



AMERICAN ACADEMY of ACTUARIES

Lifetime Income Initiative

ISSUE BRIEF

OCTOBER 2015

PLANNING THE RETIREMENT JOURNEY

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Retiree Lifetime Income: Choices & Considerations

Key to retiring with sufficient lifetime income is making good financial choices. The most fundamental choices are made very early on, decades before retirement. Saving for retirement at meaningful levels throughout your working lifetime is crucial. Not tapping into those savings before retirement is another critical choice. Making investment or other retirement-plan selections best suited to the time frame remaining before retirement commences is a good choice, as is selecting investments that minimize fees.

What are the good choices to be made during those five or 10 years leading up to a planned retirement and during retirement? Unfortunately, this is a more complicated process than the earlier savings phase. This paper explores some of key decision areas and options available in making good choices. It is intended to be educational in nature and is not to be taken as offering specific financial advice. Each individual has unique personal circumstances and needs. In addition, needs and circumstances are subject to change as one ages. The information provided here is intended to explain many considerations in retirement planning generally.

The Consumer Financial Protection Bureau has provided a list of questions consumers can consider when choosing a financial adviser. “Know Your Financial Adviser” can be accessed at http://files.consumerfinance.gov/f/201311_cfpb_flyer_senior-financial-advisors.pdf

1. When to Retire

Working longer should enhance the chance of retiring with a greater lifetime income. The longer one works, the greater the potential savings and the fewer the years that those retirement savings must last. There are other benefits that may not be quite as apparent. Working beyond age 70½ may allow for postponement of distributions from one’s employer-sponsored retirement plan and payment of taxes on them, thus preserving more

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Objective. Independent. Effective.™

1850 M Street NW, Suite 300, Washington, DC 20036

Tel 202 223 8196, Fax 202 872 1948

www.actuary.org

Mary Downs, Executive Director
David J. Nolan, Director of Communications
Craig Hanna, Director of Public Policy
Matthew Mulling, Policy Analyst, Pension

funds for the future. In addition, continued earnings could increase Social Security benefits. Continuing to work might also mean the continuation of benefits from an employer, such as health insurance that replaces or supplements Medicare. Not everyone will have the option to continue to work. But for those who can work even a few more years—especially those who may not have saved enough for retirement—the choice to keep working may be a good one.

Additional valuable information: “Big Question: When Should I Retire?” available at <http://www.soa.org/managing-retirement/> “Chapter Five – Five Ways to Close the Gap,” available at <http://www.dol.gov/ebsa/publications/nearretirement.Html>

2. When to Claim Social Security Benefits

It is a widely held view that people in good health should consider delaying commencement of Social Security benefits to age 70. The Social Security retirement benefit will increase 8 percent per year for each year beyond the Social Security Normal Retirement Age that the retiree delays receiving benefits, up to age 70. For example, consider an individual with a Social Security Normal Retirement Age of 66. By waiting until age 70 to collect benefits, Social Security will provide a 32 percent higher benefit amount when compared to the benefit payable at 66. Electing to defer benefits also provides greater benefits to surviving spouses. Of course, in order to exercise this option, individuals need to either have accumulated sufficient financial resources, perhaps through retirement benefits, to be able to support themselves until age 70 or continue to work earning an income.

Additional valuable information: “Retirement/When to Apply,” available at <http://www.ssa.gov/planners/retire/> “When Should I Take Social Security Benefits?” available at http://www.nasi.org/sites/default/files/research/BRIEF_When_Should_Take_Social_Security.pdf “Deciding When to Claim Social Security,” available at <http://www.soa.org/managing-retirement/>

3. Planning for an Unknown Length of Retirement

Everyone should, to the extent possible, plan for a retirement that may extend beyond his or her average life expectancy. Life expectancy is not a measure of when one will die, rather a measure of how long people of a certain age will live on average. Half will die sooner, half will die later. Many will live much longer than average life expectancy. How long we will live depends on such factors as our age at retirement, gender, health, lifestyle habits, family history, and luck. It is a good idea to plan for a range of possible life expectancies, including the potential for a very long retirement period. The table below (based on Social Security Administration data) shows the probability of living from age 65 to various advanced ages, both for the general population and for someone with 25 percent lower expected mortality. This latter group (75 percent of Social Security mortality) generally represents those who are fortunate to be in good health, have lived healthy lifestyles, and have worked in jobs that did not take a physical toll. The “Survivor” columns show the probability that at least one member of a couple will live to the various ages shown in the first column.

Probability of Living From Age 65 to Various Ages						
Age	General Population (Social Security Mortality)			Persons with 25% Lower Mortality (75% of Social Security Mortality)		
	Male	Female	Survivor	Male	Female	Survivor
80	60%	71%	88%	68%	77%	93%
85	40%	53%	72%	51%	62%	81%
90	20%	31%	45%	30%	42%	60%
95	6%	12%	18%	13%	21%	31%
100	1%	3%	4%	3%	7%	10%

4. How Much Retirement Income Is Needed

It is advisable that everyone planning for retirement should prepare a detailed analysis of future living expenses—fixed, discretionary, and emergency. This analysis is also important at earlier stages of one’s working years in the event of circumstances that prematurely impose the onset of retirement. It is important to understand which expenses can be reduced if necessary and which cannot. This analysis can take the form of developing a retirement budget, which should include provision for future price inflation on consumer goods and services, and should reflect lifetime income needs based on projections of a range of life expectancies and expected investment returns. A retirement budget should be formulated with consideration of all of one’s income sources, such as Social Security benefits, annuities, any pensions, and investment income. Important to this process is recognition that different stages of retirement bring with them different expenses. Early in retirement, travel expenses might be greater, while medical and home care costs may be more significant in later stages.

5. How Leaving an Inheritance Factors Into Retirement Planning

Common ways to leave an inheritance include maintaining life insurance, dying with a home that has little or no mortgage, and setting up a dedicated trust. These approaches, however, will limit the amount of funds available for retirement living expenses. Legacy planning is challenging because of uncertainty about how long one will actually live, unexpected expenses that one may incur, and future investment returns or future inflation rates. If an asset such as a home is intended for legacy purposes, the retiree will be unable to use it for lifetime income. Funding a lifetime income plan with some of the assets is more likely to avoid the potential for the retiree to become a financial burden in his or her lifetime on those heirs intended to receive a legacy.

6. What Income Annuities Are and How They Work

Single Premium Immediate Annuities (SPIAs) start lifetime income payments immediately upon purchase, and Deferred Income Annuities (DIAs) defer the payments to a specified date in the future. For both types of annuities, an insurance company provides a guarantee of a monthly fixed benefit payable for the life of the annuitant. For an additional cost, the income can be paid for a guaranteed minimum period, such as 10 years, to a beneficiary if the annuitant dies during that period. Some annuity products also feature a cost-of-living increase that adjusts the benefit annually. Prospective annuitants can purchase annuities at a reduced cost if they can demonstrate that their health is impaired; such a product is called a *substandard health annuity*.

Annuities are based on the principles of risk pooling to provide a guaranteed lifetime income. If an annuitant lives beyond his or her life expectancy, he or she should receive a greater cumulative benefit than if there is no risk pooling, assuming comparable investment returns under both approaches. SPIAs and DIAs are different than deferred fixed or variable annuities in that, while potentially providing guaranteed fixed income at some point in the future, deferred annuities generally are used to accumulate assets on a tax-deferred basis.

7. Considerations for Utilizing an Income Annuity

If guaranteed income from Social Security and a pension (if available) do not cover future basic living expenses, an income annuity can make up the shortfall. Having a guaranteed income stream in place to cover living expenses can provide assurances that one will not outlive assets. This goal can be accomplished with a SPIA, DIA, a guaranteed income benefit on a deferred annuity, or a contingent deferred annuity, which is an income guarantee added to other investments. This security can allow for focusing on other goals, such as on building

a rainy day fund or inheritance, or being more aggressive in investing remaining assets.

However, those in very poor health may find it inadvisable to buy an annuity, unless it is a substandard health annuity at a very discounted price. There are few circumstances when it might be advisable for anyone to use their entire retirement nest egg to buy an annuity, because most income annuities do not allow withdrawals for emergencies. Some people delay the purchase of an annuity to a more advanced age, with the intent of waiting until the value of the mortality risk pooling makes the annuity more attractive than average alternative investments on an annual basis. When purchasing annuities, careful review of the financial strength of the insurer should always be undertaken.

Additional valuable information: “Designing a Monthly Paycheck for Retirement,” available at <http://www.soa.org/managing-retirement/> “Making Your Money Last for a Lifetime: Why You Need to Know About Annuities,” available at http://www.actuarialfoundation.org/publications/wiser_annuities.shtml

8. Determining the Need for Life Insurance

Life insurance might be useful during retirement for several reasons: to provide support for a dependent upon your death; to pay estate taxes for those who have accumulated significant illiquid assets; to leave an inheritance to loved ones or charity; or to settle end-of-life expenses. Life insurance will not directly help secure lifetime income; however, it may indirectly help in that one’s nest egg need not be earmarked for these purposes.

Additional valuable information: “Life Insurance: It’s more than a death benefit,” available at http://www.insureonline.org/insureu_type_life.htm

9. Planning for Uninsured Medical Expenses

Medicare does not cover all medical expenses, and out-of-pocket medical expenses might be

incurred. Out-of-pocket costs can be limited by purchasing Medicare supplement insurance, which provide various premium and benefit features. Alternatively, Medicare Advantage plans often cover these costs, although some options may be limited. Some retirees may have worked for employers that provided post-retirement medical coverage, although this practice is becoming less common. For those who exhaust their savings, benefits might be available through Medicaid. One should be aware that the need and cost for health care services generally increases with age.

Additional valuable information: “Securing Health Insurance for the Retirement Journey,” available at <http://www.soa.org/managing-retirement/> “Chapter 3 – Tracking Down Future Expenses/ Facing Down Future Costs,” available at <http://www.dol.gov/ebsa/publications/nearretirement.html> “Section 1 – Learn How Medicare Works,” available at <http://www.medicare.gov/Pubs/pdf/10050.pdf>

10. Planning for Long-Term Care

Long-term care insurance (LTCI) is a private market insurance product designed to provide services and support benefits in the event that one needs care in either an approved facility or at home. LTCI policies do not provide medical benefits. They generally provide a monthly benefit with a lifetime cap. Policies can be purchased with varying waiting periods before benefits commence, optional cost-of-living increases, and shared benefits between spouses. Premium levels are based on age, gender, and medical history. Insurers generally are permitted to raise the premiums in the future on groups of policyholders, but not selected individuals, with the approval of a state insurance regulator.

Those individuals with significant wealth can self-insure their long-term care needs. Those with limited assets might qualify for Medicaid Long-term Care benefits. There are those in the middle who can benefit from LTCI. Carrying LTCI can indirectly provide lifetime income by reducing the risk of having to pay for long-term care costs from your retirement nest egg.

Additional valuable information:
“Long-Term Care Insurance,” available at <https://www.wiserwomen.org/images/imagefiles/Long-term%20care%20insurance.pdf>
“Taking the Long-Term Care Journey,” available at <http://www.soa.org/managing-retirement/under>
“Long-Term Care Insurance,” available at http://www.insureuonline.org/insureu_special_longtermcare.htm

11. Using a Home to Provide Income

Home equity can be used to provide income through a home equity loan or line of credit for qualified borrowers, but lenders usually require monthly loan payments. Alternatively, reverse mortgages allow those age 62 or older to obtain lump-sum payments, lines of credit, or lifetime incomes by drawing on the value of their homes. This prospect can be attractive for those who lack alternatives and require additional income on a temporary or permanent basis. When the home is actually sold or when the reverse mortgage holder dies, the accumulated amount due on the reverse mortgage must be repaid, thus reducing the net value that would be available to the owner or left to heirs. However, repayment of mortgage balance in excess of the home value is not required. Undertaking a reverse mortgage can get complicated, and possibly substantial fees may be incurred. Borrowers interested in using home equity to meet income needs should compare terms and fees for reverse mortgages, home equity loans, and lines of credit to find the arrangement that best suits their needs.

Downsizing to a less expensive home is another way to realize some value from a home that can be used to provide an income.

Additional valuable information:
“Considering a Reverse Mortgage?” available at http://files.consumerfinance.gov/f/201306_cfpb_flyer_reverse-mortgage.pdf

12. Having a Mortgage or Other Debt

Assuming funds are available, the decision to pay off a mortgage will depend on many factors,

including the mortgage interest rate, whether the mortgage rate is fixed or variable, and the remaining term of the loan. Other factors to consider include how long residents plan to stay in the home, their income tax bracket, and how the funds that would be used to repay the mortgage might otherwise be utilized. It is prudent that debt for other purposes generally be restricted to short-term loans or when interest rates are lower than can be earned with safe investments. Whether maintaining debt in retirement helps to enhance lifetime income levels will depend on the specifics of each retiree’s situation.

Additional valuable information:
“Carrying Mortgage Debt Into Retirement?” available at http://www.aarp.org/content/dam/aarp/money/budgeting_savings/2014-11/carrying-mortgage-debt-into-retirement-aarp.pdf

13. Plan Benefit Options: Lifetime Income or Lump Sum

Many retirees believe that a lump-sum option will provide them with greater control and higher lifetime income. There are advantages to lump-sum payments as well as some significant risks. Considerations in electing a lump-sum option include:

- Whether there are any guarantees, such as from an annuity purchased with a portion of the lump sum, that the lump sum will last long enough for retirees and their spouses so that they will not run out of money, especially if they live longer than average.
- Retirees’ ability to manage money, and whether that ability will change in five, 10, or even 20 years into retirement. Similarly, to the extent a retiree’s ability to manage their own finances over time diminishes, will a spouse (if present) be able to manage that responsibility?
- Poor investment performance of the lump-sum distribution. This can result from general stock market downturns, or simply choice of investment portfolio, whether assisted by professional financial advisers or otherwise.
- What are the tax consequences of taking a lump sum?

- After taking the lump sum, is there an ability to purchase the same level of lifetime income had an annuity or similar program been elected?

Lump sums can be good choices for certain individuals: those in very poor health who anticipate shorter-than-average life expectancy, those with very significant nest eggs, or those who have sufficient guaranteed income to cover their future basic living expenses, for instance. However, everyone considering taking a lump-sum option should weigh the pros and cons very carefully.

Additional valuable information: “Don’t Run With Your Retirement Money,” available at http://www.actuarialfoundation.org/publications/dont_run.shtml “Annuity or Lump Sum?” available at <http://pbgc.gov/wr/benefits/lump-sum-or-annuity.html> Lifetime Income Calculator, available at <http://www.dol.gov/ebsa/regs/lifetimeincomecalculator.html> (Note this calculator was not intended to be used in deciding whether an annuity or lump sum is more valuable as of a particular date. However, it provides a rough comparison of lump-sum value and possible income, although the interest assumption is high for the current economic environment.)

14. Annuity Benefit Options Under a Traditional Pension Plan

Retirees who are covered by a traditional pension plan that does not offer a lump-sum option, or those deciding not to take the lump sum, need to select an optional form of monthly annuity payment. For individuals, a lifetime payout is the default form of payment. In the case of married participants, traditional pension plans require that the default benefit option provide a benefit to surviving spouses upon the deaths of annuitants. However, couples can elect out of the default options. Many defined benefit plans offer other annuity optional benefit forms, such as lifetime income with guaranteed minimum payout periods (e.g., five or 10 years). Benefits to a spouse upon early death of an annuitant can vary, often from 50 percent of the initial monthly benefit to

100 percent. The option selected affects the amount of the initial monthly benefit and cannot be changed once the payments commence. The option ultimately selected should reflect the need to provide a continuing income to spouses or, in some cases, other dependents.

Additional valuable information: “Qualified Joint and Survivor Annuity,” available at <http://www.myretirementpaycheck.org/retirement-plans/payment-options.aspx>

15. Keeping 401(k) and Other Pension Accounts in the Plan When Leaving a Job

Retirement plans allow workers to keep their accounts in the plan until retirement age even after terminating employment, unless the value is under \$5,000. Some retirement plans may allow plan participants to keep accounts in the plan even after retirement regardless of the balance. In this case, the participant needs to assess whether the benefits should remain in the plan or be rolled over to an Individual Retirement Account (IRA).

Important to consider here are a plan’s administrative and investment expenses, whether a plan’s investment choices are appropriate for one’s current and future investment plans, and what future lifetime income options are available if the decision is made to wait. There are many more options (with a very wide range of fees) available outside of employer plans. However, for many, the level of complexity involved in making a rollover selection may lead retirees to a safer and wiser choice to keep funds in the plan, where available.

Additional valuable information: “401(k) Rollovers,” available at <http://www.finra.org/investors/401k-rollovers>

16. Managing a Retirement Portfolio

Managing investment risk within retirement accounts becomes more critical when approaching retirement age and continuing into retirement. Riskier asset classes such as stocks have historically provided higher

long-term returns and some protection against inflation, but are subject to shorter-term risks when compared to other investments such as bonds. The recessionary period that began in 2007 resulted in significant near-term challenges for retirement portfolios of those at or near retirement who held significant stock exposure. Those who needed to withdraw funds or move assets out of stock positions during the market downturn fared poorly. How much equity exposure is too much depends on each individual's willingness to accept risk and overall financial position. Those with a guaranteed income to cover living expenses in retirement can more readily take on more risk than those who are largely dependent on their investment portfolio to meet essential living expenses.

An array of options are available to manage investment risk, including SPIAs and DIAs. An investment strategy using fixed-income securities with progressive maturity dates, also known as "laddering," is another alternative. Some insurers offer variable annuities that can provide a guaranteed lifetime retirement benefit regardless of investment performance; however, these products have additional fees and restrictions.

Additional valuable information: "Treating Asset Allocation Like a Roadmap," available at <http://www.soa.org/managing-retirement/>

17. Tax Implications on Pension Benefits

Generally speaking, upon attainment of age 70½, individuals must commence distributions of benefits from tax-qualified accounts such as IRAs, 401(k)s, etc. This requirement does not apply to Roth accounts nor does it apply to employer-provided retirement plan benefits for individuals still employed who do not own at least 5 percent of the employer sponsoring the plan. The decision whether to postpone

taking taxable distributions as long as possible or withdrawing earlier and incurring taxable income requires prior planning, which could include a review of applicable tax brackets and determining whether there is an ability to stay within one's desired tax bracket by managing the payout over time. A delay of distributions, with the higher payout level, could cause one to be assessed at that point in a higher tax bracket, in which case it might make sense to start distributions earlier even if there is not a current pressing need for the distribution of those funds. An option for some might be a conversion of those funds to a tax-qualified Roth IRA, where they will be taxed but then will accumulate earnings tax-free. Lifetime income is enhanced to the extent that income taxes are minimized.

Additional valuable information: "Pensions and Annuities," available at <http://www.irs.gov/taxtopics/tc410.html>

Summary

Successful financial outcomes in retirement require good planning and well-informed choices. Often, a decision made in one instance may impact a future choice. For example, if you choose to delay the start of Social Security benefits, you may want to make different choices in managing portfolio risk. With sufficient life insurance in force, you may consider selecting a pension payout with lesser spousal benefit features. Thus, these decisions are dependent on one another, and you need to assess your personal circumstances and competing goals and objectives before crafting a balanced strategy based on sound choices.

Individuals may want the advice of professionals in making choices. Workers and retirees should seek out professionals who are highly qualified, experienced, and financially independent of specific solutions or products.

Members of the Academy's Lifetime Income Risk Joint Task Force who participated in drafting this issue brief include: Noel Abkemeier, MAAA, FSA – co-chairperson; Nancy Bennett, MAAA, FSA, CERA; Bruno Caron, MAAA, FSA; John Esch, MAAA, FSA; Andy Ferris, MAAA, FSA, FCA; Andrew Forgrave, MAAA, EA, FCA, MSPA; C. David Gustafson, MAAA, EA, FCA; Novian Junus, MAAA, FSA; Barbara Lautzenheiser, MAAA, FSA, FCA; Cynthia Levering, MAAA, ASA; Tonya Manning, MAAA, EA, FSA, FCA – co-chairperson; Mark Shemtob, MAAA, EA, ASA, MSPA; Kenneth Steiner, MAAA, FSA; Steven Vernon, MAAA, FSA; Zorast Wadia, MAAA, EA, FSA, FCA; Benjamin Yahr, MAAA, FSA