3 risk-related reasons to put off claiming Social Security

Strategy can offset threats of longevity, inflation, markets

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On Retirement

The choice of when and how to claim Social Security benefits can affect the three biggest financial risks that retirees encounter: longevity, inflation and markets.

Despite that, it remains "one of the most neglected financial decisions that retirees face," according to a recent article in The Journal of Retirement.

The move to delay benefits amounts to forgoing current income in exchange for a future stream of bigger payments that last a lifetime. The longer one waits to claim, the higher the monthly benefit. In the extreme, claiming at 70 instead of at the earliest age of 62 can raise lifetime monthly benefits by 76%.

Yet 62 remains the most popular age to start taking benefits, accounting for 50% of claims by women and 45% of claims by men in recent years, according to the article, "When should you claim Social Security."

'ROAD LESS TAKEN'

Just 5% of retirees wait until 67 or later to claim Social Security, prompting co-authors David Laster and Anil Suri to write that "delaying benefits beyond full retirement age has been the road less taken."

Consequently, many retirees may be missing out on a key strategy to improve their retirement security.

Mr. Laster is head of retirement strategy and Mr. Suri head of portfolio construction and investment analytics at Merrill Lynch Wealth Management.

Social Security is a substantial source of retirement wealth for American families across the economic spectrum. For high-income families (the top 10%), the expected value of lifetime Social Security benefits is about $390,000 for singles and $710,000 for couples.

Thus, even for many affluent retirees, future Social Security benefits are worth more than their retirement accounts or homes, or other real estate holdings.

For those whose life expectancy is near average, waiting to claim Social Security can enhance retirement security and boost the expected present value of future benefits by as much as $60,000 for single retirees and $150,000 for retired couples, according to the article.

76%
Maximum rise in lifetime benefits claiming at 70 rather than 62.

"Following a good Social Security strategy for one year is 10 times more valuable than investing a $200,000 portfolio with a manager who generates 100 basis point in alpha (extra return)," they wrote.

Many people wonder how long they must live to recoup the benefits they give up when they decide to delay claiming benefits until an older age. This is known as the break-even age.

The authors illustrate the break-even analysis with an example of two single, 62-year-old men. One claims benefits at 62, while the other waits until his full retirement age of 66.

Andy, who claimed benefits at 62, has accumulated four years of benefits at 66 and is far better off than Bill, who hasn't been collecting. But then Bill starts to catch up. Each month he receives a benefit equal to 100% of his primary insurance amount, while Andy receives just 75% of his PIA.

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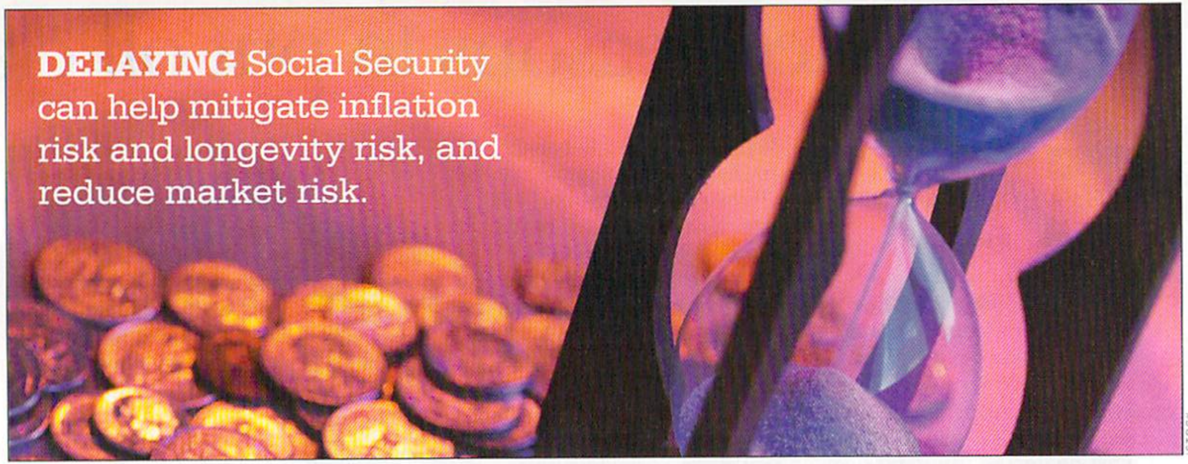
3 reasons to delay claims



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Once they reach the break-even age of 78, Bill's cumulative benefit equals Andy's. From then on, Bill's lead over Andy keeps growing.

"Since the life expectancy for a 62-year-old male is 81 years, the break-even approach suggests it pays for a man with average life expectancy to delay claiming until at least age 66," the authors wrote. "And since the average life expectancy of a 62-year-old female is 84 years, it makes even more sense for a woman to wait before claiming."

They added that break-even analysis, while informative, does not fully capture the nuances of the decision of when to claim.

"Most importantly, focusing on break-even analysis neglects a key consideration: waiting to claim provides longevity insurance," they wrote.

They note the Social Security Administration, which had a calculator on its website that performed break-even analysis, now instructs its specialists to de-emphasize the approach. Instead, a marginal analysis focuses on what a person stands to gain or lose by waiting another year before claiming.

The extra annual benefit achieved by waiting to claim has two valuable attributes.

First, it increases each year in line with inflation, helping retirees maintain their standard of living.

Second, for married couples, the additional benefit the higher-income earner gets by waiting to claim continues to be paid as long as either spouse is alive, so the resulting increase in monthly benefits will last throughout the lifetime of both spouses.

Consequently, delaying Social Security can help mitigate both inflation risk and longevity risk. But it can also reduce market risk.

Market risk is especially pronounced for retirees who regularly draw down assets to help cover expenses. These drawdowns magnify the damage done by a market sell-off. By waiting to claim Social Security, retirees increase their income from guaranteed sources, thus reducing their exposure to future market volatility once they start collecting benefits.

(Questions about Social Security? Find the answers in my e-book at InvestmentNews.com/MBFebook.)

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