Finance and Loan

Longevity, Volatility Show Growing Need for Principal Protection from Market Decline

With massive cutbacks to defined-benefit pension plans, many retirees are now using more market-based investment options, which puts their money at risk when they need it most. Identifying and utilizing more secure income sources can make a big difference in post-retirement quality of life.

Lancaster, PA – September 13, 2017/MM-LC/ - The demise of defined-benefit pension plans and the rise of defined-contribution retirement plans marked a corresponding rise in the use of at-risk investments, which can lead to a lack of retirement security. Although 8 in 10 retirees receive income from a pension plan today, only 24 percent of current private-sector employees are covered by a defined-benefit pension plan.[1] This has left many to rely on savings vehicles that are subject to the fluctuations of the stock market.

Kenneth S. Ray, Founder of Safe IRA and Investment Adviser representative with EPG Advisory, LLC in Lancaster, Pennsylvania describes the objective of products that provide protection from market declines as being “those financial vehicles necessary or helpful to maintain one’s family’s quality of life.” He observes that fact that many retirement plans only offer investments within 401 (k) plans that are vulnerable to market decline. A portfolio consisting entirely of investment vehicles subject to market decline may not be suitable for providing retirement security.

Some financial professionals are held to the suitability standard meaning they are only required to sell a product that is suitable for you. Others are held to the fiduciary standard which requires them to sell products that are in your best interest. The suitability standard can lead to potential conflicts of interest is because the financial professional may be focused on products that will allow them to receive higher commissions or fees, despite the fact that those products may not be best for the client or offer them the protection benefits they need during retirement. Additionally, as one approaches their retirement years, it is important that you work with someone not only to help with the accumulation of assets, but also with the distribution and protection component. Lack of awareness of the type of financial professional one is seeing can contribute to assets being placed in at-risk financial products instead of the more secure options available because that may not be the area in which the financial professional is focused or they may not have their clients’ best interest in mind.

Also, many retirement plans do not offer principal protected products which protect retiree contract values if there is a market decline.

“A retirement plan primarily composed of investments subject to market decline puts those assets at risk. It is important to have at least a portion of pension investments in secure alternatives that offer principal protection.” says Ray. “The mutual fund industry has provided some great products for retirement, but most of these products are subject to market decline."

Ray notes that participants in retirement plans often do not understand the difference between principal protected financial vehicles and those subject to market volatility. working Americans often lack understanding of the difference between secure financial vehicles and those subject to market volatility. Not understanding this distinction can lead them to making choices that jeopardize their savings. With so much at stake, it is important for those approaching retirement to fully understand their options in order to make the best decisions for their future.

In addition to 401 (k) plans, some other examples of at-risk products include stocks, bonds, mutual funds, real estate trusts and variable annuities. On the opposite end of the spectrum are products like fixed annuities, savings accounts, bank certificates of deposit (CDs), and social security which pose less risk but also do not provide as much opportunity for returns. Some products like equity-linked CDs and fixed index annuities offer more potential for earning than products like fixed annuities and savings accounts while still protecting one's principal. However, these products do not allow for unlimited upside potential such as that provided by stocks and mutual funds.

Fixed index annuities are linked to an external market activity while not participating directly in the actual market. "One real benefit of financial vehicles not directly participating in the market," Ray comments, "is that the assets won't be vulnerable to market decline which is important for retirement planning. The retiree will know, and can therefore better plan, for the income to be available in retirement years when it is needed."

By contrast, riskier types of financial products vulnerable to market decline, can significantly reduce one's ability to accurately determine post-retirement income. A recent study by the financial services company TIAA, for example, notes that less than half (46 percent) of working Americans know how much they have saved in their retirement savings accounts, and just 35 percent know how much monthly income they will have in retirement. [2]

The structure of the social security program—one of the most secure of secure of steady and reliable income sources currently available—gives employees a clearer picture of their post-retirement income. While debates rage over long-term solvency concerns, those currently aged 55 and over can generally expect to reap the benefits promised. Eligible recipients receive periodic statements throughout their working years that detail money contributed and payments they can expect.

Regardless of which vehicles individuals employ in their financial strategy, it is important that their decisions are informed and that they fully understand the options and the differences between them. After all, the most important outcome, Ray notes, is to have enough of "those assets necessary to maintain your standard of living and quality of life" in retirement. It can be incredibly beneficial to discuss your financial strategy with a qualified financial professional. Having a balance of both guaranteed sources of principal and income as well as some assets participating directly in the market is an important part of retirement success.

[1] TIAA. Sept. 14, 2016. "Survey Reveals Disconnect Between Retirement Income Expectations and Reality." https://www.tiaa.org/public/about-tiaa/news-press/press-releases/pressrelease651.html. Accessed March 3, 2017.

[2] Insured Retirement Institute. Sept. 26, 2016. "IRI Study: Lifetime Income Providing Financial Security for Retirees." http://www.irionline.org/newsroom/newsroom-detail-view/iri-study-lifetime-income-providing-financial-security-for-retirees. Accessed March 3, 2017.

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