett and Michael Finke explores this phenomenon and offers insight. Retirees with guaranteed lifelong income are statistically willing to spend more on discretionary expenses, as income is psychologically interpreted differently than savings. Income is likelier to be spent on nonessentials, like travel, while savings are likelier to be, well, saved.[1]

There are a few different kinds of retirement income. Like most workers, the couple in this example is eligible for Social Security retirement benefits, which provide a series of lifelong benefit payments with a cost-of-living adjustment (COLA). Some more fortunate workers also may have a pension. If Social Security retirement benefits and/or a pension do not provide sufficient retirement income, annuities can help to fill the gap. Additional guaranteed income—from whatever source—can allow retirees to confidently spend a bit on themselves.

Let's dive into the options in detail:

- **Social Security.** Social Security retirement benefits are the bedrock of most retirement-income plans. As mentioned above, these benefits consist of lifelong payments with a COLA, which cover both the worker and, in many cases, his or her spouse. 15% of the benefit payment is always federal income-tax-free, and many states do not tax Social Security retirement benefit payments. While workers can claim as early as age 62, many wait at least a few years to increase the lifelong benefit payment. Those who wait until age 70 also will benefit from the delayed retirement credit, which increases the benefit by 8% simple interest each year between Full Retirement Age (FRA) and age 70.[2]
- **Pensions.** Many government employees and some private-company employees have pensions. Pensions also can provide lifelong income, with some government plans also offering a COLA. A pension combined with Social Security retirement benefits may be enough to provide sufficient lifelong income to the worker (and often the spouse) to allow for discretionary spending in retirement.

[1]Blanchett, David and Finke, Michael. "Guaranteed Income: A License to Spend." June 2024. Retirement Income Institute.
[2]Social Security Administration. "Plan for retirement." SSA.gov. Accessed August 20, 2024.

- **Annuities.** An annuity may be a helpful strategy for those who need an additional source of lifetime income. An annuity with a lifetime income payment can provide the additional monthly income a retiree might need to feel comfortable spending on nonessentials, such as travel or avocations. There are different ways that annuities can create a lifelong payment, including:
  - **Immediate monthly income for life.** A single-premium immediate annuity (SPIA) provides payments that begin within one year of purchasing the annuity and continue for a specified period of time or for a worker's life expectancy (or expectancies with the Joint Life option). Annuitization payout options include Single Life or Joint Life with additional options for Period Certain or Cash Refund, which ensures that the remaining premium will be spent or go to heirs. In line with the above research, a SPIA is viewed as income and is therefore much likelier to be spent and enjoyed.[1]
  - **Delayed monthly income for life.** A deferred income annuity (DIA) also can provide income payments for a specified period of time or for the life of the worker (and spouse with the Joint Life option) with payout options similar to those available with a SPIA, however, they begin on a future date. If planning ahead, a DIA can reduce the capital required to fund the lifelong payments. A couple, both age 55, planning to take income when they become eligible for Medicare at age 65, can use less capital today to create future guaranteed income. With the future income guaranteed, preretirees who are seeking growth for other assets may be more willing to stay invested in volatile markets, potentially improving long-term account values. Once the income payments start, a DIA, like a SPIA, is likely to be viewed as income and available to spend.[1]
  - **Flexible choice—guaranteed income or savings**. A client who wants or needs the flexibility to decide whether an account is income or savings later might prefer a variable annuity which provides tax-deferral, growth potential through it's underlying investment options, and options for lifetime income. Some variable annuities offer an optional income benefit for an additional cost that provides additional features and guarantees for lifelong income. The tax-deferred growth potential of the account value continues until the income benefit is started. The client may decide when (or whether) to start income payments at a future point. For the couple noted previously, a variable annuity with a lifetime income benefit can be used either for savings or retirement income—a "just in case" account for either purpose.

  Keep in mind, annuities are not for everyone. It's important to carefully consider all the costs, features, and restrictions of the chosen annuity and ensure it fits a client's individual needs.

Address Clients' Spending Fears with Lifetime-Income Plans

Many retirees struggle to understand how much to spend from a portfolio, and that uncertainty can make them feel anxious. That feeling combined with concerns about longevity risk can cause a retiree (and/or spouse) to lock down their savings and underspend for a future that may never materialize. Converting some assets to lifelong income can help reduce that risk.[1]

Knowing about this trend can set you up to effectively guide client conversations around income. A shift from "living off of your savings" to "balancing lifelong income with flexible distributions from savings" may help clients feel more comfortable enjoying their retirement lifestyles.

Labor Day is an excellent time to remind your clients that the work they do is valued. With proper planning, that lifetime of work can provide lifelong income, helping clients enjoy the lifestyles they want to live. Consider encouraging clients to take advantage of the upcoming holiday to discuss their lifelong retirement-income plans.

ACTIONS YOU CAN TAKE RIGHT NOW

- **Identify clients five to 10 years from retirement who are on track to have adequate savings.**
- **Meet with each client to determine whether or not additional lifelong income may be needed.**
- **Review whether or not an annuity might address the client's lifelong income needs.**

Additional Resources and Links

Guaranteed Income: A License to Spend

Cultivating Financial Independence in Honor of the Fourth of July

Longevity Risks: Three Common Incorrect Assumptions

For more information about retirement planning, please contact our Retirement Strategies Group at RSG@PacificLife.com or (800) 722-2333, ext. 3939.

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Under current law, a nonqualified annuity that is owned by an individual is generally entitled to tax deferral. IRAs and qualified plans—such as 401(k)s and 403(b)s—are already tax deferred. Therefore, a deferred annuity should be used only to fund an IRA or qualified plan to benefit from the annuity's features other than tax deferral. These features include lifetime income, death benefit options, and the ability to transfer among investment options without sales or withdrawal charges.

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