WHICH BRIDGE MIGHT WORK BEFORE CLAIMING SOCIAL SECURITY BENEFITS?

Is your client planning on using Social Security benefits as a longevity hedge? That can be a great strategy, but those who want to retire before they claim may need an income bridge.

Our neighbors want to retire at age 60, they enjoy volunteering and travel, and want to do more in their "go-go" years. While chatting recently, one couple noted that they would like to pull the trigger at age 65 when Medicare is available. But they want to wait until age 70 to claim Social Security benefits. As both have active parents in their 90s, they like the idea of a lifetime monthly payment with a cost-of-living-adjustment (COLA). They want enough predictable income to cover their essential expenses. While they have saved carefully, they are concerned that if they spend too much in their early years, they could run short of funds.

They also are familiar with the retirement spending smile, which means that their spending will likely reduce as they grow older and become less active.

Do my neighbors have to wait, or is there an income bridge strategy that might allow them to retire at age 65? There are several options they might consider.

Set aside a cash fund to cover the years between now and claiming Social Security benefits.

They could set aside cash each year to fund their income bridge. This cash account could cover the five years between retirement at age 65 and claiming. This is an easy way to ensure funds are available. It also can reduce their sequence-of-returns risk. A downside: there can be opportunity cost because funds most likely earn only the safe money rate. Another trade-off is that if the couple underperforms their life expectancies, Social Security benefits end. Owned assets pass to heirs.

Use their qualified/IRA assets.

Traditional IRAs and qualified plans are spend-down accounts. The IRS requires that an IRA begin required minimum distributions (RMDs) by age 72. Since these funds must be used, starting to spend at age 65 might both provide needed income and reduce the future RMDs. A challenge might be the need for a higher distribution than the sustainable withdrawal rate desired. There also is more sequence-of-returns risk. Market volatility could mean depleting funds that might be needed later.

Use one of the longevity annuities, such as a DIA.

A deferred income annuity (DIA) creates a future lifetime payment that can be a good longevity hedge. The couple could claim Social Security benefits at age 65 and use the deferred income annuity for income later in life. This would allow them to benefit from the insurance company's mortality credits. Any funds not used would go to their heirs. But DIAs are illiquid assets and may or may not allow for flexible timing of the payment start date.

Possible alternative solution: a variable annuity that offers a flexible lifetime payment option.

Some variable annuities offer flexible income benefits. There might be a credit toward higher income before distributions start. Some variable annuities offer a higher withdrawal rate that reduces if the annuity is depleted. An example is a payment that starts at 7.0% at age 65. However, if the contract is depleted to zero, the payment drops to 3%. (Remember the retirement spending smile: this makes the clients a bit less concerned about this possibility.) The couple could reduce their distribution rate when they claim Social Security benefits. This strategy both continues the predictable income needed for their essential expenses and lessens the risk the annuity will be depleted. Because the additional benefit means less liquidity, the annuity might be considered a lifetime payment asset. Plus, any assets not used will go to their heirs.

My neighbors decided on a variable annuity with a flexible lifetime payment option purchased with IRA funds. They can commit funds now and know what their income payment will be at age 65. They feel confident that this flexible strategy will allow them to retire at age 65, have their essential expenses covered during their lifetimes, and have any unused funds go to their heirs. They are already planning their first trip!

Additional Resources and Links

Social Security Benefits Video

Social Security Benefits FAQs

Retirement Income Translator

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