MARKET
INSIGHTS

PACIFIC LIFE

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The Failure of Social Security, a Strategy for Its Shortfall, and More

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Key Highlights

- It's projected that Social Security retirement benefits will be depleted in about 10 years—and the U.S. government has not done much to fix it.
- Studies show most Americans will be unprepared to live comfortably throughout their retirement years.
- Some savings and investment plans may help clients prepare for retirement, but it's important for financial professionals to consider products that provide guarantees.
- The Pacific Dynamix® Aggressive Growth Portfolio, available with certain Pacific Life annuities, recently launched as a cost conscious option that seeks aggressive growth of capital and is eligible for the purchase of certain optional benefits, which offer levels of principal protection from market downturns.

What's the State of Social Security?

Since its inception in 1935, Social Security has remained among the country's most important and reliable entitlement programs. For many Americans, Social Security is expected to be the only source of guaranteed retirement income that is not affected by market risk and volatility. From the article Social Security Benefits Are Modest (12/23), according to 2017 Census Bureau Studies, roughly half of seniors depend on this entitlement program for at least 50% of their incomes, while a quarter of seniors receive at least 90% of their incomes from their Social Security retirement benefits.

While Social Security retirement benefits were not intended to fully support retirees, more seniors have become increasingly dependent on this government-sponsored program since it was initially launched. To keep up with rising prices over time, Social Security payments are adjusted for inflation. Nonetheless, Social Security benefits tend to be modest, with the average payout valuing under $1,800 per month (and less than $22,000 per year) in 2023.

For a comfortable retirement, financial experts suggest that retirees need to replace about 70–80% of their preretirement earnings. Social Security retirement benefits, by contrast, are only estimated to replace about 40% of preretirement earnings for the average worker. However, this situation is predicted to worsen as demographic profiles shift—especially as the baby boomer generation continues to retire and live longer than prior generations. This is compounded by the fact that younger generations represent a smaller portion of the population, which means fewer workers contribute their paychecks to the system.

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Under current conditions, the Social Security Administration (SSA) will be able to pay full benefits for another decade before it starts to face considerable challenges. According to projections from the SSA 2010, the program will be unable to fulfill its obligations starting in 2035 (the 100th anniversary of the signing of the Social Security Act). The Administration estimates that, unless changes are made soon, future taxes will be enough to pay for only 75% of scheduled benefits (primarily from workers' ongoing contributions).

This shortfall means future retirees will need to further stretch their savings in 401(k)s, IRAs, annuities, or other vehicles to cover their full lifespan expenses. As government entitlement programs provide a smaller portion of their future incomes, many experts believe Americans will need to stay in the workforce longer than before (which was already the case even before the 2035 deadline).

As financial professionals, you may be working with young and old Americans who are concerned about the future of Social Security and what it will be able to provide them. Given the discouraging outlook, these future retirees will need to further supplement their government entitlements with other sources and grow their assets more aggressively than ever.

Alternative Options for Retirement Saving Plans

Most American workers rely on Social Security retirement benefits for their guaranteed retirement income, and many supplement their benefits with other income sources. Although employees often prefer the guarantees associated with traditional defined-benefit (DB) pension plans, many employers no longer offer these plans. Instead, employers have shifted to defined-contribution (DC) plans, such as 401(k)s which, among other things, transfer liability away from the employing companies.

Unlike Social Security retirement benefits and DB plans, many DC portfolio values and payouts will be determined by the performance of the underlying investments. This means that the value of a DC plan is subject to market fluctuations, which can be detrimental if someone retires during a prolonged market downturn or economic recession. For most DC setups, contributions are automatic and typically distribute to certain target-date funds based on the age of the participant. However, this approach may misalign with a participant's retirement needs. In other words, many DC participants who lack investment savviness may have their plans too conservatively positioned. This is confirmed by studies and surveys that indicate most Americans appear unprepared to retire comfortably. It's possible that the "set it and forget it" approach to investing in target-date funds may be detrimental for some investors.

According to the 2024 Retirement Confidence Survey conducted by the Employee Benefit Research Institute, only 28% of workers and 32% of retirees feel confident in their retirement futures based on their current incomes, finances, and stable assets. On the other hand, nearly 30% of the surveyed reported that the total value of their savings and investments (excluding primary homes) amounted to less than $25,000 (roughly the size of the average annual Social Security benefit payout). More than 60% reported savings of less than $250,000.

Another 2024 national poll conducted by the National Institute on Retirement Security found that American workers are increasingly troubled about retirement. For obvious reasons, a large majority said that all workers should have a pension to be self-reliant in retirement. Given that pensions are fading options, nearly 80% of Americans believe there is a retirement crisis—a significant increase from 67% in 2020. This drop in confidence comes despite a surge of over 55% in the S&P 500® index between January 2020 and December 2023. From another perspective, the Russell 1000® Growth Index grew nearly 300% over a 10-year timespan between January 2014 and December 2023.[1]

Even so, more than half of those surveyed believe they will not experience financial security in retirement. Nearly three quarters of respondents also said current inflation trends make them more worried about their retirement security. Nearly all Americans believe the president and Congress should prioritize replenishing funding for the Social Security Administration.

These surveys suggest that most people may be unprepared to experience their dream retirements.

A Potential Solution for Concerned Clients

While unprepared future retirees may face overwhelming financial burdens when the Social Security Administration starts to deplete its assets, they can take measures to help protect themselves. Future retirees can prepare for the shortfall in Social Security funding by investing in properly allocated 401(k)s and IRAs, as well as other savings and investment methods. Many of these offerings can grow assets over time, but most are vulnerable to market risk, which means that the value of one's portfolio can fall significantly and completely alter one's retirement plan.

To protect themselves from market swings, some clients may opt to invest more conservatively, which could prevent their portfolio values from growing sufficiently (especially considering inflation projections). For example, the studies and surveys noted earlier indicate that a large majority of Americans need to grow their assets rather than simply preserving them. This is especially important when considering the shortfall of Social Security retirement benefits, uncertainty about inflation, and continuously rising housing costs.

While most aggressive investments are prone to high volatility, investors can help protect themselves from equity-market downturns by investing in variable annuities (VAs) with living benefit options that guarantee against specific levels of losses. Pacific Life recently made it easier for risk-averse investors to pursue aggressive portfolio returns with the launch of the Pacific Dynamix Aggressive-Growth Portfolio available with certain Pacific Life variable annuities. This strategy is a cost-conscious, tax-deferred fund eligible for a guaranteed minimum accumulation benefit (GMAB) optional benefit. The level of protection will depend on the terms of the coverage selected, and purchasing longer-term optional benefits may buffer or cover larger losses.

The Pacific Dynamix Aggressive-Growth Portfolio also is eligible with another optional benefits, including Future Income Generator, guaranteed minimum withdrawal benefit (GMWB), which guarantees a contract owner a steady stream of annual withdrawals. These customizable options vary depending on the insurance provider's platform and guidelines. Lifetime income further guarantees that the investor will not outlive his or her assets, which is particularly valuable as people continue to live longer. Furthermore, assets in a variable annuity can be directly transferred to one's spouse or other beneficiaries. Variable annuities with an optional living benefit can help reduce concerns about several key risks, including market volatility and outliving one's assets and income (especially in a down market).

For more information, please refer to Pacific Life's Variable Annuities Investment Guide to review various options.

Prepare Your Clients to Strategize Early

VAs are long-term contracts structured to help provide a more secure retirement or for other future objectives. While they may have been designed to supplement other sources of retirement income (e.g., Social Security retirement benefits and pension funds), VAs have become an important source of protection as the SSA funding depletes and pension plans fade away.

As many studies have shown, a comfortable retirement has become less certain for many people, and the outlook continues to worsen. Although the retirement dream has become more difficult to achieve, Pacific Life offers investment options like the Pacific Dynamix Aggressive-Growth Portfolio to help clients pursue their retirement goals.

Please refer to our manager insights article, "The Active Approach to Passive Investing," to understand how our lower-cost investment option can seek alpha through active asset allocation.

All guarantees are subject to the claims-paying ability and financial strength of the issuing insurance company and do not protect the value of the variable investment options, which are subject to market risk.

[1]Data source: Morningstar, Inc. as of 7/10/24.

For more insights from Pacific Life, visit

PacificLife.com

Optional benefits are available for an additional cost.

Pacific Life is a product provider. It is not a fiduciary and therefore does not give advice or make recommendations regarding insurance or investment products.

You should carefully consider a variable annuity's risks, charges, limitations, and expenses, as well as the risks, charges, expenses, and investment goals of the underlying investment options. This and other information about Pacific Life are provided in the product and underlying fund prospectuses. These prospectuses are available from your financial professional or at PacificLife.com. Read them carefully before investing.

Annuity withdrawals and other distributions of taxable amounts, including death benefit payouts, will be subject to ordinary income tax. For nonqualified contracts, an additional 3.8% federal tax may apply on net investment income. If withdrawals and other distributions are taken prior to age 59½, an additional 10% federal income tax may apply. A withdrawal charge and a market value adjustment (MVA) also may apply. Withdrawals will reduce the contract value and the value of the death benefit, and also may reduce the value of any optional benefits.

All investing involves risk, including the possible loss of the principal amount invested. The value of the variable investment options will fluctuate so that shares, when redeemed, may be worth more or less than the original cost. Please see the prospectus for a detailed description of investment risks.

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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Future Income Generator is named "Guaranteed Withdrawal Benefit XXII Rider—Single Life" and "Guaranteed Withdrawal Benefit XXII Rider—Joint Life" in the contract rider.

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The home office for Pacific Life & Annuity Company is located in Phoenix, Arizona. The home office for Pacific Life Insurance Company is located in Omaha, Nebraska.

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