FEATURED ON FORTUNE.COM

ARTICLE BY: KEITH COLLINS

PUBLISHED MARCH 2015

FORTUNE

ASSESSING THE ROLES OF GUARANTEED INCOME IN RETIREMENT PLANNING

As of today, only one in five people in the private sector workforce has a defined benefit pension plan. Since 1979, significant changes have occured in the kind of employment-based retirement plan that workers participate in. This trend accelerated after the year 2000 with the dot-com crash, bank bailouts, and the mortgage derivative crisis.

After a lifetime of hard work, retirees deserve the opportunity to live out their golden years with dignity and financial independence. But for most of the middle clas, the dream of a secure retirement is slipping out of reach. We are now facing a retirement crisis. Consider the following: The difference between what people have saved for retirement and what they should have at this point is $6.6 trillion; half of these Americans have less than $10,000 in savings. As older Americans transition out of the workforce, either voluntarily or involuntarily, many continue to lose a critical element of their retirement security: guranteed lifetime income. This problem is directly attributable to the breakdown of the traditional "three-legged stool" of retirement security – pensions, savings and Social Security.

Although defined benefit pension plans used to play an enormous role in providing a reliable source of retirement income, the pension system has been declining for decades. Fortunately, for the time being, Social Security is still strong; however, it was always intended to be supplemented by other sources of retirement income. As a result, 401(k) plans and other defined-contribution plans that were designed to supplement, not replace, traditional pensions are growing at the expense of defined-benefited plans that provide secure supplemental income to Social Security. So the all-important question is: How can retirees convert accumulated retirement savings into monthly payments they cannot outlive? I feel the word "guaranteed" is of the utmost importance in retirement planning because of another word: "risk."

The word risk comes in many forms when discussing retirement assest. First, consider longevity risk or the risk of outliving your assests. When Social Security was created, the average life expectancy was 62. Today it is 79 and is expected to surpass 87 by 2030. Next is market risk or the risk of a sudden drop in the market value of your retirement asssets. Another is ineffective financial management risk or the risk of poor investment decisions or excessive withdrawals in retirement. According to a Russell Investments study, the probability of running out of money for a 65-year-old using a 5 percent withdrawal rate, 2.5 percent COLA adjustment, and 60 percent/40 percent stock to bond allocation is 64.4 percent. Finally, there is a cognitive risk or the risk of the diminishing ability to make decisions with age. As a result of cognitive risk, retirees must consider how their finances will be managed when they are no longer capable of doing so themselves. These risks, which can leads to disappointing outcomes for retirees if their finances are not managed properly, are driving the financial services industry to create new products and services. They help participants convert lump sums of retirement savings into monthly payments in independent retirement plans.

As the financial services industry struggles to find the right solution to the risks facing retirees during their de-accumulation phase, most plan sponsors appear to be waiting for more guidance from the U.S. Department of Labor (D.O.L.). Most recently, the U.S. Treasury Department issued final regulations that pave the way for defined contribution plans -- including 401(k) plans and IRAs -- to provide participants with a new option for insuring against longevity risk. This is a welcome development. Life annuities help solve this problem by providing guaranteed income for the rest of one's lifetime, no matter how long it lasts. However, for a host of reasons -- some rational, and some not -- retirees seem to have a strong aversion to handing their money over to insurance companies in exchange for lifetime income.

One of the novel ideas that has emerged over the past decade among academics and industry thought-leaders is a new product that has come to be known as a "longevity annuity." The basic idea is simple: Rather than handing over the majority of your nest egg to an insurance company when you reach age 65 in order to start receiving income right away, you can instead hand over a much smaller fraction of your wealth at age 65 in exchange for an income stream that will start *if and* when you reach a much older age.

With much of the responsibility for funding retirement shifting to your own shoulders, a top priority for you should be generating a steady stream of income with guarantees for the rest of your life. To feel more confident about your financial future, consider a retirement income plan to help you prepared for success.

KeithCollinsInc.com

Keith@KeithCollinsInc.com