THE LONGEVITY LESSON FROM SOCIAL SECURITY

The Social Security Administration knows longevity planning matters. What valuable lessons can clients learn from the history and basic functions of Social Security retirement benefits?

Most are familiar with the Social Security Administration and its retirement benefits, but Social Security also can offer some important lessons about longevity and why lifetime income matters. Many are not aware that between 1937 and 1942, the original Social Security retirement benefits offered a one-time lump-sum payment to those who qualified for the program. The average lump-sum payment was about $58—a relatively small amount for a time when the median annual income was $723.[1]

Realizing the lump-sum strategy didn't address longevity risk, the Social Security Act was amended to start monthly payments in 1940. The Social Security Board's report recommended the changes with a practical objective: To provide a minimum degree of Social Security retirement benefit as an income base for retirees. The Board understood that a monthly check could provide the base for a more secure retirement.

The Social Security Administration never forgot the importance of longevity planning. It even has a longevity calculator on its website along with the other benefit calculators to show how important Social Security can be.

Just as the Social Security Board realized the flaw with lump-sum payments, near-retirees need to understand how planning for lifetime income can address longevity risk. Retirees concerned about having enough income to support their lifestyles may need to do some additional planning. Let's review two common ways a client can create lifetime income and consider what might work best to help manage longevity risk.

Lifetime Income Options

- **Social Security Benefits and Pensions** Social Security and/or pensions can be compelling longevity hedges. There are similarities and differences between Social Security retirement benefits and pensions. It's important to note that pensions are becoming less common in today's work environment.
- **Lifetime Income Solutions with Downward Adjustment for Claiming Early** Like Social Security retirement benefits and pensions, this strategy offers lifetime payments that cover the worker or both the worker and a spouse. Social Security and pensions typically require a noticeable reduction of benefits if the worker claims early. A retiree's age also affects what annuity income benefits might be available.

Many options allow retirees to take lifetime income with payment adjustments based on when they claim their benefits, but each come with their own unique functions. It's important for clients to consider how these strategies may fit into a well-rounded portfolio as they plan their retirement journeys.

Features of Social Security Benefits and Pensions

- **Cost-of-Living Adjustment (COLA)** Social Security retirement benefits provide lifetime payments with a COLA—a potentially vital benefit in inflationary times. COLAs are less common in pensions, except government-based plans like federal or state plans.
- **Credit for Delayed Claiming** The Social Security Administration also allows workers to gain benefits by delaying the claims. This means a retiree can receive up to 124% of their original benefit at their full retirement age—a significant increase for waiting until age 70 to claim. Few pensions provide a credit for waiting beyond the full retirement age noted in the plan.
- **Beneficiaries** Social Security retirement benefits end when the recipient (or surviving spouse) dies. Nothing will pass to children or other beneficiaries. However, pension plans may or may not offer distribution options that could provide payments to a non-spousal beneficiary. As an example, a pension might offer a Joint Life with 10-Year Certain payment option. If both individuals passed away before the end of 10 years, a named beneficiary would receive any remaining payments.

Social Security retirement benefits are the retirement income base for most retirees. A pension could provide lifetime income as well, but not all retirees have access to pensions and lack sufficient guaranteed income to cover essential monthly needs. Even if a retiree does have access to both a pension and Social Security retirement benefits, he/she may still want more flexibility—or a "just in case" sum of money—that can be used later in life if needed. This is when lifetime income strategies such as immediate or deferred annuities could offer a potential solution.

Features of Immediate or Deferred Annuities

- **Specific Monthly Payments** A single-premium immediate annuity (SPIA) is an excellent source of lifetime income for a retiree who wants a specific amount of income. The retiree can choose from different payment options, such as Life Only, Cash Refund, or Period Certain. The payments will continue for the life of the retiree or for the retiree and spouse. If payments are not needed for the first 12 months, a deferred immediate annuity (DIA) is an option that typically requires less capital. For a retiree who wants to claim Social Security retirement benefits early, a DIA offers income that starts later and can act as a pay raise.
- **Flexible Payments** Some retirees want the ability to stop and start income payments or to take a lower payment. A fixed or variable tax-deferred annuity with an income benefit provides this flexibility. As an example, a retiree may need an income bridge to allow him or her to delay claiming Social Security retirement benefits. When the retiree does claim, he or she may need only a portion, or even none, of the annuity income. A deferred annuity with an income benefit typically permits that adjustment.
- **"Just in Case" Plan** Retirees may want a "just in case" plan, or money that's set aside to be used later for income or, if not needed, to pass to children and other beneficiaries. A deferred annuity that offers a credit while waiting to use the income benefit allows the funds to be invested while ensuring a specific amount of income later. If not needed, the annuity can pass to heirs. If the heir is an individual, such as child or grandchild, the beneficiary can take distributions over his or her fixed life expectancy with access to additional funds if desired.

Longevity planning is an important part of any retirement-income plan. Social Security retirement benefits and pensions may provide a base, but when additional income is needed, the features of an annuity can improve retirement security by following the same principles that led the Social Security Board to opt for monthly payments in 1940.

Actions You Can Take Right Now

- Identify retirees and pre-retirees who may need additional income in retirement.
- Review both Social Security retirement benefit estimates and the 401(k) Lifetime Income Illustration for those making claiming decisions.
- Consider whether a "just in case" plan may benefit certain clients.

Additional Resources and Links

Social Security Analyzer Tool

Social Security and Longevity Planning–It's a Match!

Using Retirement Funds to "Mind the Gap" for Social Security Benefits

For more information about retirement planning,
please contact our Retirement Strategies Group at
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[1]Old Age Insurance: Covered Workers and Average and Median Wages in 1937. Last assessed 4/24/2023.

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