SIDELINED MONEY—FLEXIBLE PROTECTION MAY HELP

The market may be a concerning investment choice for investors eyeing retirement within the next 10 to 15 years. How does one reduce or eliminate risk while still enjoying the full upside of the market?

Michael Stein coined three phases of retirement as the Go-Go, Slow-Go, and No-Go phases. In short, as retirees age and decrease their daily activities, their spending decreases as well. Understanding how retirees spend and the sources to use during these phases can improve the efficiency of a retirement distribution plan. It also can help the investor with legacy planning.

During the pandemic, variable market uncertainty made some investors prone to keeping their cash on the sidelines. There was uncertainty about how the variable markets were going to perform. In addition, interest rates hit a historic low and many were reluctant to lose liquidity in exchange for such a low rate of return. How can using a variable annuity with a cash accumulation benefit help this situation? For the purpose of this strategy, we will focus on the Slow-Go phase and consider how this option might be used.

A cash accumulation benefit provides a return of all, or a portion, of the client's investment regardless of market performance. This option might have different terms for each company and has an additional cost. This can provide the client with confidence that no matter how the market performs, he/she will get at least a portion or all his/her investment back at a specified time.

A nonqualified variable annuity offers tax deferral, which can help investors who would like to save now, but not pay taxes until they later use the asset for a type of insurance for legacy planning. While saving, dividends for the different annuity subaccounts are reinvested, but investors do not pay taxes while they remain invested. This is key for long-term investing, because the earnings continue to compound as the market performs. Most companies offer a return-of-premium (ROP) feature for investors who are concerned about a market decline and want to be sure that they leave assets to their beneficiaries. For an additional cost, some companies also offer an additional death benefit that can capture market performance and possibly a higher legacy. A recent DALBAR study suggests that investors in annuities tended to stay invested longer-resulting in better performance over time.

Let's put this together and see how we can use this strategy for the Slow-Go phase of retirement. Age ranges for this phase are generally from 75 to 84 years old. During this phase, the retiree is slowing down in spending and has possibly changed strategy from income to saving once again for his/her legacy and heirs. In addition, the retiree may have lifetime income from Social Security benefits and/or other sources of guaranteed income that were turned on during the Go-Go years to meet extra leisure needs.

Potentially, this lump sum of assets can help the retiree start saving once again, either to ensure longevity or for a legacy. However, this same client might be concerned about market performance and is not impressed with the low interest-rate environment. Enter the cash accumulation benefit and how it can work.

The client could take a part of his/her savings and purchase a variable annuity with a cash accumulation benefit. It is important to consider the client's financial situation and his/her goals, as well as different terms and costs. The cash accumulation term typically ranges from five to 10 years. Once the benefit is added, the client will have the assurance that he/she will receive back at least what was invested within the given period. Since the investment is in the variable annuity, the client can choose to invest in the equity market to take advantage of market performance, but some investment restrictions may apply. The key to this strategy is that there are no caps or limitations on earnings. Simply invest, walk away, and watch it grow with the knowledge of limiting loss, if any.

Clients no longer need to keep cash or assets on the sidelines. There are other investment options out there that allow them to have unlimited earning potential and minimal downside. As they move on to the next phase of retirement (No-Go years), they can decide how to use the investment depending on their needs at that time.

Additional Resources and Links

[Why Dividends Matter]

[Retirement Planning Strategies for Growth, Income, and Wealth Transfer]

[Michael Stein, "The Prosperous Retirement: Guide to the New Reality" (1998)]

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