Looking for growth? Delay Social Security.

By Editor Test *Sun, Sep 9, 2012*

It's tempting, and often necessary, to claim Social Security benefits before full retirement age. But, because of low interest rates, it makes more sense than ever to postpone claiming all the way to age 70, two academics say.

If, like most people, your client is determined to draw Social Security before full retirement age or even before age 70, a new piece of research from scholars at Stanford and the American Enterprise Institute may help change their minds.

The paper, "When Does It Pay to Delay Social Security? The Impact of Mortality, Interest Rates and Program Rules," suggests that when the yield on safe assets is near zero (as it currently is), and Social Security benefits are growing by about 8% a year (as they do for people over 62 who delay taking them for up to eight years) it's smarter to spend savings and let the Social Security benefit grow.

The authors, John B. Shoven of Stanford and Sita N. Slavov of the AEI, make the further claim that, when interest rates are near zero, delaying Social Security becomes so advantageous that even people who don't expect a longer-than-average lifespan can benefit from doing it. According to the paper:

"We find that when real interest rates are close to zero, singles in all groups – even those with mortality that is substantially greater than average – gain from at least some delay. Couples in all groups benefit from delaying the primary earner's benefit, though for some groups with lower-than-average life expectancy, the couple maximizes present value when the secondary earner claims at age 62," the paper said.

"At real interest rates that are closer to their historical average, singles with substantially lower-than-average life expectancy no longer benefit from delays. However, even in this case couples in all groups gain from delaying the primary earner's benefit.

"These results have important implications for financing retirement in the presence of defined contribution balances. Financial planners often advise individuals to use defined contribution balances to purchase an annuity, using the annuity income to supplement Social Security benefits. That is, the two retirement resources – Social Security and defined contribution balances – are consumed in parallel.

"However, in today's low-interest rate environment, this standard strategy is suboptimal for most retirees. The terms for delaying Social Security are more generous than the terms for purchasing a private annuity. Moreover, as Social Security payments are adjusted for cost-of-living increases, delaying Social Security buys an annuity whose payments remain constant in real terms; such annuities are virtually unavailable in the private market.

"This suggests that for individuals with defined contribution balances, accessing retirement resources in sequence – that is, using defined contribution accounts to finance a delay of Social Security – is likely to generate higher retirement income than using them in parallel."