The Case for Procrastination: Why Delaying Social Security is the Best Deal Going

The following case study details the 'annuity' gained from waiting to begin receiving benefits, and the inherent guarantees that come with it

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Certain annuities have gotten a bad rap of late, but the one offered by the government is the best deal around. Wait …the government offers annuities? In a sense, yes, and the cost/benefit ratio is far superior to anything seen in the private market.

In fact, "Should you buy an annuity from Social Security?" a high-profile issue brief from Steven Sass of The Center for Retirement Research at Boston College, argues the following:

- Households now retiring need to transform their 401(k) and IRA savings into retirement income.
- One way is to delay claiming Social Security to increase their monthly benefit, using savings to pay current expenses while they wait.
- **In effect, they are buying an annuity from Social Security: The savings used is the "price" and the increase in their monthly benefit the annuity income it "buys."**
- Buying an annuity from Social Security is generally the best deal in town, especially in today's low interest-rate environment.

To understand exactly how delaying Social Security benefits is like buying an inflation-linked lifetime annuity, consider Ann, a retired bank teller with a full retirement age (FRA) of 66 who is considering delaying the start of her benefits from age 62 to 63.

Let's assume her primary insurance amount (PIA, or an estimation of her monthly benefits for calculation purposes) is $1,000. Her benefit, if she started at ages 62 and 63 would be $750 and $800 per month respectively due to the early withdrawal penalty. When viewed as an annuity, she could forego (and thus "pay") $750 per month for 12 months beginning at age 62 for an additional $50 of benefits for the rest of her life beginning at age 63.

Similarly, she might consider delaying benefits from age 66 to 67. When viewed as an annuity, this delay would be the equivalent of paying $1,000 per month (her PIA) for 12 months beginning at age 66, in return for an additional $80 per month in lifetime benefits beginning at age 67 due to delayed retirement credits.

Conversely, the decision to delay benefits for multiple years can also be viewed as an annuity. For example, her benefits—if begun at ages 62 or 66—would be $750 or $1,000 respectively, and the decision to delay her benefits from 62 to 66 would be the equivalent of paying $750 per month for 48 months beginning at age 62. This would be in return for an additional $250 per month in lifetime benefits beginning at age 66 (the 75% of full benefits beginning at age 62 versus 100% of full benefits at age 66).

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WHAT IT MEANS

The annuity amount available from delaying the start of Social Security benefits can be a good or a bad investment depending upon the single individual's life expectancy. Consider the annuity amount provided by delaying benefits from ages 62 to 66. If Ann dies before age 66, then her return on the foregone monthly benefits from age 62 until her death would be negative 100%. That is, those benefits would be lost.

However, increasing longevity finds most retirees are not concerned about dying too soon but living too long, and thus outliving their financial resources. If a single indi-

vidual lives to age 78, this annuity would provide a 0% real return. That is, in terms of lost purchasing power, the foregone benefits from age 62 to 66 are just about offset by the additional purchasing power of benefits from age 66 to 78. If she lives longer than 78, the cumulative purchasing power of her lifetime benefits (before adjustments for taxes) would be higher if she delays benefits until 66, or her FRA. If she lives to at least 82, then this annuity would provide at least a 3% real return.

HOW SOCIAL SECURITY BENEFITS BEAT PRIVATE-SECTOR ANNUITIES

Thus, in a private-sector annuity, the investor may hand an insurance carrier a certain amount of money today in exchange for a guaranteed inflation-adjusted monthly amount for the rest of the annuitant's life. Most annuity contracts promise a nominal (i.e., not-inflation-adjusted) amount per month for the rest of the annuitant's life, **but the SSA-provided annuities provide real (inflation adjusted) annuities.**

Consider what Social Security actuaries considered in 1983 when they set the early withdrawal/delay benefit structure. Doing so makes it clear that there are three reasons why the terms of an SSA-provided "annuity" are better than the terms available on private-sector annuities (at least currently).

1. They based the benefit structure on the life expectancy of the average American at that time and assumed that the real returns available on Treasury securities would be 3%. That is, these actuaries assumed, first, that if a person lived to at least age 62, they would therefore most likely also live to about his or her mid-80s.
2. Second, all Americans, whether in good health or bad, would be equally likely to "buy" the SSA annuity by delaying the start of benefits.
3. And, third, the retiree could invest the funds in Treasury bonds and earn 3% more than inflation (which is why they based Social Security return as they did).

Now, let's consider the annuity contracts that life insurance carriers offer today. These contract terms must be based on 1) life expectancies for new retirees 2) adverse selection, which we'll explain soon, and 3) today's low interest rates.

First, life expectancies are longer today than in 1983 and life insurance firms must promise lower payments per month because these payments are, on average, going to last longer.

Second, by using the average American's lifetime as instructed by Congress, Social Security actuaries implicitly assumed that all Americans were equally likely to "buy" the SSA annuity by delaying benefits. In contrast, life insurance firms recognize, and thus build into their contracts, the reality that the average life expectancy of retirees that buy annuities exceeds the average life expectancy of the average American.

Consider two groups of retirees. The first has relatively short life expectancies based on lifestyle (e.g., an overweight smoker who does not exercise) or simply due to heredity, while the second group has longer-than-average life expectancies. Most retirees that buy an annuity will be from the latter group. Thus the offered annuities must include lower monthly benefits to reflect this "adverse selection," that is, the fact that most annuitants come from the longer-than-average life expectancy group.

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1. See William Reichenstein and WIlliam Meyer, Social Security Strategies, 2011.

Third, insurance contracts today reflect today's interest-rate environment. In the "62 vs. 63" example discussed earlier, SSA actuaries assumed the $750 payments for 12 months could be invested in Treasuries earning 3% more than inflation. That assumption may have been reasonable in 1983, but no longer. Today, insurance firms must offer less per month because of today's much lower interest rates. For example, on October 8, 2014, 10-year Treasury Inflation Protection Security bond offered investors a 0.41% real return, plus inflation. This 0.41% real return is well below the approximately 3% real return built into the benefit structure for claiming Social Security benefits.

MARRIED COUPLES

The prior analysis considered the investment implications of the current Social Security benefit structure for Ann, a single individual. Let's now extend the analysis to Ron and Patty, a married couple.

After the death of Ron, Patty generally continues benefits based on Ron's higher-PIA earnings record, while benefits based on the Patty's lower-PIA spouse's record will cease. Thus, earnings based on Ron's earnings record generally will continue until Patty dies. That is, the SSA-provided annuities are actually real (i.e., inflation adjusted) joint-lifetime annuities that will last until Patty dies.

Suppose Ron has a short life expectancy, but Patty lives to 84. Then benefits based on his earnings record will continue until the time that he would have been 87 (since he was three years older). Recognizing that real returns available on Treasury securities are between 0% and 1% today, this couple would maximize their expected joint lifetime benefits by having Ron delay his benefits until age 70. It's therefore critical to note, the higher-PIA spouse should base his or her claiming decision on the age he or she would be when the second spouse is expected to die. For many couples, this means that the higher-PIA spouse should delay his or her benefits until age 70.

From the two examples above, it's clear that optimizing Social Security is incredibly important and can result in retirement solvency over and above what conventional advice would offer. Our research shows that a strategy that is properly maximized can extend the life of the retirement portfolio between two and 10 years. "Purchasing" and annuity form the government in the form of delayed payments is one way to do it.

For more information, call us today at 866-762-7526, extension 20, or visit www.SSAnalyzer.com

About William Meyer

Bill Meyer is founder and managing principal of Social Security Solutions, a leading Social Security software firm with patented technology that is dedicated to educating and assisting financial advisors and their clients in optimizing their Social Security claiming strategies. More information is available at www.ssanalyzer.com.

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