EQUITABLE

A case for income

Strengthening the three-legged stool for today's retirees

New insights to drive client outcomes

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Introduction

The year 2025 marks the peak of the **Peak 65® Zone,** the largest surge of retirement-age Americans turning 65 in our nation's history.[1] Over 4.1 million Americans will turn 65 each year from 2024 through 2027, which is more than 11,400 every day in 2025.[2] And the nation's retirees face a growing gap in the level of protected income they need, can count on throughout retirement and will not outlive. One research paper estimates that for households with insufficient income in retirement, the gap amounts to an annual shortfall of $7,050. That would amount to an annual national retirement income gap of approximately $230 billion in 2040.[3]

The old metaphor of the three-legged stool of retirement planning — employer pensions, personal savings and Social Security — no longer holds.[4] Retirees today face the challenge of replacing the employer pension leg in order to create a reliable income in retirement, which creates greater pressure on funding a lifestyle from retirement savings.[5]

How can retirees effectively fund a lifestyle goal? Many investors believe they are reducing risk by shifting their investments into assets that appear stable, such as CDs, money market accounts or bonds, but offer less lifestyle security when converted into income. Another approach is to increase the strength of the income and Social Security legs. **By focusing on increasing lifetime income, a retiree can reduce reliance on using savings and investments to fund a lifestyle.**

1 "The Peak 65® Zone is Here — Creating a New Framework for America's Retirement Security," Published January 2024. protectedincome.org/wp-content/uploads/2024/01/Whitepaper_Fichtner.pdf.

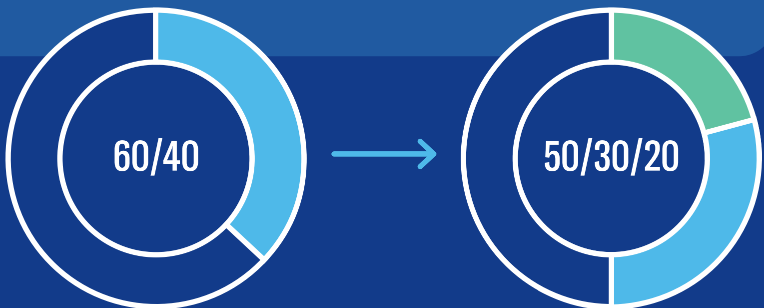
2 The data used for this calculation are from the Social Security Administration. ssa.gov/OACT/HistEst/Population/2023/Population2023.html & https://www.ssa.gov/OACT/HistEst/Population/2023/SSPopDec_TR2023.xlsx.

3 "The Cost of Doing Nothing: Federal and State Impacts of Insufficient Retirement Savings." ESI Econsult Solutions, Inc. May 2023. econsultsolutions.com/wp-content/uploads/2023/05/Impacts_of_Insufficient_Retirement_Savings_May2023.pdf.

4 Source: ssa.gov/history/stool.html.

5 For a review of the literature and evidence, see, for example: "How Will Retirement Saving Change by 2050? Prospects for the Millennial Generation." Gale, Gelfond and Fichtner. March 2019. brookings.edu/wp-content/uploads/2019/03/How-Will-Retirement-Saving-Change-by-2050.docx.pdf.

A primary goal for today's retirees could be to convert some of their defined contribution plan assets into a protected income stream that provides additional guaranteed income through the use of annuities on top of Social Security retirement income. It's important to now view protection as an asset class. A simple change from a **60/40** equity/bond portfolio allocation to a **50/30/20** equity/bond/protected income portfolio allocation may provide necessary guaranteed income to pay essential expenses in retirement.



Retirees can increase the strength of the income leg by adding a **lifetime income guarantee** that reduces the risk of an unknown length of retirement, provides protection against the risk of low returns early in retirement (known as sequence of return risk), and takes advantage of the ability to defer tax on gains. The Social Security leg can be strengthened by bridging spending between retirement and age 70, also known as delayed claiming, in order to provide an increasing lifetime income that will reduce the need to take withdrawals from savings later in retirement. By increasing the income legs of the three-legged stool of retirement planning, retirees can gain greater lifestyle security.

The new retirement landscape

With advancements in healthcare, people are living longer, offering more time for leisure, growth and relationships, but also demanding a more robust plan for funding 20 to 30 years or more of income.

Additionally, societal shifts, such as the decline of defined benefit pensions and the rise of defined contribution plans, place greater responsibility on individuals. Combined with uncertainties in markets and policy changes, retirees must navigate a complex path to ensure not just survival, but a life of meaning and financial security.

Several economic and demographic factors have reduced the strength of the employer-provided income leg of the retirement stool. First, very few private sector employers still offer a traditional defined pension retirement plan that provides protected income guaranteed throughout retirement. Since the number of people retiring with a traditional pension has declined significantly over the past several decades, more people are now saving for retirement in defined contribution plans. This has shifted the nature of protected income in retirement from receiving pension payouts as income in retirement to replacing that pension income with protected income strategies generated from defined contribution plan assets.[6] The risk and burden of funding adequate income has shifted entirely to the individual, and many are unprepared to make optimal retirement income decisions on their own.[7] The movement away from pensions creates an increasing need for financial professionals who can design a retirement income plan that blends traditional investments and private sector lifetime income strategies to meet lifestyle needs.

Second, a volatile investment market makes it challenging for retirees to generate sufficient, consistent, risk-free new income from their retirement savings that keeps pace with inflation and, equally important, can last throughout retirement. Volatility and uncertainty over interest rates adds further complexity and risk to the retirement income challenge facing retirees. Further, relying on equities and bonds as a primary option for meaningful income generation on savings creates higher levels of ongoing risk for retirement income management, including exposure to sequence of return risk, where negative investment returns early in retirement may not be overcome.[8]

Third, a significant percentage of people are claiming Social Security benefits early and missing out on the larger monthly benefits they could receive if they delayed claiming for just a few more years, depriving them of a more robust, fully protected income stream throughout their retirement.[9]

6 "The Changing Nature of Protected Income in Retirement." John Sabelhaus. Retirement Income Institute. July 2022. protectedincome.org/wp-content/uploads/2022/07/RP-09-Sabelhaus_v3.pdf.
7 "The Retirement Income Challenge in 401(k) Plans: Overcoming Legal Obstacles." Fred Reish and Bruce Ashton. Retirement Income Institute. January 2022. protectedincome.org/wp-content/uploads/2022/04/RP-04-ReishAshton_r2.pdf and "Risk Literacy in the U.S.: New Evidence and Implications for Retirement Planning and Financial Fragility." Lusardi, et al. December 2023. protectedincome.org/research/risk-literacy-in-the-us-new-evidence-and-implications-for-retirement-planning-and-financial-fragility/.
8 Source: Retirementresearcher.com/navigating-one-greatest-risks-retirement-income-planning/.
9 "How to Help Americans Claim Social Security at the Right Age." Fichtner, Koenig, Akabas and Gladstone, Bipartisan Policy Center. August 2020. bipartisanpolicy.org/download/?file=/wp-content/uploads/2020/08/BPC-Economy-Brief-SS-Claiming.pdf.

Strengthening the personal income leg

In the absence of an employer pension, a retiree must supplement their lifestyle by creating an income from savings. It may be tempting to believe that by taking less investment risk, for example by investing in CDs, money markets or other low-risk assets, a retiree can create a stable lifetime income to pay for basic expenses not covered by Social Security, such as property taxes, utilities, healthcare and insurance. Unfortunately, investment risk is not the only risk a retiree faces. They also face the risk of not knowing how long retirement will last.

Within an investment portfolio that consists of stocks, bonds and cash, annuities can substitute for bonds and cash investments to provide a higher and more secure lifetime income because they are designed to protect against longevity risk.

Asset allocation and annuities

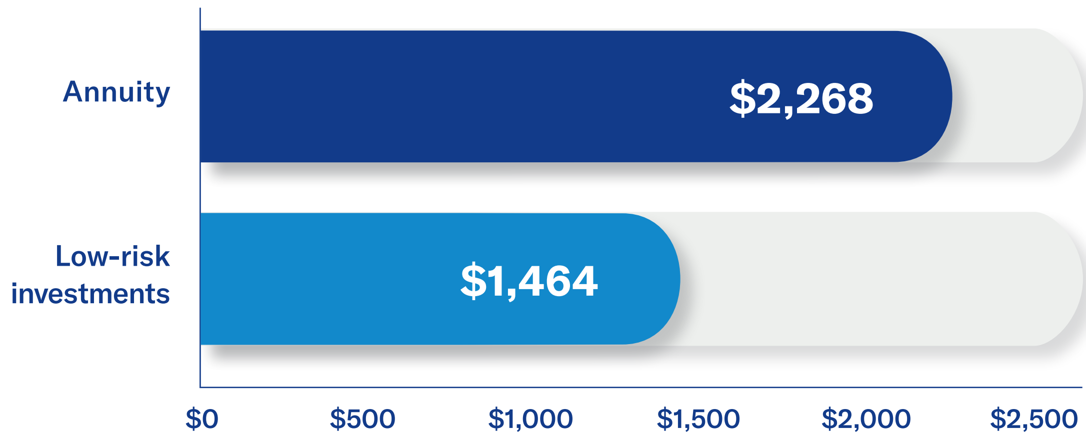
Consider a 60-year-old healthy woman who has saved $250,000 in certificates of deposit (CDs) to fund these basic expenses after she retires. Her remaining investments will fund more flexible spending goals and her bequest. At today's CD rates and at a 32% combined state and federal marginal tax rate, she can grow her $250,000 to $308,724 by age 67 when she retires.[10] At retirement, she would like to invest in low-risk investments such as Treasury bonds to create an income to an age at which she has only a 10% chance of outliving her savings, which is about age 100.[11]

10 Average of top five CD rates on bankrate.com June 6, 2025 (roughly 4.5%).

11 Society of Actuaries Individual Annuity Mortality table (2012) with 0.5% annual mortality improvement to 2025.

Would she be able to spend more with an annuity? Consider the following example that illustrates the minimum income a retiree could create from an annuity purchased for $250,000 at age 60 with income withdrawals beginning at age 67. She can spend $2,268 each month with a deferred income annuity and $1,464 if she invests in CDs earning 4.5% until age 67 and then purchases $308,724 of Treasury bonds that mature to provide a stable income until age 100.[12] In other words, each month she can spend an extra $804, or about 55% more, by investing $250,000 in an annuity 7 years before retirement rather than investing in safe assets such as CDs and Treasury bonds.

Monthly income at age 67



How is it possible to spend more in retirement through the use of an annuity? First, an annuity allows a retiree to spend more each year without the fear of running out of money because an annuity transfers the risk of an unknown lifespan to an insurance company. Imagine that the retiree only wanted to spread out their savings to cover basic expenses until their average longevity, which for a 67-year-old retired woman, is roughly age 90. Half of the time, this risky strategy will result in running out of money. What if she spreads her savings to age 95? She will still have about a 30% chance of running out. Typically, retirees would not be willing to take this risk, so they will spend less.

Forty-five percent of the increase in monthly income comes from a concept known as longevity risk pooling. A retiree can spend more by transferring the risk of an unknown lifespan to an insurance company because they don't know how long retirement will last. If a retiree is not willing to risk the possibility of running out of savings in old age, they will need to spend cautiously. Pooling this risk through an annuity lets the retiree enjoy their lifestyle without the fear of running out.

12 Average of top five DIA rates from Cannex for a woman age 60 with income commencing at age 67 incorporating a cash refund option, and Treasury bond yields as of June 6, 2025.

Second, the government encourages retirement saving through the use of an annuity by offering tax deferral on the growth of assets held within the annuity. Since she purchased the annuity at age 60 and began income at age 67, she received 7 years of tax-deferred growth within the annuity. This provided about 10 percentage points of the 55% increase in income.

The transfer of longevity risk can occur either through full annuitization (trading savings for a promise of income) or through a living (income) benefit. An income benefit allows a retiree to invest within an annuity and provides the ability to continue spending from the annuity even after the account value falls to zero. This type of annuity with an income benefit offers greater accessibility, optionality about how much (and when) to take income, and the possibility of future income growth if investments held within the annuity rise in value.

In addition to the mathematical benefit of annuities, research shows that the ability to receive a lifetime income guarantee allows retirees to spend twice as much as a retiree with retirement investments of an equal value.[13] Financial professionals may view purchasing additional protected income from a retirement portfolio as a trade-off for potential growth in assets. While retirees may be excited about the prospect of claiming Social Security when they retire, claiming too early means that a retiree will need to take more money out of investments to fund spending goals for decades. Financial professionals can help retirees focus on the benefit of delayed claiming by showing them how much of their future budget will be covered by higher Social Security retirement payments and protected lifetime income from an annuity. Showing the percentage of a budget that will be covered by lifetime income sources is an easy way to help clients recognize the value of a strengthened-income approach compared to an early-claiming, investments-only approach. By increasing the share of wealth allocated to guaranteed income, retirees can address both longevity risk and achieve a more comfortable and enjoyable retirement by feeling the freedom to spend more.

Because retirees spend more from the portion of their savings allocated to an annuity (as shown in the example above), they can meet a greater percentage of their income goal from a smaller percentage of their investment portfolio. **They can also take greater investment risk from the remaining portfolio since they now have a stream of income that covers less-flexible expenses, allowing them to invest more aggressively to cover more flexible expenses and legacy goals.**

Allocating more of a retiree's portfolio to protected income has another additional benefit — it can help them stay calm during market fluctuations. For example, market volatility was extremely high during 2020 due to the COVID-19 pandemic.[14] More recently, the first half of 2025 also experienced extreme market volatility.[15] The S&P 500 stock index ended 2024 at 5,881.63 and fell to a bottom of 4,982.77 on April 8 before rebounding to finish the first 6 months of 2025 at a record high of 6,198.01. That's a 15.3% decline over roughly the first 3 months of 2025 and then a 24.4% increase from the April 8 low to the close on June 30. Returning to the market volatility in 2020, research on investor trading found that investors aged 55–70 who had higher portfolio allocations to an annuity that provided guaranteed lifetime income were less likely to trade.[16] This suggests that protected income products have the potential to provide investors the emotional security not to sell stocks after they have fallen in value because they fear losing their retirement savings.

13 protectedincome.org/wp-content/uploads/2025/03/RP-30_BlanchettFinke_v3.pdf.

14 fred.stlouisfed.org/series/VIXCLS, accessed June 5, 2025.

15 finance.yahoo.com/quote/%5EGSPC/history/.

16 protectedincome.org/wp-content/uploads/2022/09/RP-16-Blanchett.pdf.

A primary goal for today's retirees could be to convert some of their defined-contribution plan assets into a protected income stream that provides additional guaranteed income on top of Social Security. This protected income leg can complement the investment leg of the retirement stool by funding a larger share of a retiree's spending goal and helping them better manage investment volatility, while allowing the retiree to preserve or grow the investment leg to fund legacy goals and unexpected large expenses.

Strengthening the Social Security leg

A Social Security retirement benefit is an annuity. Specifically, it is an inflation-protected stream of reliable income for life. Twenty-nine percent of Americans claim income benefits at the earliest possible age of 62, while only 29% wait to claim beyond full retirement age.[17] However, the percentage claiming after full retirement age nearly quadrupled from 6.1% to 22.9% between 2010 and 2022, and higher-income Americans were most likely to delay claiming. A possible reason for the increase in delayed claiming among higher-income Americans may be the increasing awareness of the benefits and access to professional advice.

Why is delayed claiming increasingly popular among higher-income Americans? Over recent decades, higher earners have made the largest gains in longevity with higher-income men gaining more than 5 years of longevity after the age of 55.[18] In addition, the formula used to estimate the lifetime increase in income from delayed claiming was created in the 1980s when Americans did not live as long. This creates an opportunity for retirees, particularly healthier higher-earning workers, to get an actuarially unfair benefit from delayed claiming.

In other words, retirees can strengthen the Social Security leg of the stool to take even more pressure off the investment leg by waiting until age 70 to claim Social Security benefits. Workers born after 1960 will reach full retirement age at 67. Even if they retire at this age, they can increase their Social Security income benefit by a total of 24% (8% per year) through delayed claiming.

By waiting just 3 years, a retiree can receive 24% more income from Social Security for life. This is the equivalent of an additional $40,000 in present value retirement wealth for a healthy man and $50,000 for a healthy woman.[19]

Perhaps more important than the increase in wealth, is the impact of delayed claiming on an investment portfolio late in life during periods of high inflation. While research suggests that many financial professionals do not discourage early claiming, perhaps to avoid using investments early in retirement to fund a bridge, asset values rebound quickly after delayed claiming payments begin.[20] An increasing Social Security benefit can reduce the need to liquidate investment assets to fund later-life spending, reducing portfolio values and increasing the probability and consequences of portfolio depletion.

17 bipartisanpolicy.org/blog/social-security-claiming-age-importance-claiming-behavior-and-trends/.

18 pmc.ncbi.nlm.nih.gov/articles/PMC4866586/.

19 thinkadvisor.com/2021/05/21/why-delayed-social-security-claiming-is-more-valuable-than-ever/.

20 papers.ssrn.com/sol3/papers.cfm?abstract_id=4749066.

Retirees who claim Social Security early cut down one of their income legs for the duration of retirement in order to extend the investments leg temporarily. A more balanced approach that equalized the Social Security, private income and investments legs could provide better outcomes throughout retirement. Individuals can delay claiming by either drawing from the personal income leg of the retirement stool through the use of a flexible annuity or by temporarily increasing withdrawals from investments. This so-called Social Security bridge will result in a lower portfolio value at age 70, but the increase in Social Security wealth will allow the retiree to withdraw less from their investments after age 70 and take greater investment risk, resulting in higher expected portfolio values and a higher inflation-protected income base later in life.

A flexible annuity strategy with a guaranteed minimum income benefit can allow a retiree to increase withdrawals early in retirement while also maintaining the ability to receive an annuitized lifetime income benefit later in retirement. This can reduce the need to withdraw a significant amount of bridge assets from an investment portfolio while maintaining a base of lifetime income on top of the higher Social Security floor.

Case studies

Strengthening the legs of the retirement income stool means that retirees rely less on a volatile investment portfolio to fund their lifestyle. A benefit of strengthening income from Social Security and private savings through an annuity is that a larger share of the retiree's expenses can be funded by a flow of lifetime income. This can allow them to cover basic expenses, such as utilities, groceries, healthcare expenses, property taxes and a mortgage, with an income that lasts a lifetime, while allowing the remaining risky portfolio to grow and provide additional income to pay for more flexible lifestyle expenses, such as vacations or meals with friends.

The following case studies provide a comparison of strategies that use investments and Social Security benefits initiated at retirement (savings-based) with a strengthened-income strategy that uses an annuity with a guaranteed minimum income benefit and delayed claiming of Social Security to age 70. This strengthened-income approach requires a maximum 7% withdrawal from the annuity during the bridge period and a subsequent 5% withdrawal after delayed Social Security payments begin. Assumptions are provided in the Appendix.

The strengthened-income approach initially results in a faster depletion of bond investments to create the bridge. After the bridge period, the combination of lifetime income from the annuity and the substantially higher Social Security income benefit reduces the amount that must be withdrawn to meet income needs after age 70. In each case study, we compare the income produced by each strategy and the long-term impact on financial wealth.

Case study: 1

Meet Helen

- **Age 60**
- $500,000 in retirement savings
- $100,000 in emergency funds
- $250,000 in savings reserved for basic expenses
- Goal of $70,000 annual income during retirement

Background

Helen is 60 years old and has saved $500,000 in a qualified retirement savings plan that she will roll into an IRA at age 67 when she plans to retire. She holds an emergency fund of $100,000 and has $250,000 invested to fund basic expenses in retirement using certificates of deposits that earn 4.5%. She is eligible to receive a Social Security retirement income benefit of $22,000 if she claims early at age 62 and $31,429 if she claims at age 67. Her goal is to maintain a lifestyle of $70,000 per year net of income taxes adjusted for expected increases in the cost of living. She expects to invest in a portfolio of 50% stocks and 50% bonds within her qualified (IRA) retirement savings accounts.

Insight

Her plan is to withdraw from her safe nonqualified savings account to fund basic expenses through the age of 100, when she only has about a 10% chance of outliving her savings. She then plans to fund the remaining spending gap through her IRA.

An alternative plan is one that focuses on strengthening the income legs of the retirement stool by purchasing a variable annuity with a flexible guaranteed minimum income benefit rider at age 60 with the $250,000 she currently has invested in CDs and withdrawing 7% from the annuity at age 67. This will allow her to more easily create an income bridge that allows her to withdraw less from her IRA savings between age 67 and 70. At age 70, she will be receiving a Social Security income that is 24% higher than the benefit she would have received at age 67, allowing her to reduce her annuity withdrawals to 5.5%, while maintaining lifetime income protection.

This higher Social Security benefit coupled with income from the annuity allows her to spend far less from her retirement savings as she ages, increasing her investment balance and providing a base of income that is substantially higher than the income she could have received from claiming Social Security at age 67 and funding basic spending with safer investments, such as CDs or Treasury bonds.

Strengthened-income

↓

Social Security (Claim at 70)

↓

Private income

Buy **$250,000 annuity** from nonqualified savings at 60, take maximum income at age 67 through age 70 to help bridge delayed claiming

↓

Retirement savings

Withdraw the difference between the spending goal and income from Social Security and the annuity

Savings-based

↓

Social Security (Claim at 67)

↓

Private income

Invest in **safe assets**, such as **CDs,** and withdraw income from safe savings to age 100

↓

Retirement savings

Withdraw the difference between the spending goal and lower Social Security income and safe savings withdrawals

The primary advantages of the strengthened-income strategy are:

1. The **ability to defer taxes** on the safe savings held to fund basic retirement expenses.
2. The **additional spending** that can be achieved from the annuity by transferring longevity risk to an insurance company (also known as mortality credits).
3. The **increased expected retirement wealth** from delayed Social Security claiming.

The baseline comparison assumes a constant portfolio return of **5.7%** on IRA savings and on the portfolio held within the annuity. Obviously constant returns are not realistic, but the baseline scenario demonstrates the advantages of the strengthened-income strategy and shows how **a flexible annuity that allows higher withdrawals during the Social Security bridge period puts less pressure on the investment portfolio, which results in higher growth over time.** The constant portfolio return ensures that the annuity income never increases, or steps up, beyond the baseline. Retirees who receive a higher return, especially early in retirement, will likely receive a higher income guarantee.

Let's begin with an analysis of the income that can be created from strengthened-income and savings-based strategies.

We estimate the amount of income net of taxes that will be withdrawn from the annuity and Social Security using the strengthened-income strategy. This strategy takes the maximum (7%) withdrawal from the annuity during the Social Security bridge period to supplement income during the first 3 years of retirement (ages 67, 68 and 69). The annuity withdrawals are subsequently reduced to 5.5% for the remaining life of the annuity, resulting in a roughly stable annuity income. After age 70, the retiree receives the higher Social Security payment and the reduced annuity income.

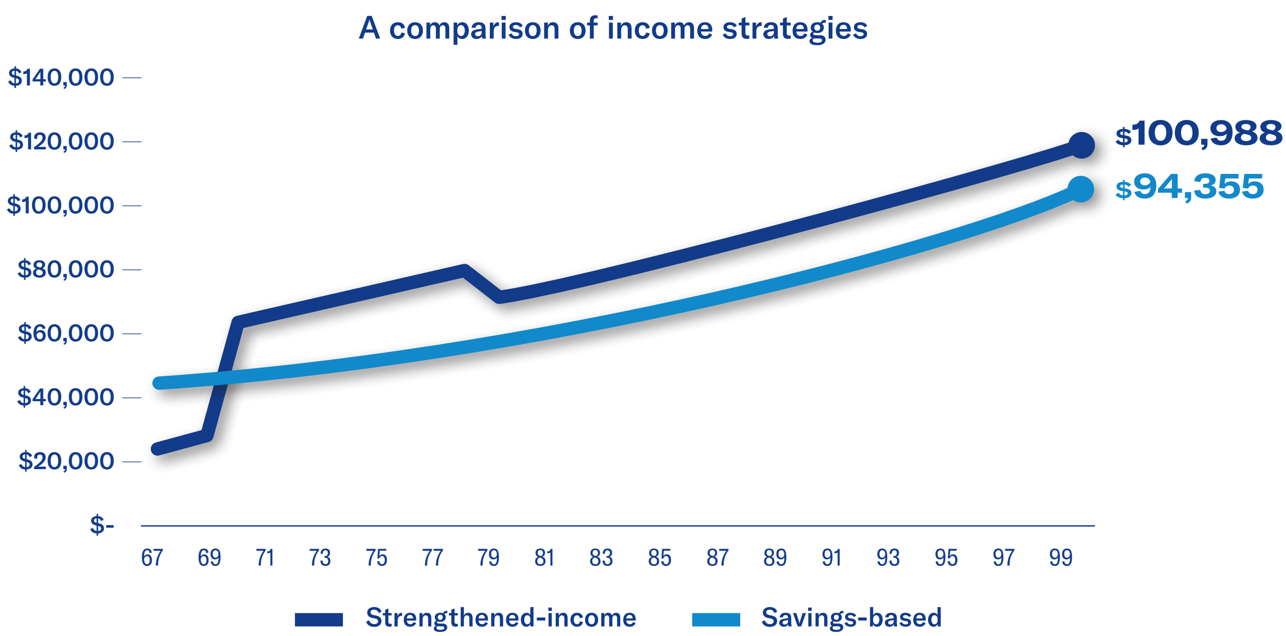
7% withdrawal from annuity for the first 3 years

5.5% withdrawal for the remaining life of annuity

We compare the strengthened-income strategy to the savings-based strategy in Figure 1. The income from the savings-based strategy is the Social Security retirement income benefit taken at full retirement age of 67 added to withdrawals from liquid savings. We assume that the liquid savings (CDs or money market accounts) are invested between age 60 and 67 and then withdrawn starting at age 67 to rise with inflation and last until age 100. The income from the initial $250,000 invested in safe assets starts at $12,397 at age 67 and rises to $25,167 by age 100. This represents the private income leg of the savings-based strategy that is combined with Social Security to create a base of income.

Figure 1

Annual income from an annuity/delayed claiming strategy compared to claiming at age 67 and drawing income from an equal investment in safe assets



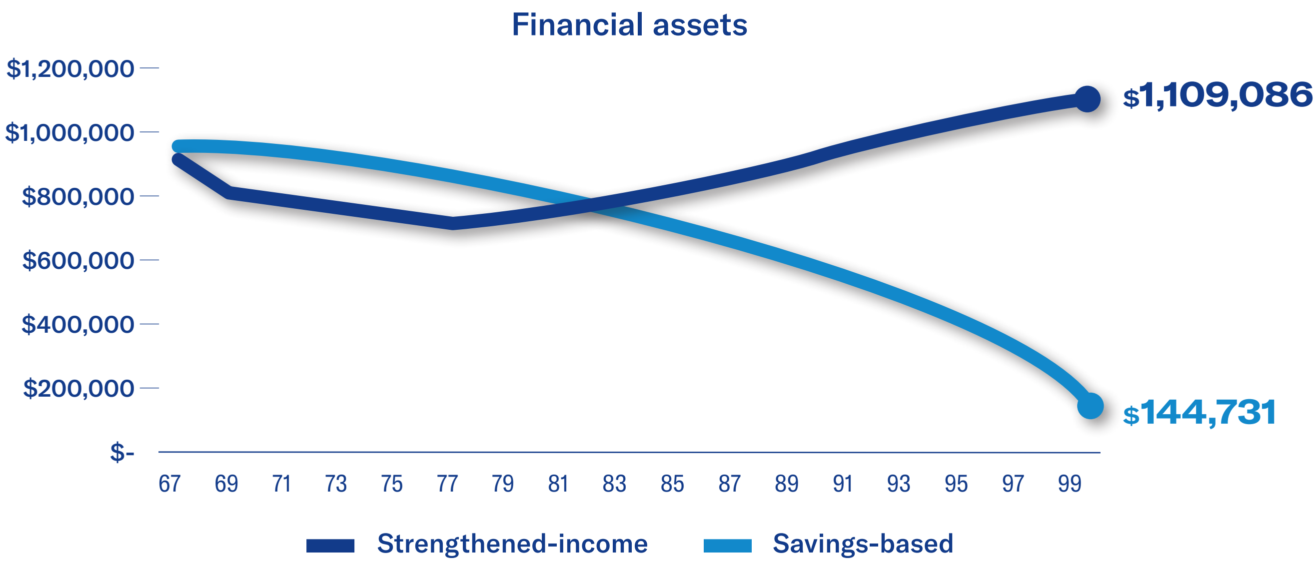
The flexibility of the variable annuity with a GMIB rider allows the retiree to increase withdrawals from age 67–69 providing a base of income that replaces about half the combined income from safe investments and Social Security claimed at age 67. At age 70, the after-tax delayed claiming/annuity income rises to $64,665, or $17,226 higher than the savings-based strategy, and remains more than $10,000 higher for the next 30 years. The short period of higher after-tax income from the strengthened-income scenario reflects the period in which annuity payments are considered a return of principal and not subject to income tax.

The bridge period increases withdrawals from IRA savings for 3 years when following the strengthened-income strategy, but the higher subsequent income reduces withdrawals for the next 30 years.

Not surprisingly, this reduction in pressure on investments to fund the spending goal results in higher IRA balances beginning at age 72, and in greater total wealth, including the balance of safe nonqualified investments, the contract value of the annuity and total IRA assets by age 82 (Figure 2). Among healthy women who reach retirement age, 80% will still be alive at age 82 when total wealth for the strengthened-income strategy surpasses the savings-based strategy, and 50% will still be alive at age 90 when total financial asset wealth is $321,212 higher with the strengthened-income strategy.[21]

Figure 2

Total retirement wealth change, including qualified, nonqualified and annuity assets



The strengthened-income approach temporarily reduces the value of the investments leg in retirement in order to strengthen the private income and Social Security legs. By transferring $250,000 from CDs into a flexible annuity, Helen is able to take advantage of tax-deferred growth and longevity risk protection to fund a greater percentage of her spending goal from the private income leg. She also receives the economic benefits of waiting to claim Social Security by bridging income from the annuity and the investments leg.

Relying less on the investments leg to fund spending throughout retirement allows Helen to preserve her wealth until later in life. In this example, her private income leg is taken from the fixed income portion of her investment assets and the remainder of her portfolio is annually rebalanced to maintain a 60% stock allocation. The following table shows how her wealth evolves throughout retirement when using the strengthened-income and savings-based strategies.

21 Society of Actuaries Individual Annuity Mortality table (2012) with 0.5% annual mortality improvement through 2024.

Strengthened-income				Savings-based

Helen — age 69

Strengthened-income			Savings-based	
Variable annuity with GMIB	$28,101 Annual after-tax income	Private income	$13,096 Annual withdrawal	Stable withdrawal from money market
Delayed claiming	$44,608 Bridge from retirement	Social Security benefit	$28,505 Annual income net of taxes	Claiming
Qualified retirement balance	$600,909	Retirement savings	$638,698	Qualified retirement balance

Helen — age 78

Strengthened-income			Savings-based	
Variable annuity with GMIB	$24,505 Annual after-tax income	Private income	$14,545 Annual withdrawal	Stable withdrawal from money market
Claiming	$50,394 Annual income net of taxes	Social Security benefit	$40,641 Annual income net of taxes	Claiming
Qualified retirement balance	$721,801	Retirement savings	$566,812	Qualified retirement balance

Helen — age 100

Strengthened-income			Savings-based	
Variable annuity with GMIB	$15,195 Annual after-tax income	Private income	$25,167 Annual withdrawal	Stable withdrawal from money market (depleted)
Claiming	$85,793 Annual income net of taxes	Social Security benefit	$69,188 Annual income net of taxes	Claiming
Qualified retirement balance	$1,109,085	Retirement savings	$144,731	Qualified retirement balance

Building stronger private income and Social Security legs of the retirement security stool allows retirees to create a higher lifetime income, withdraw less from the retirement savings leg and ultimately build greater wealth by taking advantage of tax deferral, annuity income benefit guarantees and overly generous delayed Social Security claiming rules. Additionally, creating a higher base of lifetime income provides a psychological benefit that allows a retiree to spend more freely than if they had to replace their lifestyle primarily from investments, and to accept greater investment risk because a greater percentage of their lifestyle goal is covered from protected lifetime income.

Case study: 2

Meet Lisa

- **Age 55**
- $2 million in qualified retirement savings
- $1 million in nonqualified retirement savings
- Goal is to spend $15,000 per month in retirement

Background

Lisa is a 55-year-old near retiree with $2 million in qualified retirement savings and $1 million in nonqualified savings consisting of $500,000 in stocks and $500,000 in a combination of bonds and money market funds who hopes to retire at age 65. Her goal is to begin spending $15,000 per month ($180,000 per year), increasing by inflation corrected for actual retiree spending growth.

Insight

She is considering reallocating $300,000 of her nonqualified bond/money market savings and $500,000 of qualified savings from the bond portion of the portfolio to an annuity to provide a generous minimum base of income. After allocating $500,000 to the annuity, she will maintain a 67% equity allocation in her qualified savings. She is eligible for an estimated inflation-adjusted Social Security benefit of $60,084 in 10 years at the age of 65 and $94,848 at the age of 70. By claiming Social Security 2 years before full retirement age, she will miss out on 2 years of 6.66% increases and 3 years of 8% increases in the delayed claiming credits. She hopes that by building a base of income, she will be able to grow her investments, while also reducing the possibility of cutting back on spending later in life, greater tax efficiency and a larger legacy benefit to her loved ones.

Lisa's willingness to create income from both nonqualified and qualified accounts through the purchase of two variable annuities with a flexible guaranteed minimum income benefit gives her two important advantages that strengthen the private income leg of her retirement plan. First, substituting half of her bond portfolio within the qualified account gives her an opportunity to grow income that benefits from annuity guarantees, allowing her to spend more each year than if she had retained longevity risk and invested in bonds. Second, investing $300,000 of her nonqualified bond and money market portfolio in the annuity provides 10 years of tax-deferred growth, while bond and money market growth is taxable each year at her high (32%) preretirement marginal tax rate.

The two strategies can be summarized below.

Strengthened-income

↓

Social Security
(Claim at 70)

↓

Private income

Buy **$300,000 annuity** at 55 in nonqualified and a **$500,000 annuity** from qualified savings, and take maximum income at age 65 through age 69 to help bridge delayed claiming

↓

Retirement savings

Withdraw the difference between the spending goal and income from Social Security and the annuities

Savings-based

↓

Social Security
(Claim at 65)

↓

Private income

Invest in **bonds** and **money markets** and withdraw income starting at age 65 from safe savings to age 100

↓

Retirement savings

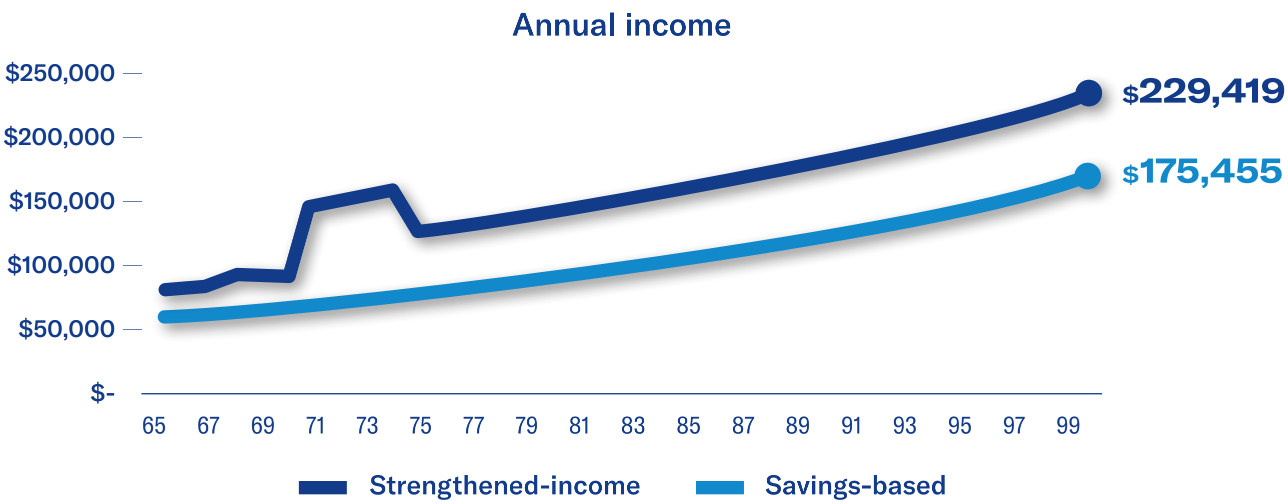
Withdraw the difference between the spending goal and lower Social Security income and safe savings withdrawals

Because Lisa allocates such a large amount of savings to annuities and takes the maximum annual withdrawal from each annuity between age 65 and 69, she is able to create a stream of income during the bridge period that is larger than the income created by following the savings-based approach in which she receives a significantly lower Social Security income benefit at age 65 and withdraws from $500,000 of taxable bonds and money market savings.

Her lifetime income streams are compared in Figure 3. Because Lisa allocates a larger share of her wealth at age 55 to annuities and benefits from a longer deferral period than Helen in case study 1, she is able to receive an even higher income during the Social Security delayed claiming period than if she had followed the savings-based approach. Once the substantially higher Social Security benefits begin, the difference widens further.

Figure 3

Annual income from an annuity/delayed claiming strategy compared to claiming at age 65 and drawing income from an equal investment in safe assets

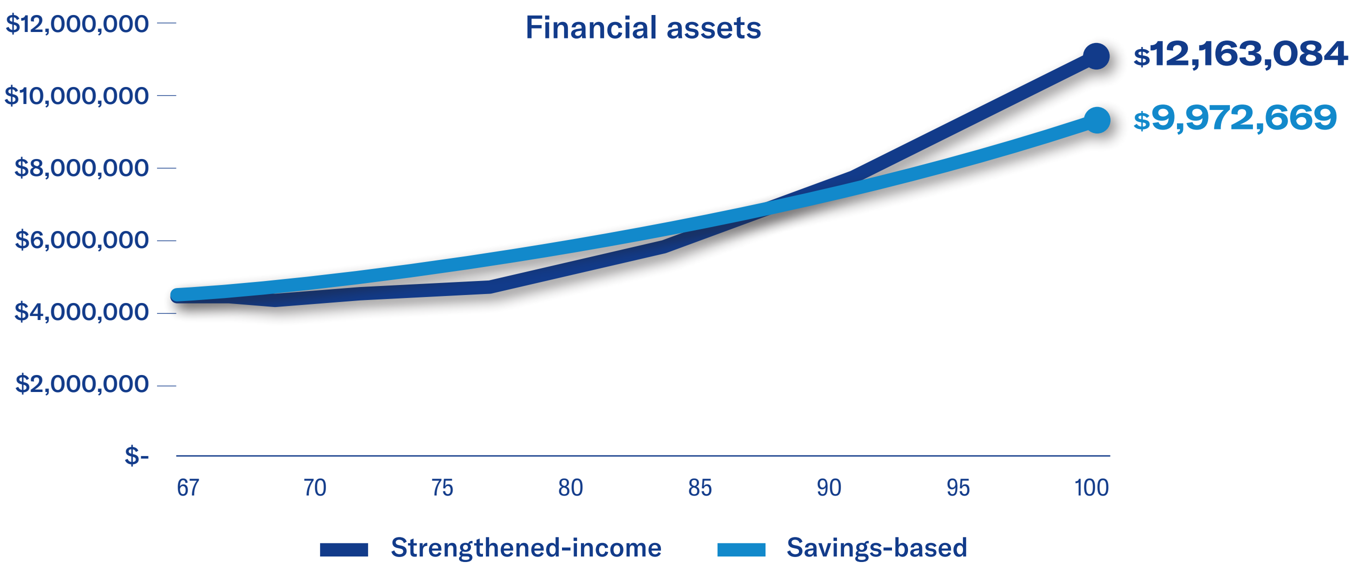


Because Lisa chose to allocate $500,000 of her IRA savings to an annuity, she can expect to withdraw more each year from her retirement investments if she follows the savings-based approach than the strengthened-income approach. She begins by withdrawing roughly an additional $15,000 at age 65, and after the higher Social Security benefit begins at age 70, she must withdraw roughly an additional $50,000 each year between age 70 and 100. While her IRA balance in the savings-based strategy is $3 million at age 65 compared to a $2.36 million IRA balance using the strengthened-income approach, the substantially higher withdrawals from the savings-based approach eventually deplete the IRA balance so that by age 84, it is now larger in the strengthened-income approach.

The primary wealth difference between the two approaches is the growth in qualified retirement assets after the strengthened-income approach pulls ahead after age 84. Wealth from annuity contract values falls as Lisa makes maximum withdrawals during the bridge period, while IRA assets also fall during the bridge period for the strengthened-income approach. Lisa spends down her bond/money market wealth to fund income in the savings-based approach and does not touch her $200,000 bond balance in the strengthened-income approach. Neither strategy requires that she spend down her nonqualified stock investments, which continue to grow throughout retirement. Her ability to maintain a higher stock allocation in her IRA when using the strengthened-income strategy means that she will not sacrifice long-term equity growth in order to increase her base of retirement income, and her asset base will be similar early in retirement and higher later in retirement, as the strengthened-income allows her to withdraw less from invested assets.

Figure 4

Total retirement wealth change, including qualified, nonqualified and annuity assets



As Lisa's example shows, **a higher marginal tax rate and longer deferral period allows an investor to receive a substantially larger income from an equal amount of savings.** Allocating a portion of her qualified savings to the annuity without reducing the amount invested in stocks allows her to create a higher income from IRA assets without sacrificing long-term growth. An additional 5-year deferral on Social Security income significantly reduces the pressure on funding her lifestyle goal from IRA savings, resulting in greater financial wealth over time.

The following table shows how Lisa's income and wealth change over time using the strengthened-income and savings-based strategies. At the end of the bridge period at age 69, Lisa is withdrawing $92,938 from her private income and taking a $102,550 bridge from her retirement savings account in order to meet her spending goals. Using the savings-based approach, she is able to withdraw $21,650 from her money market account and receives $53,255 in Social Security. Once she begins receiving higher Social Security payments at age 70, she begins to withdraw far less from her qualified retirement savings account.

Age 70

She spends just $51,101 from her retirement savings account using the strengthened-income approach compared to $121,954 using the savings-based approach.

Because she has substituted withdrawals from her annuity and retirement account to cover expenses in order to increase the value of her Social Security income payments, the value of her total financial assets will be slightly lower.

However, she will have increased the value of her Social Security income benefit, which will allow her to rely less on retirement savings to fund income in the future.

Age 85

Lisa still has a 75% chance of being alive and her wealth is now higher using the strengthened-income approach.

The guaranteed minimum income benefit continues to provide an income stream and she also continues to receive a substantially higher Social Security benefit from delayed claiming.

This allows her to withdraw just **$77,158** from her IRA to fund spending compared to **$129,869** from the savings-based approach. The reduced pressure on her retirement savings account begins to create a gap in total financial wealth that widens as she gets older. By the age of 100, Lisa has $2.19 million more in total financial wealth using the strengthened-income approach.

Bridge spending from retirement savings

	Age 70	Age 85
Strengthened-income approach	$51,101	$77,158
Savings-based approach	$121,954	$129,869

Strengthened-income | **Savings-based**

Lisa — age 69

Strengthened-income			Savings-based	
Variable annuity with GMIB	$92,948 Annual after-tax income	Private income	$21,650 Annual withdrawal	Stable withdrawal from money market
Delayed claiming	$102,550 Bridge from retirement	Social Security benefit	$53,255 Annual income net of taxes	Claiming
Qualified retirement balance + qualified annuity value	$2,778,470	Retirement savings	$3,138,430	Qualified retirement balance
Qualified and nonqualified	$4,404,168	Total financial assets	$4,817,189	Qualified and nonqualified

Lisa — age 85

Strengthened-income			Savings-based	
Variable annuity with GMIB	$48,190 Annual after-tax income	Private income	$26,406 Annual withdrawal	Stable withdrawal from money market
Claiming	$116,369 Annual income net of taxes	Social Security benefit	$85,458 Annual income net of taxes	Claiming
Qualified retirement balance	$3,661,883	Retirement savings	$3,597,149	Qualified retirement balance
Qualified and nonqualified	$6,712,724	Total financial assets	$6,640,029	Qualified and nonqualified

Lisa — age 100

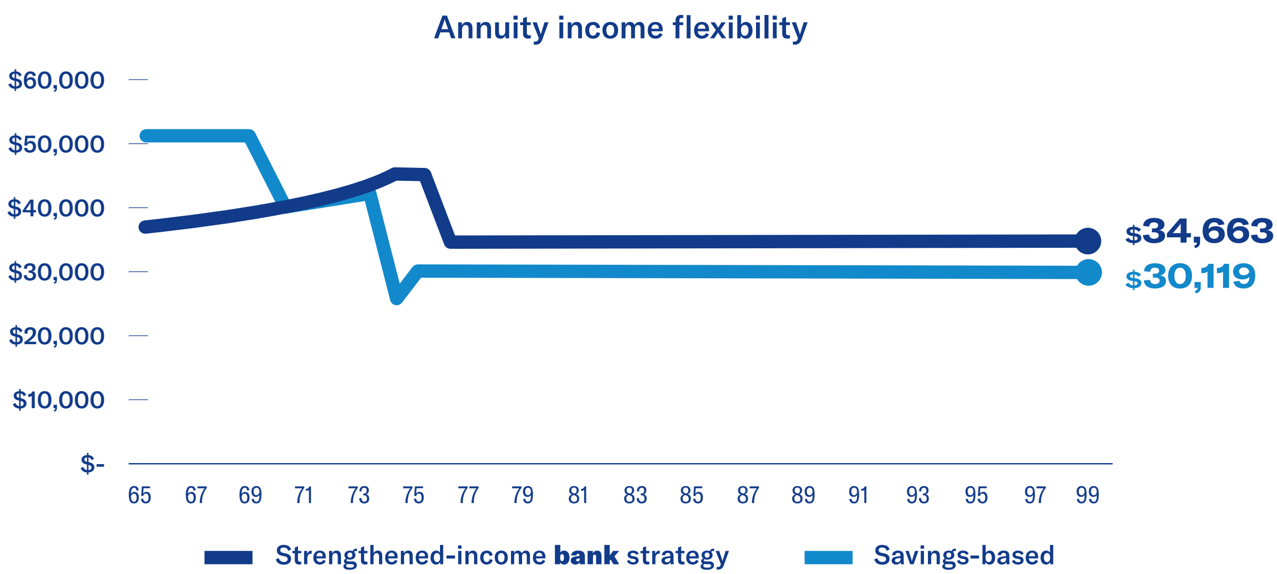
Strengthened-income			Savings-based	
Variable annuity with GMIB	$48,190 Annual after-tax income	Private income	$42,314 Annual withdrawal	Stable withdrawal from money market (depleted)
Claiming	$181,229 Annual income net of taxes	Social Security benefit	$133,141 Annual income net of taxes	Claiming
Qualified retirement balance	$5,511,009	Retirement savings	$3,914,457	Qualified retirement balance
Qualified and nonqualified	$12,163,084	Total financial assets	$9,972,669	Qualified and nonqualified

The strengthened-income approach allows Lisa to maintain a comparable asset base early in retirement, but the much higher base of income allows her to withdraw less from her investments, resulting in a higher investment balance over time. A benefit of the strengthened-income approach is that it provides insurance against an expensive retirement for those who live a long time. This allows Lisa to continue to grow her wealth into old age without the fear that doing so will compromise her legacy goals.

Lisa can also choose to avoid taking the maximum 7% withdrawal from the annuity during the bridge period in order to maintain a higher base of lifetime income later in retirement. This highlights the flexibility of a GMIB product that provides control over the trajectory of future lifetime income by choosing either to take more early in retirement or **bank** the withdrawals to provide higher future income.

Figure 5

Lifetime after-tax annuity income from a bridge and bank withdrawal strategy



Since Lisa has the ability to withdraw more from her retirement savings to cover the bridge period between ages 65 to 70, she can take less income out of her annuity. This allows her to **bank** a higher future lifetime income that lasts for the remainder of retirement by spending less early in retirement. The bank strategy provides additional longevity risk insurance that allows Lisa to fund a greater share of her income from the annuity after age 73, resulting in a bequest at age 100 that is $83,311 higher than the bridge strategy.

Conclusion

Creating a sustainable financial foundation is the cornerstone of any retirement plan. An ideal approach focuses on strengthening the two income legs of the retirement stool rather than placing too much of a burden on investments to fund a retirement lifestyle.

The strengthened-income approach begins with maximizing the lifetime inflation protection that Social Security provides. Deciding when to claim Social Security benefits can significantly impact lifetime income. Delaying benefits, if possible, leads to higher monthly payments, enhancing financial security in later years.

Second, strengthen the private income leg of retirement planning by incorporating annuities into the retirement portfolio. Annuities provide the benefit of tax deferral and mortality credits that allow a retiree to spend more for each dollar of preretirement savings than comparable assets whose gains are taxed annually, and which do not provide protection against longevity risk.

> **A flexible annuity that allows larger withdrawals during the Social Security bridge period can reduce the amount of investments that need to be withdrawn from retirement savings to fund a lifestyle goal, and provide a much higher base of lifetime income from a higher Social Security income coupled with a protected lifetime income from the annuity.**

Finally, sufficient protected income in retirement can help mitigate many of the financial risks associated with retirement. Creating a higher base of guaranteed lifetime income protects against the risk of low or negative asset returns early in retirement, which can require a significant adjustment in spending. A lifestyle-focused approach can be used to show how a retiree can fund their spending goals with a smaller percentage of their retirement savings with tax-efficient annuities and delayed Social Security claiming.

Funding a larger percentage of a lifestyle goal with a smaller percentage of the portfolio allows a retiree to take greater investment risk and achieve more favorable lifestyle and legacy outcomes without risking the possibility of a reduced lifestyle from living a long life and experiencing low investment returns.

Emphasizing protected income also provides the freedom to spend freely from assets allocated to annuities and from Social Security. Not only can a strategy that focuses on strengthening the two income legs of the retirement stool be more efficient, it can also allow retirees to meet their lifestyle goals without the fear of outliving savings.

Appendix

Methods

In the case studies, we make a number of simplifying assumptions to demonstrate how a strategy that strengthens retirement income through delayed claiming and partial allocation to a variable annuity with a guaranteed minimum income benefit rider affects outcomes in retirement. In each of these analyses, we take advantage of the flexibility of the annuity product to provide income as dictated by the retiree's lifestyle goals. Our baseline assumption is deterministic growth in retirement investments to illustrate the benefits of shifting a portion of investment wealth to an annuity and increasing Social Security income through delayed claiming.

Our initial assumptions include an expected future stock return of 6.7% and bond return of 4.6% with 1% total asset and advising fees.[22] The advising fees are included to allow a direct comparison between investment-only and partial annuity retirement income strategies managed by a financial professional. Annuity fees, including subaccount expenses and GMIB rider fees, are deducted from the contract value. Case study 1 assumes a preretirement state and federal income tax rate of 28% and a post-retirement tax rate of 20%, while case study 2 assumes 32% and 25%, respectively. Retirees increase their lifestyle goal each year by an inflation rate set at a fixed 3% and corrected to reflect actual retiree spending patterns (the **spending smile**).[22] All spending goals are net of taxes. We assume the highest Social Security tax rate (85% taxable) and apply tax to annuity payments initially from gains and after depletion of the original investment amount.

22 Based on Blackrock capital market assumptions for U.S. Equities and aggregate bonds: Capital market assumptions — Institutional | BlackRock. These are also consistent with Vanguard 30-year capital market assumptions, which range from 4.7% to 6.7% for U.S. equities and 4.1% to 5.1% for aggregate bonds: Vanguard Capital Markets Model® forecasts | Vanguard, 2024.

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