Episode #190: How to Create Your Own Pension Using an Annuity

Video Transcription

Hello everyone, and welcome to another episode of Money Script Monday. My name is Michael Clemente. And first of all, I want to thank you for attending today. The topic of discussion is, how to create your own pension using an annuity. I want to bring this up because a pension creates lifetime income. We know the importance of creating, not an accumulation plan but an income plan, one that you can outlive on a guaranteed basis. Pensions are exclusive. Exclusive in the fact that not everyone has one. They're mostly offered through government-mandated jobs, firefighters, teachers, police officers. The promise that you work here for this job, when you retire, you will have lifetime payments no matter what, and that's a contractual guarantee. I want to show you how you can create your pension by using an annuity.

Annuities, social security, and pensions. They offer the same thing, that lifetime income. We talk about de-risking your retirement portfolio. When I say de-risk, what do I mean? What are the risks we're protecting you from? We've broken that down into four main risks. The first one being, stock market volatility. If you look at your retirement accounts and you see that if the market goes below zero, do your account values drop below zero as well? Are you incorporating the risk that you may lose money to the volatility aspect?

Next one, inflation. We know today's dollars are not the same as tomorrow's dollars, so when you're accessing income that you've created in your plan, do you account for inflation? Can you take an increasing income paycheck each year to account for this risk? The next one we've analyzed, sequence of returns. We all love the positive returns, every time the market goes up, my account values go up. What happens if we throw in some negatives in the mix? When they happen, how does it affect your account? If it happens towards the tail end when you already have a big accumulation value, do the negative returns affect it that much versus if we throw it in the beginning? If when you first start you're already in the negative so the whole idea is we need to get back to our original investment, how does that affect your retirement?

Lastly, longevity. I call this, the risk multiplier. The longer you live, the more subject you are to volatility, higher inflation, and also losing money based on a sequence of returns. If you're planning to live till 90, 95, 100, you need a plan that can take you all the way to those ages. When we talk about risk, we want to use retirement income to mitigate these risks. What do I mean when I say retirement income? I mean that it's guaranteed for life. Meaning it's a contractual guarantee that no matter when you pass away, what date that is, you have money until that day. There are three sources we see where guaranteed income comes from. The government through social security, an employer through a pension, and then lastly what we're talking about today is using an annuity. We're using an annuity from an insurance carrier to create that contract, to create that value so that no matter what happens, you have an income plan. We're talking about that this will continue after the account value goes to zero. Meaning that you are funding your social security through your taxes, your pension through your paycheck, and your annuity through premiums. When that account value runs out to zero from the government, from your employer, from the insurance carrier, the promise is that you will continue these payments through the rest of your life.

Let's take an example of an accumulation play, so growing up your account value versus taking a consistent income. We're talking about today is a one million dollar premium for a 56-year-old and we're doing to defer income until age 69. We're gonna look at the annuity versus a steady 6% return brokerage account. That's a pretty good account. If I can promise you 6% each year with no losses, that should be something of value. What does it look like when we stress test it based on an income plan? If we look at age 69, our annuity has grown to $1.5 million in that bucket. The steady 6% return, a little bit more, $1.8 million. We're going to look at $125,000 per year which our annuity produces. We're taking this money on an increasing income basis to account for inflation. We're gonna do the same thing on a steady 6% return bucket.

If we look at the steady 6% return first, the total income we've taken is $2.7 million, and the income expires at age 85. The bucket's over, there's no more money in there, so we either have to keep funding it or go back to work, versus our annuity plan. We're leveraging the insurance carrier to pay us out each year on an increasing basis, and by 95, we've taken a total income of $6.5 million. The most important part of this product is that the income continues for life. When this account value runs out to zero, the promise from the insurance carrier, the contract in play says, "We'll continue paying you." If you are in a position and you have these big buckets of money, and you're concerned about running to zero before your life expectancy, it may be of value to talk to a financial professional about how you can incorporate an annuity into your retirement plan to mitigate these risks we talked about, and so you have income into your life expectancy.

My name is Michael Clemente, and I want to thank you for your time today. We'll see you next Monday.