# Episode 187: Couples, Roths, and SPIAs-Oh My!

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Retirement income, Social Security, Bond ladder, Roth funded annuities, Survivorship benefits, Primary insurance amount, Monte Carlo software, Single premium immediate annuity, Tax-free income, Roth IRA, Taxable account, Asset location, Safe withdrawal rate, Financial planning, Income protection profile.

**SPEAKERS**
Briana Corbin, Alex Murguia, Wade Pfau

**Briana Corbin** 00:00
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**Briana Corbin** 00:38
retirement questions have simple answers. These are not those questions. Wade and Alex tackle bond ladder leftovers, Roth funded annuities and rather, flexibility really is the best strategy.

**Alex Murguia** 00:53
Hey everyone. Welcome to retire with style. I'm Alex, and I'm here with my good buddy, Wade Pfau, hello, hello, hello, hello. 10 four, breaker. Breaker. I think good buddy is from dukes of hazards.

**Wade Pfau** 01:08
You got a copy on this? Mud duck

**Alex Murguia** 01:12
Shepherd, a lot of sheep. Shepherd, a lot of sheep. This is Little Bo Peep. All right, man, we're here continuing our, you know, YouTube Live session where we had questions that were going through and nothing to but to do it right, man,

**Wade Pfau** 01:30
that's right. Let's keep moving on, moving forward.

**Alex Murguia** 01:33

All right, so question coming in here is okay? All right, I'd like to listen to a podcast about strategies when the older, higher earning spouse works until age 70, and the younger spouse, seven years younger in my in my case, wants to retire early. I'm sure you do. Should I take my Social Security given that my spouse has maxed his out, and therefore my survivorship benefits will be higher, my Social Security would be higher than half of his Pia, so spousal benefits would not apply to me.

**Wade Pfau** 02:18
Okay, yeah. I mean, this is a great question. We talk a lot about the idea of delaying Social Security, but it's important to emphasize, really we're talking about the high earner in the couple. And so I think the this question is really getting at that theme, that there's more flexibility for the low earner in the couple, and in this scenario, especially with the low earner and the couple being seven years younger than the high earner in the couple to claim at a different age, they don't necessarily need to both claim at at 70. So I even just to it's always great to check this with software. So I went to open social security.com and plugged in a scenario that matched what we're talking about here with a seven year age difference. So the high earner seven years older, I have the high earners, primary insurance amount

**Alex Murguia** 03:06
is, yeah. And I said Pia as an acronym, and I should have said primary insurance amount,

**Wade Pfau** 03:12
yeah. And that's what your Social Security statement would tell you, is, what you're looking at, is your retirement as social security retirement benefit at your full retirement age, but it'll be higher if you delay 270 Yeah. And so the I plugged in, I think, just to get at the theme of what this was, the high earner spouse's primary insurance amount was not that this specific number matters too much, but $3,000 and then I put in $2,000 for the low earning spouse to get at the idea, reflected in the question that their benefit was more than half so that they're not going to get a spousal benefit. But that actually didn't matter to the answer, ultimately she'll get there. And then the higher earner was seven years older than the low earner, so I plugged that into Open Social security.com and it spit out the optimal strategy was the high earner claims at 70, the low earner claims at 62 now that's just the idea. You have flexibility in there, and if you both ended up, say, living to 100 years old, there would be benefit from both delaying to age 70. But with the situation is for a couple, the high earner spouse, their benefit lasts for the joint lifetime of the two individuals. It's the retirement benefit for that person, or it's the survivor benefit for the spouse. If the spouse outlives that worker, the benefit of the low earning individual in the couple only lasts until, like the first to die, until, as long as both individuals are alive, as soon as one of them has passed away, then the Survivor Benefit kicks in. And so the you just think about what the seven year age difference as well that low earner is not necessarily going to be. At a very not to be morbid or anything, but not going to necessarily be extremely old when with that seven year age difference, when they may become the surviving spouse in that couple, so they could get away with claiming at an earlier age. And that's what the software shows based on the life expectancies projected in in Open Social security.com the high earner claims is 70. The low earner claims is 62 the high earners benefit can be expected to last for quite a long time, because it's the joint lifetime of that couple. The low earners benefit isn't projected to last as long, and that's why you can get that sort of answer, that it's not necessary for both of them to delay their Social Security benefit. And I think that's the theme in the question, Is it okay for the low earner to claim in an earlier age? Yes, I think you were thinking about this correctly. And

yes, it's always important to check it with software, just to make sure there's not some other nuances we may have missed out with answering here, but Yeah, certainly the potential is there for the low earner in the couple, especially with that kind of age difference, to claim at a younger age.

**Alex Murguia** 06:08
The other thing, and as much as yes, this is a solid answer. Wade, look, these are just questions we're answering. Do not take this as investment advice. I'm sure there's going to be a lot of pre recorded. Caveat said here, look, at the end of the day, if you have a question, speak to an advisor. Doesn't have to be us. If it's us, you know where to find us. We're managing principles of McLean asset management, and that's a traditional wealth management firm. And we also have an online community retirement researcher, where we have workshops and almost like a master class for retirement income planning that you could check us out there where it's a little more drilled down. Remember, this is a podcast, so it's not full on advice. I don't want it to be mistaken as such, but I think we're just pointing you in directions for you to further explore how's that way?

**Wade Pfau** 06:57
Very good. All right. All right.

**Alex Murguia** 07:01
Next question, what do you do with excess funds from bonds maturing in my ladder? When proceeds from the ladder, when the proceeds from the ladder are greater than the actual spend? In a prior episode, you gave a rule of thumb to extend a bond ladder if total current asset base is greater than what it was at retirement, if the asset total is less, do I keep in cash or invest in equities? Wait before you get to that, I want to point something out that I think it's also it leads to some confusion when people when we talk about bond laddering, for folks, all right, if you don't mind, and just humor me here. So let's say we set up a bond ladder. And so a three year bond ladder, that means that I am going to buy bonds that will mature in one year, bonds that will mature in two years, and bonds that will mature in three years. And let's say, for argument's sake, there's gonna be at the end of year, right? And so during that process, I get dividends from those bonds at the end of fir the first year, let's say it was, they were each $10,000 bonds, right? So at the end of the first year, that first bond that's maturing, you know, you now have the dividends that came in during the year, but also that $10,000 right? And you have, you can do something with it or not. When we're talking about, like living off a bond ladder, we're actually talking about using that maturity, that principle that comes in for your spending needs. You know, most we're not like thinking, Okay, you're just going to live off the dividends and that's it. And then when a bond matures, extend it and buy another bond with it. We don't see a

**Wade Pfau** 08:54
distinction between a retirement income bond ladder, you're spending the proceeds versus just when people hear the term bond ladder, they might think you're gonna, as a bond mature, you reinvest them. Yeah,

**Alex Murguia** 09:05
well, we're talking about retirement income bond ladder. We're talking about you're actually using the proceeds. It would be, I mean, rates are higher, and I guess the math is the math, but

it would be damn near impossible to get everything just from bond yields. And then it's kind of tricky in that sense, because you're without being overly concentrated in one area, et cetera, et cetera, et cetera. So when we're talking about retirement income planning, we actually are spending the proceeds from the bonds maturing your your how do you continue the bond laddering once you're out of years? It comes from like a portfolio or something, right? That's why you know that. Just wanted to put that out there. And by something, I mean some asset base, some other asset base that you've been expecting to draw from, not just randomly. Oh, wow, look at that. We'll take from here. Wade,

**Wade Pfau** 09:55
yeah, yeah. And so the question understands that nuance. Yes, it was kind of just a situation. Say, No,

**Alex Murguia** 10:02
no, I know he I was more. I think a lot of folks, when we've read questions, when they talk about bond yields, they're like, How can I do a lot of the yields are slow, so low right now that you get nothing forward. And I think they miss out that you're actually using the principle as well. Yeah, just

**Wade Pfau** 10:17
just like with the 4% rule for retirement income, it assumes you're willing to spend down principal, you're not just living off the interest and dividends of the portfolio. But yeah, so what the question was getting at was, in real life, you don't necessarily know how much you're going to need to spend. So what if I had sent up to get set up that this year I've got $100,000 coming in from maturing bonds and interest payments, but I only ended up needing to spend $90,000 so I've got an extra $10,000 left over. What do I do with that? And just strictly speaking, the decision so much of the when we talk about research about retirement income strategies, there's strict rules that are followed just for the purposes of managing those simulations in real life, things can be a little bit more fungible or flexible. I mean, just simply, the 4% rule is a very strict interpretation of how people are going to spend in retirement that won't really match real life considerations about having flexibility or not. Every year, your your budget doesn't increase precisely for the inflation rate in the economy. It's a simplification, and so it's just strictly with what's researched. With these types of analyzes, you would follow that decision rule. So if you did well in the purest sense of the research, you never have surplus funds because you built the bond ladder for exactly what you want to spend.

**Alex Murguia** 11:41
Well, in real life, I don't have surplus funds either. Wade, so maybe, like art, art, art, art imitates a life.

**Wade Pfau** 11:50
But if we relax that idea, and you did, you did have these surplus funds, like I mentioned, say you're you're planning to spend $100,000 you have bonds maturing with that you only ended up needing to spend 90,000 What do you do with the $10,000 well, I guess strictly speaking, you would apply the decision rule, which is like the question mentioned, if you're following I'm going to extend the ladder if my portfolio balance is larger than where it was at the start of retirement, I'm not going to extend the ladder if my portfolio Balance falls below where it was at the start of retirement. So in this case, you wouldn't extend the ladder. So that would mean you're investing

it in your growth portfolio. The idea of the you've got your bond ladder and you've got your growth portfolio when there's a surplus of funds, I wouldn't use that to extend the bond ladder if my portfolio was falling short of its threshold according to that decision rule, so I would invest it in the growth portfolio now, with real life considerations as well. If it's not that big of amount of money and you feel more comfortable just holding it in cash or using it to extend your bond ladder, that's fine. There's no problem with making some minor deviations from these decision rules in real life. But if you were follow strictly following the decision well, you would use it to you would invest in your growth portfolio, not extend your bond letter.

**Alex Murguia** 13:12
And I would say this. I mean, this goes back to the 4% rule, or these decision rules that we have. I mean, they're meant because you can operationalize the management of assets in a in a study or in some sort of investigation that can obviously directionally show you what makes sense what doesn't make sense from a strategy perspective. But at least McLean, for instance, we're well versed in all these strategies. Wade is a managing principle here. We obviously know the research, and I can't think of anyone that's in some sort of automated strategy co pilot kind of thing. It really is. The discussion of, Hey, what should we do this year with this and that? And yeah, there's these generalities of things we're implementing. But to think that if you're do it yourself or at home, and to think you have to follow these things, you know, by the letter of the law, because that's the way it is, and that's the way the research has shown that it is et cetera, without thinking that you're never going to course correct on any of these things, give yourself some grace around that, because that's just not how it is in real life.

**Wade Pfau** 14:24
And also, even if you're not like course correcting, it's just your spending is going to fluctuate over time. And all financial planning software, whether it's Monte Carlo based or whether our funded ratio, it's really more the matter of you're entering, you're entering your cash flows. It's accounting for taxes that you have to pay in those cash flows and income sources. And then whenever you need more more distributions to meet expenses, it will take them from the investments, and it recognizes that the amount that will be distributed from investments will probably fluctuate quite a bit over time, even leaving out human flexibility to adjust what you're actually going to spend. Yes, but just do the natural nature of income sources changing over time, expenses changing over time, taxes changing over time. So that's why software doesn't usually talk about the safe withdrawal rate. It doesn't tell you, okay, the 4% rule is safe. It doesn't say anything like that. It just tells you either what's the probability that your plans projected to work, or what's your funded ratio? Because it knows that there really is no such thing as talking about the safe withdrawal rate, because there's no such thing as a constant inflation adjusted spending distribution there

**Alex Murguia** 15:34
have been and going back to software, just to put into light, Wade and I look, we created a well oiled Monte Carlo software program we've created, you know, Risa. We're well on our way to creating other things that we think are a great interest, such as in the funded racial world, right? And the reality is, there's been many softwares, not many. That's the wrong way of saying it. There's been two or three providers that have tried to make a dent in the industry, taking the sustainable withdrawal research and creating a software solution around that, and marketing it to advisors. And the reality it's it's fallen flat, not because of anything of the software, I'm sure it's very good, and it does what it needs to do, I would think it's fallen flat. And I define fallen flat

by hasn't really taken the industry by star. It's fallen thought, because no one practically does that. And yeah, I may be generalizing by using the word no one, but the reality is, when you do it like that, you're sacrificing the humanness of it all, and at that point you're you're just, you're missing the the forest for the trees, of why you're investing, etc, etc, yeah,

**Wade Pfau** 16:49
and that's just a long winded way to say and research simplifications are needed so that you can option operationalize a plan to know What's going on in real life, people won't always strictly follow those rules, but I did try to provide an answer to that in terms of what the decision rule would tell you to do, which is, if you had a surplus and your portfolio is below the threshold of where it needs to be, you would stick that in the growth portfolio. There we go. In real life, you've got more flexibility to do what you're comfortable doing

**Briana Corbin** 17:21
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**Alex Murguia** 17:47
Speaking of real life, we've got another real question here. Here it is, I would like to hear your thoughts on the pros and cons of purchasing a spea, s, p, i A, which is a single premium immediate annuity. So think of that as like the most basic traditional pension. You you cut a, you cut a check for, for a guaranteed sum of monthly money through until you die. That's it's basic vanilla form. All right, so your thoughts on the pros and cons of purchasing the spea in retirement from a Roth IRA assumption is that the retirements, the retirees income style fits with the guaranteed income model, assuming he's obviously going towards income protection profile, that there are sufficient Roth funds to fund the SPIA while leaving plenty of liquid account balance remaining for other tax diversification, that there is a gap between social security and required spending needs, ie, that a SPIA is justified. The benefit of this approach could be a lifetime of tax free income stream, a life could be a lifetime tax free income stream as well as enabling positive knock on effects. Hey, that's our phrase, knock on effects, keeping Social Security out of taxation, keeping Irma risk low at death of first spouse, or after RMD starts. I have not really heard any retirement planner suggest this approach, and it seems like it would be highly beneficial. It would be a highly beneficial one scenario here is a married couple with no children and legacy benefit needs, ie die with zero. I wonder if there is too much hang on the Roth mindset with others to consider this.

**Wade Pfau** 19:43
Wait, yeah, I think it's a great question getting at an important point. I think it could potentially make a lot of sense to consider what, what the question is asking, which is using the Roth IRA for us via just, just a couple broad points about that? Yeah, if. You are planning to leave an inheritance. A Roth IRA is a great source of inheritance that you get that 10 year window to distribute it. So it's even slightly better than the step up in basis on a taxable account, and there's no embedded income tax liability to the beneficiary. Now, there could be estate tax issues, but at least there's no income tax issues to worry about. Now, why don't we talk about Roths for spears? Well, yeah, probably it just doesn't get as much attention. A couple of things are just, I think we're only slowly getting to the point where people will have significant Roth

balances to begin with, and I still remember, even in my own lifetime of investing the $2,000 annual contribution limits on Roth, it's it's higher now, but if you're only able to put in $2,000 a year for a significant chunk of your career, your Roth may not be all that sizable at this point. Now, with Roth conversions, with the development and rise of Roth 401, K plans and so forth, we're maybe getting to the point where people where this conversation even makes sense, people have significant amounts in their Roth IRAs to even be thinking about the possibility of using them to purchase an annuity. And so that being said, this last week's episode, we had a question about, if you're really overfunded for retirement. What to be thinking about a spea and a Roth IRA could be a great solution to what I was talking about there, which is, you're really overfunded for retirement. You've got significant amounts in your IRA, your Roth IRA, and then you have a big taxable account. And that taxable account if you if you're following asset locate, I guess I didn't specifically mention the asset location principles, but that's generally where you have your most tax efficient us, stock index funds, that sort of thing, that are going to be kicking off qualified dividends that are taxed at those preferential rates. And whenever you have any ordinary income, it's going to be some of those qualified dividends or long term gains that are stacking on top of that, are going to be getting pushed from 0% to 15% and raising your marginal tax rate. And so there can be a bigger tax hit than you might think, from getting the annuity in the taxable brokerage account or or in the the IRA in that kind of scenario. So, yeah, I think that what the person's asking, of course, there's not not providing advice here. Everyone's situation is different, but absolutely, there's value in looking at is the Roth the best resource for purchasing that income annuity? That way, I'm I'm getting to have all that spending power from the annuity without having any of that going into my adjusted gross income, that can help with the Social Security taxes, although, I mean, if we're talking about overfunded scenarios, maybe still hard to avoid, because your your long term gains and qualified dividends do contribute to how much of your Social Security is taxed, but it could help with those Medicare premium surcharges. It's just it can add value and to be more diversified with your tax situation giving you more flexibility. If you did have a spending shock to then maybe you could take that out of your taxable account more easily, because you don't have a lot of other ordinary income. So if you really think about where's the best place to purchase an income annuity, and especially if legacy is not an issue, so that you're not trying to preserve the Roth account for legacy, absolutely, I think it could make a lot of sense to consider purchasing an income annuity inside of a Roth IRA

**Alex Murguia** 23:34
go Wade. Wade, I got a question that you hear every so often. It's not a direct question, but this answer could spawn some people asking, like, these basic questions. And if you don't mind, maybe going over some like, maybe rules of thumbs are is too rough of a phrase. But the whole you don't want to buy this inside. You don't want to buy an annuity inside of a tax deferred account. Obviously, Roth is different. You know, tax free, etc, etc, what, what can you just have a little back and forth about those kind of things, or, Oh, because you're just paying taxes on your principal, you know, whatever, just going into the the whole, like, back and forth of folks here,

**Wade Pfau** 24:15
yeah, a question that comes in quite a bit is just, where should, and this would be a cousin effect, where should I buy the annuity, in my taxable brokerage account, in my IRA or 401 K, or in my Roth IRA, 401 k. And the answer has to be a big It depends. And so there's advantages and disadvantages to reach. And so this question was really, yeah, hey, don't ignore the Roth IRA. That might be the best option in some cases,

**Alex Murguia** 24:42
but maybe take it through the whole arc of that particular

**Wade Pfau** 24:46
thinking, yeah, and in the previous episode or no, it was this. Was it this? We talked about culats recently. Well, those are only there's no reason to have a qlac in a Roth IRA because there's no RMD issue. Culax only apply to IRAs. So anything. Coming from a qlac, or anything coming from an annuity in an IRA. As that income is distributed coming out of the IRA, it's taxes, ordinary income. If you have a spea inside a taxable brokerage account, you get the exclusion ratio treatment, which is until you get to your IRS, IRS projected life expectancy, part of your payments are treated as the return of your premium. So like the cost basis, it's not taxed. Part of your payments are taxed as ordinary income. And then once you get past that life expectancy, 100% of the payments you receive are taxed as ordinary income.

**Alex Murguia** 25:37
And they'd be the way they congratulate you for living so long and say, at a attaboy or atta girl, right?

**Wade Pfau** 25:45
Yeah, or at least it's just, it'd be nice if you could have that treated as long term gains. Because if I bought an annuity that's over the long term, it really is more of a long term gain than anything. But no, it's, it's all treated as ordered right now, just like, Hey,

**Alex Murguia** 25:58
did all the right things, I stayed healthy.

**Wade Pfau** 26:02
And having if you're really trying to be tax efficient, having ordinary income in retirement can be problematic. And so that's where with this answer, maybe you do want to think about the Roth, but otherwise it can also depend on where you have funds. So if most of the funds are in the IRA, there's potentially that may be the best option for you.

**Alex Murguia** 26:23
No fly zones. Are there any fly zones

**Wade Pfau** 26:27
that you see? No no fly zones? The disadvantage to consider with the taxable account, if it's an issue, is you have to sell the assets to purchase the annuity, and if you have a lot of capital gains embedded in those assets, there could be a big tax bill involved, and just freeing up the funds to purchase that would

**Alex Murguia** 26:44
be the same thing with any different strategy, or anything like that that you'd want to do. But

**Wade Pfau** 26:48
that would, that could be a case where, because I have this huge tax bill, I might decide to consider either the IRA or the Roth IRA, which is

**Alex Murguia** 26:56
fine, that's a valid point. But okay, all right. All right. Wait, I'm gonna call an audible here. You know, we got 25 minutes in. We've answered three good questions and give a little exploit on another one the next questions coming up center around like bonds and treasury, you know, insurance, protect the securities tips and so I'd rather cluster them in one episode that way, it's just easier to digest for our readers, I think. All right, we'll call it on this one. What do you think sounds good? All right, everyone, thank you for listening, and we'll catch you next week on

**Wade Pfau** 27:34
retire with style. Bye, everyone.

**Briana Corbin** 27:41
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