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The Flooring Approach to Retirement Income Strategies

A rule of thumb in planning for retirement income is to initially withdraw no more than 4% of a portfolio in the first year of retirement with annual adjustments for inflation thereafter. However, recent studies have proven this rule may not be as effective as once thought.

Given periods of stock market volatility, low interest rates and longer life expectancies, the "4% rule" may need to be reconsidered.[1] Enter the flooring approach to retirement income strategies.

ESSENTIAL INCOME NEEDS VS. DISCRETIONARY SPENDING GOALS

The income-flooring approach, in its most basic form, converts assets into a well-managed stream of income in retirement. The focus is to distinguish between essential and nonessential retirement income needs and create a strategy to address both.

First, an ***Income Floor*** is designed by targeting some cash flow to meet essential day-to-day living expenses (e.g., housing, food, energy costs). Second, the ***remainder of the portfolio*** is then managed to meet discretionary spending goals. Let's further investigate both parts of the income-flooring approach below.

1. THE INCOME FLOOR

It is important to focus clients' attention to distinguish what they feel needs absolute protection, versus things they want to have but could live without, versus things that they wish to have if the finances allow for it. Needs are typically addressed with items such as income annuities, the maximization of Social Security benefits,

as well as pension plans. These three items can help generate a sustainable income that the client cannot outlive as well as cover basic expenses.

The benefit to creating this income floor is twofold:

Help Provide Peace of Mind — a client could sleep better at night knowing that income needs may be met.

Simplicity — especially important in the later stages of retirement since the potential for cognitive abilities may decline.

1 Barron's, Retirement Myths Debunked: Why the 4% Rule is Outdated, Sept. 2019. https://www.barrons.com/articles/retirement-myths-debunked-why-the-4-rule-is-outdated-51569153602

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2. THE REMAINDER OF THE PORTFOLIO

Once the income floor is established, the remainder of the portfolio is used to meet discretionary spending goals. This could include items such as an IRA, Roth IRA, 401(k) and other assets.

Life insurance could also be considered part of this portfolio to protect a surviving spouse in the event of an early death. Long-term care insurance could be part of this as well.

AN EXAMPLE

Jim and Jane would like to lock in an income stream to pay for their rent, groceries and car insurance (among other fixed expenses). They purchase an immediate annuity to provide income on a joint and survivor basis until they both have died.

Jim and Jane can combine their annuity income with their Social Security income and Jim's pension income to pay for the basic expenses. Because Jim and Jane have created an income floor, they will then use the remainder of their portfolio to provide for their budgetary "wants and wishes."

For more information on this concept, please contact The Lafayette Life Insurance Company, Advanced Markets at 800.443.8793 to speak with Michael Buckner, CLU, ChFC, RICP, CPC, QPA, QKA, ext. 4917.

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The Lafayette Life Insurance Company
400 Broadway
Cincinnati, OH 45202-3341
LafayetteLife.com