Social Security in the New Retirement

Financial Engines' Social Security methodology

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Overview

Americans retiring today face a new and increasingly complex retirement landscape. The mid to late 20th century model of the three-legged stool of Social Security, pensions, and individual savings no longer applies to many retirees. With the incidence of traditional defined benefit pensions declining, Social Security provides on average about two-thirds of total income for individuals age 65 and over who are receiving benefits.[1] Given the important role that Social Security plays for many retirees, it is increasingly important to ensure that they are making the most of this resource.

Despite Social Security providing the lion's share of retirement income for many, the rules surrounding Social Security claiming are poorly understood by the average retiree. There are literally thousands of rules that govern the calculation of Social Security benefits for retirees and their spouses. Interpreting and internalizing all of these complex rules strains the ability of even experienced financial advisors.[2] Accordingly, most retirees have only the most basic understanding of how Social Security works. For instance, many retirees have little awareness of how benefits increase by starting them at later ages. Since the benefit increases from delaying are poorly understood, impatience tends to win in deciding when to claim. Based on recent data, 43 percent of Social Security claimants take benefits within two months of the earliest possible claiming age of 62, and 60 percent take them within two months of the later of age 62 or the date of retirement (Shoven and Slavov, 2012). Given the large benefit increases available by delaying the start date of Social Security, a great majority of retirees would benefit from waiting until age 70 before starting their benefits. But an optimal claiming decision for Social Security is not merely a matter of evaluating the benefits for an individual. The potential gains for married couples are even more dramatic. However, benefit rules for married couples are even more complex than for single retirees, and there is little conventional wisdom about the right way to optimize a married couple's benefit claiming decisions.

Financial Engines seeks to help individuals and married couples create a successful retirement. How retirees choose to claim Social Security may be the single most important financial decision they will make with respect to their retirement. Relative to the early claiming decisions that most retirees make, the gains in expected lifetime income from an optimal claiming decision can be dramatic. For individuals, our analysis indicates that the gains can exceed $100,000 in expected higher lifetime income, while for married couples the gains can exceed $250,000. Since the typical near-retiree has less than $70,000 in their 401(k) plan[3], it is easy to see why getting the most from Social Security is critical to the retirement success for many households. It is difficult to identify many 401(k) decisions that can have as much impact on lifetime retirement income as getting Social Security right.

In this paper, we will describe the key components of effective Social Security claiming strategies. We will also illustrate how Financial Engines helps retirees understand the key tradeoffs and opportunities within the Social Security benefit rules. Financial Engines' services also address the behavioral challenges in getting near-retirees to properly assess the benefits of optimizing their Social Security claiming strategy, in particular by providing a holistic portrait of all of the household's sources of retirement income: Social Security; pensions; part-time work; and well-timed withdrawals from retirement savings accounts.

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[1] See Table 9.A1 in Social Security Administration, "Income of the Population 55 and Over, 2010," published 2012.

[2] Greenwald et al. (2011) report that 22% of surveyed financial advisors felt "very knowledgeable" about how the Social Security system works, and the advisors believe clients should claim benefits at a median age of 66.

[3] The median balance in Vanguard defined contribution plans for those age 55-64 was $67,239 in 2012 (Vanguard 2013).

The Basics of Delaying Social Security

Social Security provides a lifetime income stream that is inflation adjusted and is backed by the full faith and credit of the federal government—that is, Social Security is a real annuity paid by the U.S. government. Social Security benefits are typically described as providing a "full" benefit amount starting at a person's "full retirement age." For Baby Boomers, born between 1943 and 1954, that full retirement age is 66. Early claiming results in reduced benefits, such that claiming at 62 yields 75 percent of the full benefit amount. The reduced benefit is permanent in that it continues at that reduced level for the rest of the individual's life. Delaying claiming results in permanently increased benefits, up to 132 percent of the full benefit amount for claiming at age 70.[4] These delayed retirement credits (more correctly thought of as credits for delayed claiming) were created in order to make an actuarial adjustment: if benefits are claimed later, benefits will be paid out for a shorter period, justifying a larger monthly benefit.

Until recently, it was commonly asserted that the delayed retirement credits were actuarially fair, in the sense that the average individual would get the same expected present value of lifetime benefits regardless of what age they claimed their benefits. If this were true, then delaying benefits would only make sense for those who expect to live longer than average. However, the delay credits today are actually more generous than actuarial fairness would dictate. First, average longevity has increased since the delay credits were last changed in 1983. If the 1983 adjustments were actuarially fair, then improved longevity since 1983 means the current adjustments assume "too short" an average longevity and hence are too large a reward for delaying. Second, actuarial adjustments to maintain a constant present value assume some set of interest rates. The period since 1983 has been marked by a consistent decline in U.S. interest rates. Since Social Security represents an inflation-protected promise by the U.S. government, these benefits should be discounted by real, not nominal Treasury interest rates. The real interest rate available to purchasers of inflation-indexed "I bonds" from the Treasury has hovered at or near 0.0% since 2009 (as of 12/31/2013).[5] In today's low interest rate environment, the benefits to delaying Social Security benefits are even more substantial than a simple consideration of longevity increases would dictate. There is a third, less recognized reason why delaying Social Security benefits is often desirable in the context of 401(k) participants. And that is the population of 401(k) participants is on average better educated and has a higher income, and thus likely to live longer than the population of Social Security beneficiaries that is used by the Social Security Administration to calculate the mortality distribution. There is a high correlation between better health and higher levels of income and education across individuals. This is particularly relevant for companies that employ large proportions of highly educated and higher income workers.

To demonstrate the economic incentive to delay Social Security benefits, consider the example of John, a 62-year-old male who is considering taking benefits at three different ages. John's earned benefit available at his full retirement age of 66 is $18,000 per year.[6] If he were to take benefits at the earliest possible claiming age of 62, he would receive a reduced benefit of $13,500 per year, or 75 percent of his

[4] These differences may seem small, but they can be reframed in a way to better understand the reward for delaying. The annual benefit if claimed at age 70 is *76 percent higher* than the benefit if claimed at age 62.

[5] During 2013, the real yield on 10-year Treasury Inflation Protected Securities (TIPS) ranged between -0.74% and 0.92%. Retrieved Feb. 7, 2014 from http://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=realyield.

[6] A benefit amount of $18,000 is not a high-income individual. This benefit amount would be projected for a 65-year-old male who currently earns $32,000 per year and had career earnings growth equivalent to the Social Security population.

full retirement age benefit. However, delaying his benefit start until age 70 would increase his annual benefit to $23,760, or 132 percent of his full retirement benefit. Since John is single, the main uncertainty that impacts this decision is how long he might live. Some retirees and their advisors might use a simple, deterministic approach of adding up benefits received until life expectancy is reached to determine which start date would be optimal. Given current longevity data, John has approximately a 50 percent chance of living until the age of 85.[7] As the third column of Table 1 shows, starting at age 70 would yield the highest cumulative benefits through age 84. Although there are fewer years of benefits, the higher annual benefit amount more than compensates for the delay.

Table 1
Delaying Social Security for a Single Retiree

Age of Claiming	Annual Benefit	(Deterministic Mortality Approach) Cumulative Benefits through Age 84	(Probabilistic Mortality Approach) Expected Lifetime Benefits
62	$13,500	$310,500	$302,800
66	$18,000	$342,000	$333,100
70	$23,760	$356,460	$350,800
Gain from Delaying from 62 to 70		*$45,900 (+15%)*	*$48,000 (+16%)*

The simple deterministic calculation examines only one out of many possibilities for how long John might live. As a result, it is a rough approximation of a more complete, probabilistic approach that analyzes all of the possible longevity scenarios. For example, there is a 25 percent chance that John will die before the age of 78. Under that scenario, starting benefits at age 66 would yield higher cumulative benefits than starting at either 62 or 70. There is, on the other hand, a 25 percent chance that he will live until the age of 91. Living that long would make delaying until age 70 even more attractive than suggested by the deterministic life expectancy calculation. By using the full set of survival probabilities at different possible ages (up through age 120), and analyzing the cumulative lifetime benefits under every possible longevity scenario, we calculate the average or expected total lifetime benefits shown in the fourth column of Table 1. In this example, the deterministic approach produced estimates that were a reasonable approximation of the more accurate probabilistic calculation.[8] However, when we turn to analyzing married couples, there will be larger differences.[9]

The reward to delaying Social Security is not limited to those with average or better than average longevity prospects. As an example, if we make John's probability of dying in each year 20 percent higher than the Society of Actuaries' tables imply, then the gain from delaying from 62 to 70 is still a relatively large $37,300 increase in expected lifetime benefits. There will of course be special cases

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[7] Throughout this paper and in Financial Engines' Social Security guidance, we use mortality tables published by the Society of Actuaries. These tables reflect group annuitants, which are a better reflection of the better-than-average longevity of 401(k) plan participants than population average mortality tables. See Society of Actuaries (1995).

[8] For benefit amounts different from the $18,000 amount assumed for this example, the dollar amounts could be scaled up or down accordingly, while the percentage gain of 16 percent shown in the bottom row would still apply.

[9] The expected lifetime benefits calculated here are also net present value calculations, given real interest rates of zero percent. Thus, maximizing expected lifetime benefits is the appropriate way to choose among different Social Security benefit streams that start at different ages. Under positive interest rates, the deterministic approach becomes a worse approximation for the correct, probabilistic approach.

where an unmarried retiree has a known health condition that dramatically reduces their survival prospects, making delaying benefits financially unattractive. However, these cases are relatively uncommon among large plan 401(k) participants.

As a final note on the incentive to delay for single retirees, it is worth mentioning that women will generally have a larger gain from delaying. The simple reason for this is that the delay credits are gender-neutral, but women's longer life expectancies make them more likely to live to older ages that make delaying Social Security benefits attractive. Assuming the same earned benefits as what John is entitled to, a typical single woman could improve her expected lifetime benefits by $69,900, or 21 percent, by delaying from 62 to 70.

Delaying Benefits for Married Couples

Married couples face a much more complex decision, because the rewards to delaying are greater and because there are many more ways to claim benefits. To understand these possibilities, we first need to introduce a couple of important concepts.

Incorporated into the Social Security law is the concept of *spousal benefits*. Spousal benefits are benefits to which a spouse (or ex-spouse) is entitled, generally equal to half of the full earned benefit of their partner. This part of the law is designed to protect the interests of a spouse who may choose not to work in order to raise a family, or who earns substantially less than the primary earner in the household. As we will see, spousal benefits can play an important role in maximizing the lifetime income of a married couple, even in situations where the two partners have similar lifetime earnings.

Another important concept under the Social Security law is *survivor benefits*. Survivor benefits are the benefits that go to the second-to-die spouse in a married couple. Social Security is structured such that the surviving spouse receives the higher of the benefits being paid to each member of the household. For example, if one spouse's earned benefit was $20,000 per year, and the other was receiving $10,000 per year, the surviving spouse would receive $20,000 per year no matter which partner dies first. Survivor benefits are very important, as the average length of time that one spouse will be expected to outlive the other is approximately 10-12 years for most couples of similar age.[10] This is in contrast to most people's intuition that the number would be equal to the gap in average life expectancy between males and females of two to four years. In reality, the chance of one spouse substantially outliving the other is quite significant.

[10] We calculated these estimates based on the same mortality tables used throughout this paper.

As a general rule, when maximizing lifetime benefits for a married couple, the higher earner within a couple will have an incentive to delay taking their earned benefit, often to age 70. This action will increase the size of the higher earner's annual earned benefit. There are two other significant reasons why this approach is an effective way to maximize the household's expected lifetime benefits:

1. In addition to spousal benefits generally equal to one half of the primary earner's full benefit amount, the secondary earner is also entitled to the *higher* of his/her own earned benefit and an increased survivor benefit, if the primary earner delays benefits. The fact that survivor benefits also increase makes the delay credits an even better deal for the household. This is an especially significant boost, because the expected length of widowhood or widowerhood is approximately 11 years, as mentioned above.[11]

2. A rule change in 2000 created the opportunity for an uncommon claiming strategy, often called "file and suspend," that further boosts lifetime benefits for many couples. The strategy involves the following steps:
    a. At 66 (full retirement age), the primary earner files for but suspends the earned benefit. That earned benefit will continue to grow by the delay credits until age 70.
    b. During that time (while the primary earner accrues delay credits), the secondary earner can start taking spousal benefits equal to one half of the primary earner's full benefit amount.

   This approach allows the primary earner's benefits to grow and the survivor benefits to increase while the household also receives some spousal benefits.[12]

Consider an example to help illustrate the benefits of delaying and using this less well known filing strategy. Suppose Bob and Jane are married and both are the same age, and that Bob is entitled to a full benefit amount of $18,000 per year if he were to claim it at the full retirement age of 66. If he were to take it at the earliest age of 62, he would receive a reduced benefit of $13,500. Suppose Jane had minimal work history during her career, so her spousal benefit is greater than her own earned benefit. If Jane were to wait to receive her spousal benefits until the full retirement age of 66, she would receive $9,000, which is half of Bob's full earned benefit. If Jane files for her spousal benefit at the same time as Bob, at age 62, she would get a reduced benefit of $6,300[13]. This approach is shown under the "Early Claiming" heading in Table 2a.

[11] The boost to survivor benefits can be understood in a different way, for those familiar with annuities. For a single person, benefits represent a single-life annuity. If the delay credits were actuarially fair, then delaying benefits would simply be exchanging one single-life annuity for another that starts later, but both would have the same value. For a married couple, Social Security provides a joint annuity with a free 100 percent survivor benefit. Delay credits increase the joint annuity, as well as the free 100 percent survivor benefit.

[12] This "file and suspend" strategy can also be done by swapping the spouses. It is not necessary that the person who files and suspends is the primary earner, although effective claiming strategies will usually involve the primary earner doing so.

[13] The reduction for early claiming of spousal benefits is larger than for earned benefits, up to 30 percent for 48 months of early claiming.

Table 2a
Delaying Social Security for a Married Couple (Single Earner)

Age	*Early Claiming* Bob	*Early Claiming* Jane	*Highest Expected Lifetime Value* Bob	*Highest Expected Lifetime Value* Jane
62	$13,500	$6,300		
63	$13,500	$6,300		
64	$13,500	$6,300		
65	$13,500	$6,300		
66	$13,500	$6,300		$9,000
67	$13,500	$6,300		$9,000
68	$13,500	$6,300		$9,000
69	$13,500	$6,300		$9,000
70	$13,500	$6,300	$23,760	$9,000
71	$13,500	$6,300	$23,760	$9,000
72	$13,500	$6,300	$23,760	$9,000
73	$13,500	$6,300	$23,760	$9,000
74	$13,500	$6,300	$23,760	$9,000
75	$13,500	$6,300	$23,760	$9,000
…	…	…	…	…

Under the improved approach that yields the highest expected lifetime value of benefits, Bob files for but suspends his benefit at age 66. He intends to wait until 70 to take a higher earned benefit of $23,760. Because Bob has filed for his benefit (even though he's not receiving it), Jane can start her spousal benefit at age 66. The cumulative benefits calculations in Table 2b show that if both Bob and Jane live until age 80, the improved approach has surpassed the early claiming approach. This breakeven calculation is only part of the picture, however, because it ignores what happens if either of them lives past 80. Bob's delaying the start of benefits also increases the survivor benefit that Jane would receive after Bob dies, by an extra $10,260 ($23,760 - $13,500) per year. When we account for the various possibilities for how long they each may live, the expected lifetime benefits are more than $110,000 (or 22 percent) higher under the improved approach. Moreover, under the improved approach, Bob and Jane will receive higher lifetime benefits 93 percent of the time relative to the early claiming strategy.[14] This reinforces just how valuable the strategy of delaying benefit start dates can be for a typical household.

[14] We enumerate all of the possible combinations of lifespans for Bob and Jane, and weigh them by the likelihood of each combination occurring. The improved approach yields higher lifetime benefits than the early claiming approach in approximately 90 percent of those scenarios. Thus, while there is no guarantee that deferring benefits will be better in all cases, the chances of regretting that decision are small.

Table 2b **Benefits of Delaying Social Security for a Married Couple (Single Earner)** Cumulative benefits assuming both alive (ignores survivor benefits):		
	Early Claiming	***Highest Expected Lifetime Value***
70	$178,200	$68,760
75	$277,200	$232,560
80	$376,200	$396,360
85	$475,200	$560,160
Survivor Benefit	$13,500	$23,760
Expected Lifetime Benefits	$515,900	$627,600 (+22%)

Next consider an example for a couple where both husband and wife have significant earned benefits. Suppose Bob can take a full earned benefit of $18,000 at age 66, while Jane is entitled to her own full earned benefit of $15,000 at age 66. If they were to both take benefits at the earliest age of 62, they would get reduced benefits of $13,500 and $11,250, respectively. Those benefits are shown in Table 3a.

Table 3a **Delaying Social Security for a Married Couple (Two Earners)**					
	Early Claiming		***Highest Expected Lifetime Value***		
Age	**Bob**	**Jane**	**Bob**	**Jane Spousal**	**Jane Earned**
62	$13,500	$11,250			
63	$13,500	$11,250			
64	$13,500	$11,250			
65	$13,500	$11,250			
66	$13,500	$11,250		$9,000	
67	$13,500	$11,250		$9,000	
68	$13,500	$11,250		$9,000	
69	$13,500	$11,250		$9,000	
70	$13,500	$11,250	$23,760		$19,800
71	$13,500	$11,250	$23,760		$19,800
72	$13,500	$11,250	$23,760		$19,800
73	$13,500	$11,250	$23,760		$19,800
74	$13,500	$11,250	$23,760		$19,800
75	$13,500	$11,250	$23,760		$19,800
…	…	…	…		…

The approach that maximizes the expected lifetime value of benefits involves both Bob and Jane delaying their own earned benefits. In addition, Jane can take a spousal benefit of $9,000 (half of Bob's full earned benefit of $18,000) from 66 through 69.[15] When they turn 70, Bob and Jane start their earned benefits of $23,760 and $19,800, respectively. Table 3b summarizes the cumulative benefits received under each strategy, assuming both partners are alive. Before the age of 80, the improved approach has reached the "breakeven point" versus the early claiming approach. Taking into account all the possibilities for how long they might live, the expected lifetime benefits increase by $142,500, or 23 percent.[16] Thus, smart filing strategies can mean a significantly larger improvement for couples than for singles, due to the opportunities for increasing spousal and survivor benefits.[17]

Table 3b
Benefits of Delaying Social Security for a Married Couple (Two Earners)
Cumulative benefits assuming both alive (ignores survivor benefits):

	Early Claiming	*Highest Expected Lifetime Value*
70	$222,750	$79,560
75	$346,500	$297,360
80	$470,250	$515,160
85	$594,000	$732,960
Survivor Benefit	$13,500	$23,760
Expected Lifetime Benefits	$606,400	$748,900 (+23%)

Recognizing Behavioral Challenges

We've seen that the economic benefits to smarter Social Security claiming decisions are often large. Unfortunately, the vast majority of retirees are foregoing significant future retirement income by claiming benefits as soon as they retire. It is almost certain that most couples filing for early benefits do not realize how much money they are leaving on the table. Correcting their mistakes will require not just informing them, but also overcoming some of the behavioral biases behind their impatience.

Many retirees may approach the Social Security decision within a narrow frame of reference. For a single person, the decision boils down to taking a smaller monthly amount sooner versus taking a larger monthly amount starting later. Many will be familiar with the idea of a breakeven point. As we showed above, the breakeven age is typically before the age of 80. What may make this decision difficult for many retirees will be the uncertainty about how long they may live. While they may understand that life expectancy is in the mid-80s, the possibility that they may not live to that age might loom large in their evaluation of the decision. However, for married couples the situation is more complex. It is not only

[15] This requires that Bob file and suspend his earned benefit.
[16] As with the one-earner case, the improved strategy results in increased lifetime benefits for the couple approximately 90 percent of the time relative to the early claiming strategy.
[17] Higher-income households will generally have larger earned benefits, and thus their improvements in expected lifetime benefits will be larger in absolute dollar terms.

individual life expectancy that matters. Delaying the primary earned benefit is beneficial even if only one of the partners lives to an older age. That is, it is important to evaluate the chance that *at least one* of the members of the household makes it to an advanced age, a probability that is much higher than for an individual. For example, for a husband and wife who are currently both 62 years old, there is a 25 percent chance that at least one of them will reach age 96.

We already demonstrated that the expected total lifetime benefits are improved by the suggested deferred claiming strategies. But is improving expected lifetime benefits enough to convince retirees to use these strategies? To provide greater context, we can also calculate the likelihood that the improved claiming approach surpasses the benefits from the early claiming approach. For the married couple examples, it turns out that the improved approach yields higher total lifetime benefits approximately 90 percent of the time.[18] With all of these statistics available, a participant can come to an understanding that the improved approach *does better on average*, *does better the vast majority of the time*, and *does better without requiring anyone live especially long*.

Health status may also play a role in the decision to take Social Security benefits early. As mentioned above, the average 401(k) participant is likely healthier than the overall Social Security population, and thus is more likely to benefit from delaying the start of benefits. However, not everyone is average. If a primary earner has information that their lifespan is likely to be much shorter than average, then it may not make sense to plan to delay benefits for very long.[19] Correspondingly, if a participant has reason to believe that they might live longer than average (e.g., their parents lived into their nineties), then delaying benefits will be even more important to maximize lifetime benefits. However, the decision to delay benefits is not necessarily irreversible if an unexpected health crisis should arise.

One interesting wrinkle in the Social Security rules provides an option for people who file and suspend benefits, but later discover a health issue that will compromise their longevity (e.g., diagnosis of a terminal illness). In this situation, it is possible to contact the Social Security Administration and “undo” their file and suspend decision, such that they can pick the year that they would like their benefits to have started. The Social Security Administration will then adjust their monthly benefit to start immediately at the level commensurate with the selected start age (say age 66). Moreover, they will provide a lump-sum benefit equal to the total amount that would have been received over the time period when they were suspending benefits. This “undo” option can be valuable to households in the challenging circumstances of dealing with an unexpected health event. It also means that planning to delay benefits is not an irreversible decision.[20]

While the outcome statistics we have illustrated show that informed claiming strategies can result in large increases in overall lifetime benefits, many retirees may be averse to delaying benefits because they may not have other sources of income to fund their early years of retirement.

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[18] This percentage may be surprisingly high, and there are two reasons. First, the improved strategies’ cumulative benefits surpass the early claiming strategies’ cumulative benefits if both Bob and Jane reach age 80, which is before life expectancy. Second, the large $10,000 increase in survivor benefits is relevant for a long time, given the long average length of widowhood.

[19] The household would want to recognize that, while the primary earner might not receive benefits long enough to make the delay “break even” in terms of his/her own benefits, the surviving spouse would benefit from higher survivor benefits if the primary earner were to delay taking benefits.

[20] Filing and suspending can only be done once a person has reached full retirement age.

These “gap” years can be funded in a number of ways:

- Working longer
- Taking a part-time job (part-time jobs may be sufficient to fill gaps in years where only one person is taking a spousal benefit)
- Accelerated withdrawals from 401(k) savings, with the portfolio appropriately allocated to generate the required cash flows. The Income+ framework in the Financial Engines Professional Management program can provide such cash flows
- Lump-sum withdrawal from a defined benefit pension

There may be situations where these other resources are simply not enough to bridge the gap to facilitate a proposed claiming strategy. In addition, some retirees may have different expectations about their health or longevity or have specific income needs in certain years, such that following the strategy that maximizes lifetime benefits is too long to wait. Financial Engines can provide another alternative: a customized filing strategy that starts some benefits at an earlier age, with the age being chosen by the plan participant. In effect, a participant can ask for a filing strategy that tries to maximize expected lifetime Social Security benefits, but subject to a constraint that benefits not be delayed beyond a certain age. This allows households to personalize their strategy to incorporate specific concerns, while still getting the benefit of optimizing across a range of possible strategies.

As an example of a personalized claiming strategy, let’s return to the example of Bob and Jane from Table 3. Suppose the couple decides to start Jane’s earned benefits at age 62. It turns out that this decision doesn’t sacrifice much of the improvement over the early claiming strategy. As shown in Table 4a, Bob can take a spousal benefit at age 66, leaving his earned benefit to grow until age 70. Table 4b shows that the total expected lifetime benefits still increases by over $100,000, or 21 percent. The strategy that fully maximizes expected lifetime benefits increased expected lifetime benefits by only a slightly higher 23 percent, but the cumulative benefits received through age 70 are now almost twice as much ($155,010 in Table 4b versus $79,560 in Table 3b). This means that other household resources can remain untouched for longer into retirement. Households are more likely to choose a claiming strategy that doesn’t require putting off all benefits for a number of years.

Table 4a
Delaying Social Security for a Married Couple (Two Earners)

Age	*Early Claiming* Bob	Jane	*Partial Delay* Bob	Bob Spousal	Jane Earned
62	$13,500	$11,250			$11,250
63	$13,500	$11,250			$11,250
64	$13,500	$11,250			$11,250
65	$13,500	$11,250			$11,250
66	$13,500	$11,250		$7,500	$11,250
67	$13,500	$11,250		$7,500	$11,250
68	$13,500	$11,250		$7,500	$11,250
69	$13,500	$11,250		$7,500	$11,250
70	$13,500	$11,250	$23,760		$11,250
71	$13,500	$11,250	$23,760		$11,250
72	$13,500	$11,250	$23,760		$11,250
73	$13,500	$11,250	$23,760		$11,250
74	$13,500	$11,250	$23,760		$11,250
75	$13,500	$11,250	$23,760		$11,250
…	…	…	…		…

Table 4b
Benefits of Delaying Social Security for a Married Couple (Two Earners)
Cumulative benefits assuming both alive (ignores survivor benefits):

	Early Claiming	*Partial Delay*
70	$222,750	$155,010
75	$346,500	$330,060
80	$470,250	$505,110
85	$594,000	$680,160
Survivor Benefit	$13,500	$23,760
Expected Lifetime Benefits	$606,400	$732,700 (+21%)

Social Security and Income Planning with Financial Engines

Financial Engines now provides near-retirees a rich set of tools that provide guidance on how best to claim Social Security, and how to combine various sources of income into a multi-year retirement income strategy.

Social Security guidance can be accessed in two ways:

- Participants can independently access Social Security guidance online; or
- Participants can talk to an investment advisor representative, who can guide them through how Social Security works and what makes an effective claiming strategy.

Participants can use a projected Social Security estimate calculated by Financial Engines based on their current salary, or provide a better estimate accessed from the Social Security Administration. From that point, Financial Engines will apply our methodology to calculate the benefits of delaying earned and/or spousal benefits, evaluate hundreds of different possibilities for how long each household member might live, and suggest a strategy that increases the expected lifetime benefits. Financial Engines can also help the participant develop a more personalized strategy that may include taking some benefits earlier to better match their specific preferences. With any strategy, the effect on total lifetime benefits as well as survivor benefits are clearly identified, so that participants understand how much their personalized choices impact both their current and future incomes.

Once a Social Security claiming approach is selected, the income streams associated with that strategy (earned and spousal benefits) are incorporated into an "Income Plan," which is a comprehensive portrait of the household's annual retirement income. The plan includes income from various sources such as withdrawals from investment accounts, pensions, any jobs in retirement, rental income, etc. Since many suggested claiming strategies may create gap years where the combined income from jobs and Social Security may not meet household needs, Financial Engines will smooth out income in retirement by calculating accelerated withdrawals from investment accounts in those gap years. This fuller picture of retirement income with income smoothing makes it easier for retirees to act on improved Social Security claiming strategies. Thus, the availability of *personalized* income strategies, in addition to Social Security guidance, means that the economic benefits of improved filing strategies can be achieved, at least in part, by almost everyone.[21]

[21] There may still be some retirees who have no choice but to start benefits at age 62 and have no other resources to afford delaying even by a few months.

Summary

Retirees who claim Social Security benefits right after retirement or close to age 62 may be sacrificing a large part of the implicit retirement wealth available to them. Financial Engines' services can suggest potentially better strategies to help realize the full potential of retirees' Social Security benefits. These strategies have recently begun to attract notice in the financial press (see Bernard [2013] and Franklin [2013]). However, what participants need in addition to generalized guidance is a way to develop overall retirement income strategies that reflect their specific circumstances: their specific benefit entitlements; the ages of household members; other income sources available in retirement; retirement accounts available to fund delaying benefits; the willingness to draw from retirement accounts; and the desire for a "reserve" amount to provide for emergencies.

Financial Engines' approach places the Social Security decision in a complete retirement income context. Effective timing of Social Security benefits may require timing of other income streams, in particular withdrawals from retirement accounts. This broader context gives retirees and near-retirees the confidence to take actions that may increase their lifetime retirement income by hundreds of thousands of dollars.

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Frequently Asked Questions

If I choose to delay my benefits, can I change my mind if I need the money earlier than planned?

The short answer is yes, decisions to delay benefits are not irreversible. At any time after age 62, you can file to start your benefits. There's an extra feature most people don't know about, once you've reached full retirement age. Suppose that you file and suspend your benefits, say at age 66, with the intention to start your earned benefit at age 70. If you need money at age 68, then you can start your earned benefit then. On top of that, you can also backdate your start date (to as early as your suspension date) and collect a lump-sum equal to the payments you had not received from that start date (without interest). Generally, we wouldn't recommend you delay benefits if you don't have an emergency fund set aside, but this lump-sum option does provide some extra cushion in case there are bad health surprises in your retirement.

What if my spouse or I have already started taking benefits?

You might still be able to get some increased benefits. Depending on when you started, you might have two options. The first is to *withdraw* your claim. This can be done if you became entitled to benefits in the last 12 months, but it requires that you repay the benefits you have received (and even including spousal benefits based on your work record). Down the road, you can claim your benefits as if you'd never received anything in the past, taking advantage of any delayed retirement credits that might apply. The second option is to *suspend* your benefits, which you can do if you've reached full retirement age. Once your benefits are suspended, your earned benefit will start accumulating credits for delayed retirement, up to age 70.

If I take benefits later and have to draw on my retirement savings earlier, I'm giving up on the potential growth of those accounts. Why isn't that factored into your analysis?

Your retirement account *might* grow by more than the delay credits, but there's also a risk that it'll decrease in value. When it comes to evaluating whether to delay Social Security, it's important to factor in that it's a guaranteed, inflation-indexed benefit provided by the government, so its risk is likely much lower than the risk of your retirement account investments. A reasonable discount rate to apply to the Social Security decision, that has similar risk, is the after-inflation rate of return on inflation-protected Treasury bonds, which is close to zero. Your retirement account would need to exceed this *plus* the implied return embedded in the delayed retirement credits (factoring in how those delay credits impact your benefit as well as your spouse's/survivor's benefits). This might be achievable with some portfolios *in an average sense*, but that is because the financial markets are providing higher expected returns to compensate you for taking more investment risk in some types of assets. By investing in higher risk assets (e.g., stocks), you might actually lose money over the period.

How do these proposed filing strategies affect my taxes?

Taxes can be very complicated and you should consult a tax advisor to fully understand your tax situation. There are two things to watch out for. First, if you take Social Security benefits and work at the same time before full retirement age, your benefits will typically be reduced. (Benefits after you stop working will typically be increased later if this happens.) Second, if you take Social Security benefits and also have 401(k) withdrawals in the same year, you might have to pay income taxes on a portion of your Social Security benefits. Most of the filing strategies we propose will create more separation between the years you receive Social Security income and the years you receive other forms of income, so they are likely to be somewhat more tax efficient. For example, if you delay benefits until age 70 and take more 401(k) withdrawals from retirement until age 70, those withdrawals will not trigger any taxation of Social Security benefits. (Withdrawals after age 70 might make your benefits taxable, but your total retirement balances will be lower by that point, meaning less of your benefits will be subject to tax.) In addition, converting pre-tax balances into Roth balances can help reduce the taxability of Social Security benefits.

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