PACIFIC LIFE insights

RETIREMENT STRATEGIES GROUP

OCTOBER 2020

HEDGING STRATEGIES TO HELP WITH LONGEVITY RISK FOR PRE-RETIREES (PART 2)

What if early retirement years include a "bucket list"? For many retirees, the first years of retirement offer an opportunity for fun and adventure. Deciding when, and how, to claim Social Security retirement benefits can make a difference.

In our first blog post, we noted how important it is that financial professionals consider the effect of claiming strategies for Social Security benefits. We discussed Steve and Sandy, two 62-year-olds, and how they used a deferred income annuity (DIA) (form number MUP1240-0719 or form number 50075-15A), to create a longevity-risk hedge and proceed with claiming Social Security benefits.

This time, we meet Tom and Tammy, local travel mavens. They are both age 57 and plan to retire at 67, their full retirement age (FRA). They plan to spend their early retirement years completing their travel bucket list, with occasional detours to visit the grandchildren.

Tom and Tammy are willing to plan for retirement income now. As both sets of parents are in their 90s and doing well, a longevity-risk hedge is high on their list. They planned to use Social Security benefits as a cost-of-living (COLA) longevity-risk hedge. Their question: To keep their target retirement date and travel plans, will one, or both, need to claim Social Security benefits at age 67, or even earlier.

Can Tom and Tammy still retire at FRA, meet their travel goals, and have the longevity-risk hedge they might need?

Social Security benefits may still be a good, COLA-adjusted, longevity-risk hedge for Tom and Tammy. Unfortunately, after the 2015 changes, it also may be riskier. Let's consider three different strategies, and their potential issues, that might offer possible solutions.

1. One Claims, One Waits

Either Tom or Tammy can claim Social Security benefits at age 67, creating cash flow to help support their travel goals. As their benefits are similar, the outcome will be similar. The remaining person can claim at age 70, gathering delayed retirement credits (DRCs). One benefit will have a higher lifetime payment with a COLA, helping manage longevity risk.

Potential Issue: *They may need to take income from other assets, because one Social Security benefit may not be enough to meet their travel goals.*

2. Both Claim at Age 67

Tom and Tammy could both claim Social Security benefits at age 67 and use their other assets to provide income later in life. As they will not receive DRCs, their ultimate benefits may be lower. However, their cash flow at age 67 will be higher. This might work well.

Potential Issue: *They will likely still need an additional longevity-risk hedge to provide predictable income later in life.*

3. Both Wait to Claim

Both Tom and Tammy could wait and claim Social Security benefits at age 70. They would both receive DRCs, which would provide them with a nice longevity-risk hedge. They will need an income bridge for the years before they claim and would use some of their assets earlier than planned. They also are concerned about leaving a legacy, and they worry about ways they can create temporary, and flexible, predictable income.

Potential Issue: *If leaving a legacy is important, some options for creating temporary income may not be appropriate*

Consider an Alternate Strategy

One possible solution for Tom and Tammy is to use the "one claims, one waits" strategy, but complement it with a variable annuity offering guaranteed principal protection. They want to travel, and one person claiming, plus a bit more, will achieve that goal. The portion of their funds in the variable annuity with principal protection will grow for the future, providing both protection and a longevity-risk hedge.

An additional potential benefit is flexibility. If Tom and Tammy find their circumstances change during the next 10 years, the principal protection will guarantee that a lump sum is available as a full distribution, or to produce income if they buy a single-premium immediate annuity (SPIA), or simply by taking distributions as desired. And, hopefully, their assets will continue to grow and provide a legacy for their children.

Next time, we will meet Lori and consider how to create a flexible solution for an "almost" retiree.

Additional Information and Links

Social Security Claiming Strategies Update (VLC1311-0319)

Social Security Strategies: Deciding When to Take Your Benefits (VLC1314-0319)

Social Securities Strategies: Deferring Social Security Benefits (VLC1309-0319)

Understanding Spousal Survivor Benefits (VLC1308-0319)

For additional information about hedging strategies, please contact the Retirement Strategies Group at (800) 722-2333, ext. 3939, or email RSG@PacificLife.com.

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VLC1845-0820W

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