What To Do When Your Pension Is Going Away

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Anyone could face issues with their retirement in today's economic environment. If you are one of the few who still has a pension at your workplace, you should consider yourself fortunate. Private-sector defined benefit pension plans are becoming more and more uncommon for today's workforce. The percentage of private sector employees who still have a pension is now 4%, down from 60% in the early 1980s.[1]

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Gone are the days when someone worked for 40 years with the same employer and then, upon retirement, started receiving more combined income from Social Security and pension payments than they did during their working years. Personal savings were merely a supplement to the guaranteed Social Security and pension income streams, as opposed to a primary source of income. When pensions were the dominant retirement income source, only a portion of income would be affected if your retirement savings balance dropped precipitously (i.e., during the dot-com bubble of 2000-2002[2] or the global financial crisis 2008-2009[3]).

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Let's look at some numbers to bring things into a clearer perspective:

Let's assume a family's monthly income needs are $9,000 per month. If a husband and wife both earned the same amount of income over the years and each collect $2,000 per month from Social Security and $2,000 per month from pension income, the remaining income need of $1,000 per month could be funded by personal savings as long as enough money was saved prior to retirement. The monthly Social Security and pension checks all have cost-of-living adjustments that can help keep up with inflation.

Fast-forward to today's retirement income conundrum for the same family without pension income. The combined $4,000 Social Security checks would still be there (as long as Social Security stays fully funded beyond 2034-2035), but the remaining $5,000 per month of income with cost-of-living adjustments would need to come from personal savings and investments.

What if the lost decade returns when I retire?

Remember the good old days of the late 1990s when investing in the stock market seemed like much less of a risk?[4] How about the subsequent 10-year period that included three bear market corrections in 2000-2002, 2008, and 2009?[5] This lost decade period beginning in 2000 was a stressful time for many savers, and it was even worse for the many retirees facing Required Minimum Distribution (RMD) during the same time period. Imagine the stress of being forced to withdraw money out of at-risk qualified retirement accounts when account balances decreased by 43% during the first three years and 38% or more during year nine (fortunately, RMDs were forgiven for 2009).

How do I make sure I don't run out of money in retirement?

Much has been written regarding "safe" portfolio withdrawal rates. Depending on the study, some experts such as David Blanchett from Morningstar recommend 2.8% as a safe withdrawal rate for retirees "wanting a 90% probability of achieving their retirement income goal with a 30-year time horizon."[6] However, others still recommend a maximum of 4% as a safe withdrawal rate for a portfolio.[7]

For those looking for an alternative to a pension, the Single Premium Immediate Annuity (SPIA) is increasingly being used to mirror pensions and provide guaranteed income that either one or two individuals will not outlive.[8] Payout rates can vary by age, length of payout, number of lives, and other factors. For anyone over age 60, the amount needed to fund an immediate annuity is much less than the amount necessary to fund other types of investments using the widely recommended 4% “safe” portfolio withdrawal rate. So, assuming a guaranteed 6% payout rate, $1 million can be placed into an SPIA to guarantee income of $5,000 per month for two lifetimes. Then, the remaining amount of personal savings and investments can be saved in whatever account fits your goals. In theory, this is supposed to work, but reality can be a different story.

What about inflation?

Based on the 104-year average of 3.14% inflation, by the time a 60-year-old couple reaches age 84, over twice the monthly income is needed to keep up with average inflation.[9] Where does that money come from? If savings and investment accounts produce adequate returns and no corrections happen during retirement, there is a chance those funds could come from their savings and investments alone (if there is a large enough pot of money to draw from that can weather any storm). But what if you do not have a huge war chest? What if you prefer guaranteed income that keeps up with inflation? If a pension is not a part of your plan, is there another way to guarantee income other than the SPIA?

Enter the DIA

Another investment option that can often be a more suitable replacement for a lost pension is a Deferred Income Annuity (DIA), with either inflation-adjusted income or income that increases when the account earns interest. With a DIA, the same $1 million can duplicate the SPIA income, plus increase with inflation. The main difference is that in a DIA, you wait two to three years to start income withdrawals from the annuity, based on what is currently available in the marketplace. What options are there to fund the first two to three years? You can draw from savings, work a part-time job, tighten your belt, and/or reduce expenses. If it means not outliving your money, can you afford not to do it?

When your working career ends and retirement begins, the game changes. It becomes much less important to grow your money than to make sure you do not outlive it. Retirement is full of choices. It's about managing risk the best way you can and rolling with the ebbs and flows that life throws at you. You can remove a huge burden from your shoulders if a guaranteed income stream, indexed for inflation, is part of your retirement plan.

If you do not have both a traditional pension plan and Social Security to provide that increasing income, you may consider an annuity from a highly rated company to provide guaranteed income you cannot outlive. The best place to look for assistance is from a fully independent broker or fiduciary that will have your best interest in mind and access to insurance companies offering hundreds of annuities to choose from, not a short list of annuities that many financial companies limit their representatives to offer.

Retirement income can be a complicated process. Facing it with added guaranteed income that keeps up with inflation can help take the guesswork out of what future interest rates, retirement account returns, and inflation hold, giving you the freedom to spend more time focusing on the things that truly matter in life.

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