Creative

wealth maximization strategies*

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Social Security Maximization Strategies:

Ginger or Mary Ann? Elvis or the Beatles? Paper or plastic? Alongside these time-worn debate topics, Baby Boomers have added another either/or obsession: Should they start claiming Social Security retirement benefits at age 62 or wait until 70?

Math and econ nerds can produce a blizzard of spreadsheets, graphs and analysis supporting both positions. But some observers are not impressed, saying these elaborate calculations that supposedly "maximize" Social Security are irrelevant distractions. Brenton Smith, a risk manager who regularly writes on Social Security topics says "You have a better chance of maximizing your benefits with Tarot cards than listening to experts on the issue of setting your claiming date."

What's the fuss about?

The Options: From 62 to FRA, to 70

Fully-vested participants born between 1943-1954 can receive their full Social Security retirement benefit at age 66. This is known as one's Full Retirement Age (FRA), and serves as the baseline for calculating benefits taken earlier or later. (For those born between 1955-1960, the FRA advances two months each year, while all those born after 1960 have an FRA of 67.)

Participants may elect to receive benefits as early as 62, or defer them to age 70. For each month you receive benefits prior to your FRA, the monthly amount is decreased. For each month income is deferred past the FRA, the benefit increases. Beginning at 62 results in a 25 percent reduction compared to one's FRA benefit, while waiting until 70 increases it by 32 percent.

So….**is it better to receive smaller payments for a longer period, or larger payments over a shorter one?** According to the Social Security Administration, it really doesn't matter:

If you live to the average life expectancy for someone your age, you will receive about the same amount in lifetime benefits no matter whether you choose to start receiving benefits at age 62, full retirement age, age 70 or any age in between.

Because Social Security includes a Cost of Living Adjustment (COLA), the impact of inflation on waiting is negated; benefits withdrawn at a later date are projected to have the same purchasing power as ones received today.

The graph here, from business consultant Randall Bolton, supports the general equivalence of benefits received, regardless of when they begin, as the payment option lines converge around life expectancy.

The graph also charts the "cross-over points" for different claiming options. This is the year in which waiting becomes more profitable than taking benefits early. **The cross-over between claiming at age 62 and 66 is roughly age 78, meaning, you need to live past age 78 to be better off by waiting until age 66. The cross-over for waiting until 70 instead of 66 is 83.**

For Bolton, "(T)he decision about when to start your benefits hinges on how long you – and your potentially surviving spouse, in some cases – expect to be around. The longer you expect to live, the more it makes sense to hold off starting for a couple of years in order to collect the higher benefit."

But Cross-Over Calculations Are Fluid

An article by Doug Lemons, a retired Social Security Administration regional commissioner, in the January 2012 *Journal of Financial Planning* took the cross-over calculations a step further, attempting to factor the impact of taxes and investment returns. Including these variables moved cross-over points, depending on the assumptions used. Instead of cross-

In This Issue…

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overs between 78 and 83 in Bolton's model, the range was 81 to 87. A February 2013 *US News & World Report* article observed that when lower rates of return are assumed, a "62-year-old claimant comes out 'ahead' by filing early."

But all these conclusions are based on guesses about the future. In the end, any maximization calculation regarding the timing of Social Security is really a bet on whether you will live longer or shorter than the average American. Cross-over calculations can establish the odds, but don't guarantee outcomes. The ultimate financial value of your Social Security decision depends on how your life plays out.

Which Brings Us to the Real World…

According to Social Security Administration statistics published in a June 27, 2015, *Washington Post* article, 37 percent of people take reduced benefits at 62, as soon as they are eligible. And most likely, they don't make this decision because of a cross-over calculation. Other factors are primary; for most, a maximization analysis is irrelevant.

Two primary deciders are **health** and **employment status**. Workers in poor physical condition are more likely to begin Social Security as soon as possible. If health is already affecting their ability to work, and is likely indicative of a shorter life expectancy, claiming at 62 is physically and financially logical.

The prospect of declining health is a factor even for those who expect to live a long time. If you claim Social Security earlier, your ability to enjoy it is probably greater. As the *Motley Fool's* Brian Stoffel put it in a March 2015 forum, "(Y)our ultimate goal should be to *enjoy* retirement – not necessarily maximize your Social Security payments. I haven't heard of many people on their deathbed saying, 'I wish I would've waited to claim Social Security.' "

A May 28, 2014, *Forbes* article cited SSA statistics, finding that "Those who work in physically-demanding blue collar jobs and those who have put in a full 35 years on the job tend to claim benefits early at age 62. Also, a greater share of those who reported being retired, unemployed or otherwise out of the labor force, claim early."

Additional external factors influencing a Social Security decision are marital status, taxes, and other retirement assets. If a spouse is still working, his/her income might cause a portion of Social Security benefits received by the other to be taxable, negating some of the benefits of an early claim. Depending on the disposition of other retirement assets, it may be desirable to take distributions from retirement accounts from 62 to 70, then receive the increased monthly benefit that comes from the deferral.

And there's still **concern about the long-term viability of Social Security. SSA trustees have told Congress there is a less than 50-50 chance that full benefits can be sustained beyond 2033,** at which point benefits may be reduced. A lot can change in the next 18 years, in taxes and benefits, to move that number.

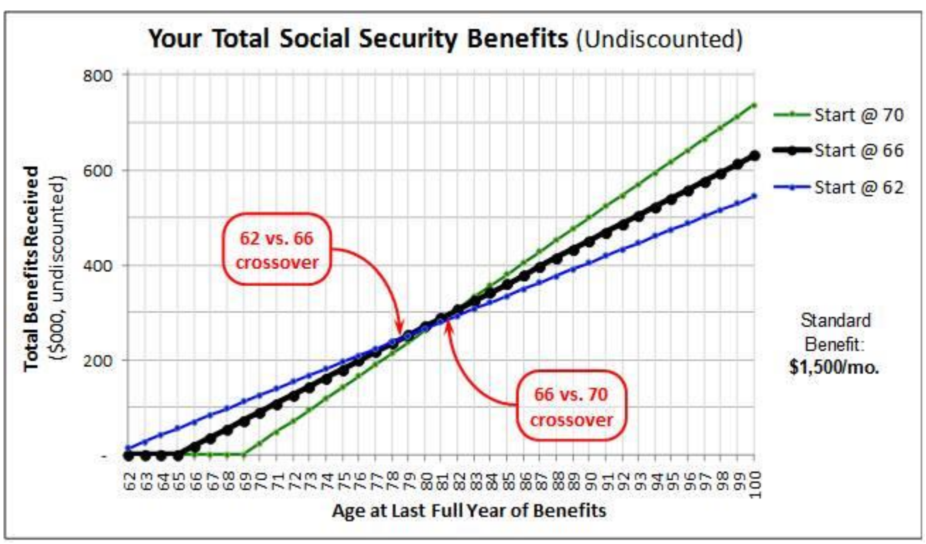
But right now, a female turning 62 this year has a projected life expectancy well beyond 2033. Deferring to receive potentially diminished benefits completely undoes any present maximization calculation.

As you approach retirement, you need to know your Social Security options. But because the true financial returns from Social Security can only be calculated at death, it's difficult to determine which claiming date is going to be optimal while you're alive. And other issues, financial and non-financial, will almost certainly be more important in your decision.

Your Financial Representative can help you understand your financial options, and lower retirement stress. ❖

"(Y)our ultimate goal should be to *enjoy* retirement – not necessarily maximize your Social Security payments.

- Brian Stoffel, *Motley Fool*



Misconception of an Annuity

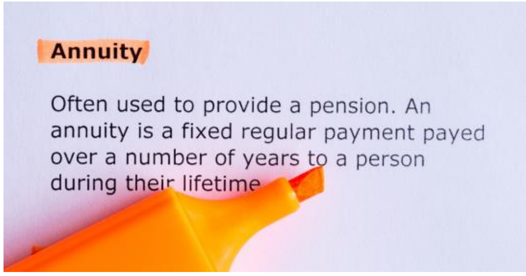
Some people – even some "financial experts" – have an irrational dislike of annuities. Even though annuities have been used since the Roman Empire, they resolutely denigrate their purpose and insist other options are better. Why? After processing their explanations, it appears they don't want to accept simple financial concepts. Such as:

There is no free lunch.
You can't have your cake and eat it too.

As Jack Nicholson's Col. Jessup would say, "They can't handle the truth!" Okay, maybe there's a bit more to it. But as you read along, remember the clichés.

"Risk-Free" Isn't Free

An annuity is a contractual agreement to receive a series of payments over a defined period. Individuals obtain annuities from insurance companies by making either a lump-sum or a series of deposits, then selecting a payment option and start date. These payments may be for a specific term, such as 10 years, or as long as one lives. These as-long-as-you-live annuities are commonly known as life annuities.



A principal attraction of a life annuity is that recipients (referred to as annuitants) are contractually entitled to payments, no matter how long they live. This is a big deal. A 2015 survey commissioned by the American Institute of Certified Public Accountants (AICPA) found that the **greatest single retirement concern** – even among high net worth individuals **– was running out of money**. When an individual places a portion of their assets in a life annuity, the insurance company assumes that longevity risk.

A life annuity stops payments when the annuitant dies. If an annuitant dies sooner than projected, any undistributed balance is retained by the insurance company to ensure payments for those who might live beyond their life expectancy. This is a basic insurance concept. By pooling resources, everyone's risk is diminished, and every annuitant can expect a guaranteed income for life.

For annuity-haters, here's the rub: What if you're an annuitant who doesn't live to expectancy? If, for example, you give the insurance company $250,000 for a life annuity at 65 and die in an accident at 70, a good portion of the $250,000 deposit will be retained by the insurance company for someone else's benefit. Everyone wants the guarantee of a lifetime income, but no one wants to be the "loser" in a pool of annuitants.

To offset this concern, some life annuities offer a cash refund option; if the annuitant dies prematurely, the balance of the principal is paid out in a lump sum to a beneficiary. Example: If the individual in the example above had received $15,000 a year for five years, the remaining principal of $175,000 would be distributed to heirs. This feature mitigates against the risk of an earlier-than-projected demise. But the combination of a guaranteed lifetime income and refund of principal will lower the monthly income payment in comparison to a straight life annuity. Every financial guarantee has a cost, even it's for something you end up not needing. It's a characteristic trade-off at the heart of every insurance transaction.

Managed-Payout Accounts:
(No, you can't have your cake and eat it too)

A review of past performance suggests it might have been possible to exceed the returns offered by an annuity through astute asset management. Thus, in hindsight, one might say, "Well, you know, they really didn't need that annuity guarantee. If only they had kept the money in (fill in the blank), there would have been more than enough income to last their entire life."

This train of thought ignores two obvious factors: no one knows *how long they will live*, and no one knows *whether past investment performance can be replicated*. Surrender of principal and potentially lower returns are the price for securing guarantees against these two unknowns.

But this doesn't stop some people from wanting to believe they can have an annuity's advantages without paying for them. A June 13, 2015, *Wall Street Journal* article titled "In Search of Steady Income" commented on the development of managed-payout funds, which are accounts designed to "take a lump sum and convert it into monthly income."

Similar to a life annuity, these accounts aim to pay a steady income over a set period. Unlike an annuity, the payments and principal are not contractually guaranteed; they fluctuate depending on investment performance. However, assets can be withdrawn from the account at any time, and any balance remaining at death can be inherited by beneficiaries.

Simply put, the managed-payout structure offers the possibility of everything in retirement income, but *guarantees nothing*. Why would this format be attractive for retirees concerned about running out of money in retirement? Per Liz Moyer, the *WSJ* reporter, "The concept can be appealing to investors who are reluctant to buy annuities, which also offer steady income, but require investors to surrender control of the lump sum."

So…when you can't accept that guarantees have a cost, you're apparently willing to believe there's a format to ensure that you won't need them. *That's irrational.*

In fact, several experts mentioned in the *WSJ* article admitted the managed-payout concept is problematic. One financial planner said he couldn't recommend the strategy because of the lack of guarantees. An investment-research firm analyst said, "Investment firms are at the drawing board trying to figure out what will resonate with investors. There are widely accepted views on how to diversify and accumulate savings. There's not a consensus on how best to help investors take out income."

The Best Solutions Still Use Insurance

As the Baby Boomers surge into retirement with lump sums from IRAs and 401(k)s instead of pensions, interest in, and use of, annuities is on the upswing. This demand is also driving some annuity innovation. An example: Some new life annuity features allow the owner a one-time option to stop payments and either suspend the undistributed balance, or receive it as a lump sum.

Like other contractually guaranteed provisions, the annuity owner pays an annual fee to retain this privilege, and the monthly payments will be slightly lower compared to a straight life annuity. The guarantees come with a cost, but the consumer has greater flexibility and knowledge in selecting benefits and paying for them.

The idea that smart people can produce guaranteed financial outcomes without using insurance is quite improbable. The future is unknown, and the only reasonable way to improve financial certainty going forward is with insurance and with guarantees.

When someone says, "I hate annuities," one veteran annuity expert is fond of replying, "I hate 'em, too. But I like what they do." An annuity is a guaranteed solution to retirees' greatest concern: running out of money. ❖

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