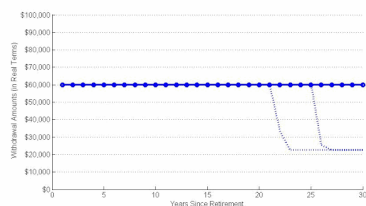


Claiming SS at 62 or 70: A Comparison

By Editor Test Mon, Jun 10, 2013

If you want to retire at 62 and you want to maximize your bequest, don't claim Social Security benefits at age 62, an American College retirement professor advises. Better to delay Social Security until age 70 and fill the income gap with an eight-year period certain annuity.



A consensus in the financial planning profession is that while the Social Security claiming decision is quite difficult and there can be exceptions, it is often beneficial to delay the receipt of Social Security retirement benefits.

I will provide an exploration of this issue. What follows is not an effort to optimize any decision-making, but rather to observe the long-term impacts of two different types of claiming strategies. I'm considering the case of a 62-year-old male who has left the workforce. This person may or may not be married, and I'm not making any effort to separately determine about a spousal claiming decision.

The 62-year-old leaves the workforce and is estimated to have a \$2,500 monthly Social Security benefit at the full retirement age of 66. If this person claims that Social Security benefit at 62, they are entitled to receive 75% of the benefit. On the other hand, if the person waits until age 70, they will be eligible to receive 132% of the benefit.

The 62-year-old has \$1 million in assets and a lifetime inflation-adjusted spending goal of \$60,000 per year.

The first option I consider is that this person begins Social Security at 62 and then uses financial assets to cover the remainder of their spending needs for as long as possible (as long as assets remain) throughout their retirement.

The second option is that this person delays Social Security until age 70, but purchases an eight year period certain immediate annuity. This is not a lifetime annuity, but an annuity that makes payments for eight years and then stops regardless of whether or not the beneficiary is alive.

This immediate annuity is not inflation-adjusted, so it will not provide precisely the same income as Social Security would have given with its inflation adjustments, but I otherwise assume that the individual withdraws what they need from their portfolio to spend \$60,000 per year after accounting for any income first from the annuity, and then later from Social Security.

The age 62 Social Security monthly benefit is $.75 \times 2500 = \$1,875$. Currently, according to Cannex, spending \$100,000 on an eight-year annuity provides monthly income of \$1,084. Thus, with the second strategy, I assume the person spends \$172,970 to purchase the annuity that will last through age 70 when Social Security benefits begin.

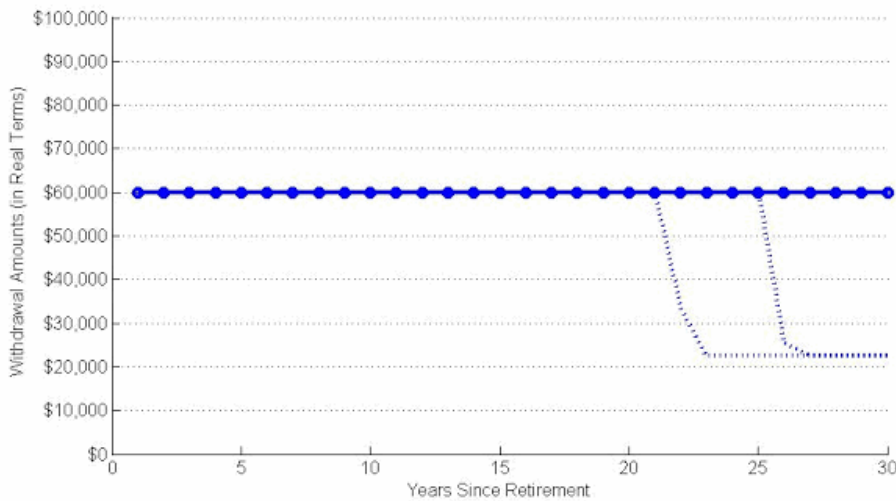
The following analysis is based on 2000 Monte Carlo simulations, with portfolio administration fees of 0.2%. Market returns and inflation are stochastic, and are based on the same current market conditions I have been using in recent research articles.

For the two strategies, I will track the real spending and real remaining wealth over retirement. The figures show the 10th, 25th, 50th, 75th, and 90th percentiles of outcomes. For spending, the distribution is not wide since I assume that the person spends \$60,000 per year (in inflation-adjusted terms) for as long as possible. When the dashed lines fall from the spending level constant, it means that wealth is depleted first at the 10th percentile, and then at the 25th percentile, and so on. When financial assets are depleted the only income that remains is the Social Security benefit (wealth is never depleted in the first eight years when annuity income is part of the budget).

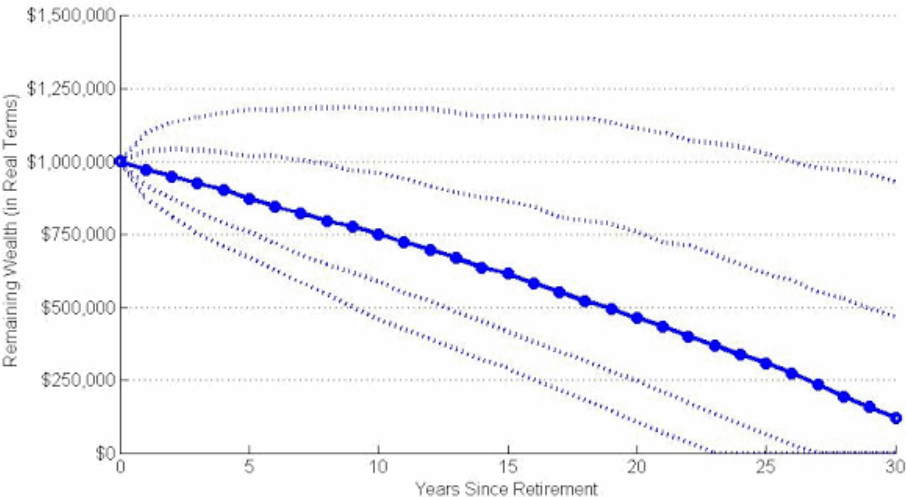
For both strategies, I assume a fixed asset allocation of 40% stocks and 60% bonds for the financial assets.

Strategy 1: Claiming Social Security at age 62

Real income

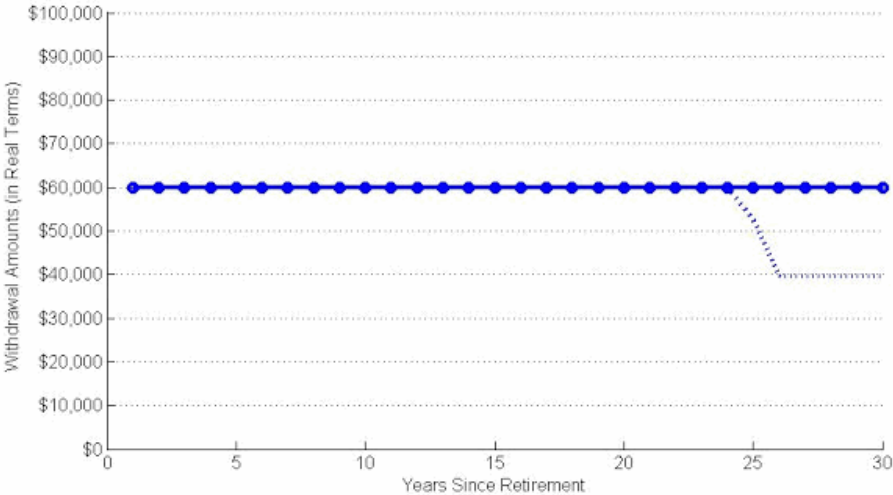


Real remaining wealth

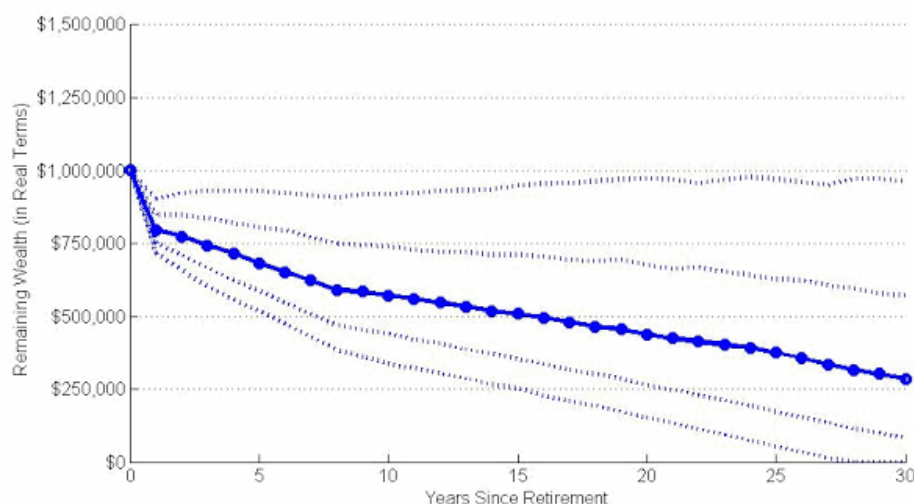


Strategy 2: 8-year period certain annuity and claim Social Security at age 70

Real income



Real remaining wealth



With Strategy 1, the impact from claiming Social Security at an earlier age is that financial assets are more likely to be depleted and that income drops further in the event of portfolio depletion. The approach used in Strategy 2 of combining the annuity and delaying Social Security makes retirement spending plan more sustainable over the long-term horizon and reduces the harm caused by financial asset depletion. In other words, running out of financial assets is both less likely to happen and less damaging when it does happen.

The main reasons why this is the case is that the benefit increases built into delaying Social Security assume a real return on underlying assets of about 2.9%, which is quite favorable compared to what investors could expect with their portfolio.

The other interesting impact to observe is the distribution of remaining real wealth over retirement. Immediate uptake of Social Security can potentially allow for a higher bequest if one dies early in retirement, but the potential for leaving a bequest actually improves later in retirement with the delayed Social Security strategy. This has rather interesting implications for anyone seeking to provide a legacy to the next generation.

We must think about the marginal utility of wealth. If someone dies early in retirement, they will leave a larger nest egg to the next generation, and the fact that Strategy 1 provides an even bigger nest egg than otherwise may not have all that much impact on the lifestyle of the recipient.

But in cases with a more lengthy retirement period, the nature of this bequests changes. Delaying Social Security makes it less likely that financial assets are depleted, which means there will be less strain on any potential bequest recipient [e.g., children] to provide reverse support to the retiree. The potential to leave a larger bequest actually is higher with delayed Social Security in these cases when the available bequests with both approaches are less and each dollar of bequest will count for more. In this sense, a retiree may actually be doing a favor for the subsequent generation by delaying Social Security, which may be a counterintuitive result.