MERCER

SECURING RETIREMENT OUTCOMES

ARTICLE FIVE IN A MERCER AND STANFORD CENTER ON LONGEVITY SERIES

HOW TO IMPROVE YOUR EMPLOYEES' RETIREMENT SECURITY AT MINIMAL COST

AUTHORS:

Bruce Cadenhead
Partner, Retirement, New York

Steve Vernon
FSA Research Scholar, Stanford Center on Longevity

MARSH & McLENNAN COMPANIES

Social Security benefits provide a significant proportion of retirement income for the majority of Americans. Recent data from the Social Security Administration show that Social Security funds provide 50% or more of all retirement income for two-thirds of all retirees, and 90% or more of all retirement income for one-third of all retirees.

With such a significant dependence on Social Security benefits, low- and middle-income workers who optimize those benefits can significantly improve their financial security in retirement.

One big hurdle, however, is that roughly half of all Americans now start Social Security benefits at age 62 — the earliest possible age with the lowest amount of retirement income. This claiming behavior is suboptimal for people in average or above-average health; for these people, retirement security can be enhanced substantially by delaying the start of Social Security income. For example, delaying the start of benefits from age 62 to age 66 can increase annual Social Security income by 33%, while delaying to age 70 can increase annual Social Security income by as much as 76%. Of course the ability to delay Social Security depends on the individual having sufficient savings from which to draw down or other sources of income.

HALF OF ALL AMERICANS NOW START SOCIAL SECURITY BENEFITS AT AGE 62 — THE EARLIEST POSSIBLE AGE WITH THE LOWEST AMOUNT OF RETIREMENT INCOME.

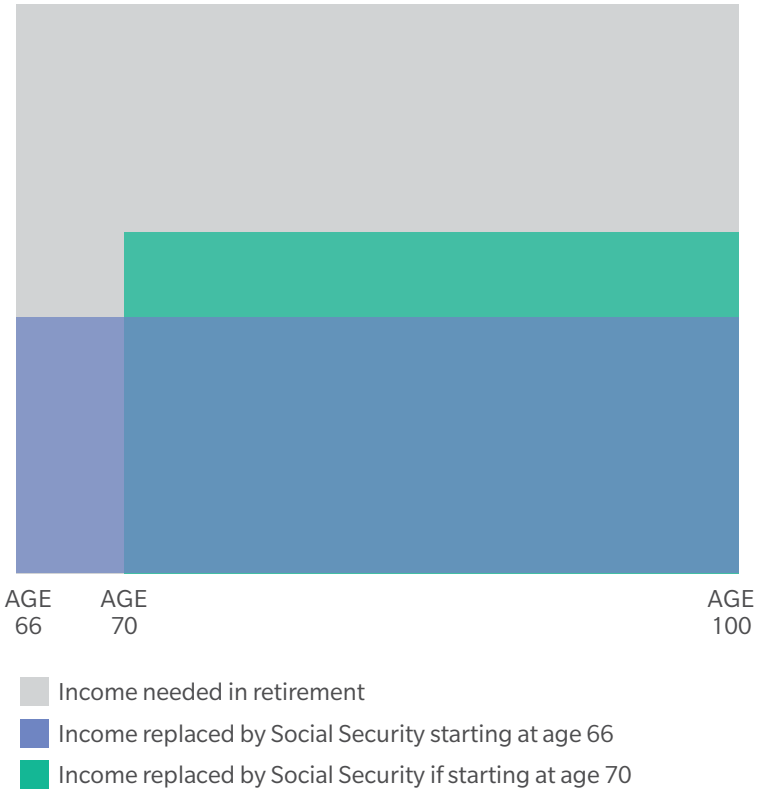
Dr. John Shoven, director of the Stanford Institute for Economics Policy Research, recently published a paper that explains how Americans can delay the start of Social Security benefits[1] effectively.

Currently, most Americans use retirement savings to supplement their Social Security income and start withdrawing from savings upon retirement — a method Dr. Shoven calls a "parallel" strategy. Instead of this, he advocates using a "series" strategy, in which retirees first draw down retirement savings to pay for living expenses and delay the start of Social Security benefits until age 70. In effect, retirees will use their retirement savings to "buy" a higher annuity from Social Security.

In today's market, this effective "annuity purchase rate" is a much more favorable rate than the cost of annuities purchased from private insurance companies. The reason is, Social Security's delayed retirement credits were developed when interest rates were higher and life expectancies were lower compared to today. As a result, Social Security's delayed retirement credits are more than fair actuarially for someone in good health.

Dr. Shoven's paper contains hypothetical examples of single retirees as well as couples who can increase their retirement incomes by several hundred dollars per month at age 70 if they delay Social Security benefits for the primary wage earner to age 70; the increase in retirement income from deploying this strategy translates to anywhere from $1,000 to $1,400 per month by age 90. In one example, the gain in the expected present value of retirement income was $200,000.

Delaying the start of social security significantly decreases the gap in retirement income for all future years, providing greater protection against inflation and longevity risks. The charts on the right illustrate the increase in retirement income by delaying Social Security benefits until age 70[2].



[1] Efficient Retirement Design: Combining Private Assets and Social Security to Maximize Retirement Resources, Shoven et al., 2013 http://siepr.stanford.edu/system/files/shared/documents/Efficient_Retirement_Design-March_2013b.pdf

[2] Post-retirement income needs are assumed to remain level. Figures in the chart are shown in constant dollars, disregarding future inflation. Income needs in retirement will vary by person, but will usually be flat or decrease in the first several years after retirement and increase toward the end of life. For further information on income needed in retirement read our POV Securing Retirement Income for the Employee: Why the Employer Should Intervene http://www.mercer.com/insights/point/2014/securing-retirement-outcome-why-the-employer-should-intervene.html

To illustrate how to think about delaying Social Security benefits, let's review some words of wisdom from author Andy Landis, who offers an excellent description of the considerations for claiming Social Security in the latest edition of his book, *Social Security: The Inside Story*[3]. Landis recommends remembering two numbers: age 78 and age 82½. Let's see why he says this.

We will look at three people born in 1951, all currently earning $75,000 per year and all earning similar amounts in prior years, adjusted for wage inflation. All three plan to stop working at age 62. Person A plans to start Social Security at age 62 and will receive $1,500 per month. Person B plans to start Social Security at age 66 (the Full Retirement Age for these three individuals). The initial monthly income for this age-66 starter will be $2,000 per month. Person C is going to wait until age 70 to start Social Security and will receive $2,640 per month.

Landis's yardstick for Social Security success is the total amount of income a person would receive over his or her lifetime. Using this yardstick, the age-62 starter will be "money ahead" of the age-66 starter during the early years of retirement because of the four years of payments the age-66 starter missed by waiting four extra years to begin drawing benefits. According to Landis, however, the age-66 starter catches up to the age-62 starter by age 78 and is thereafter "money ahead." By age 85, the age-66 starter is ahead by $42,000.

PERSON A	PERSON B	PERSON C
CURRENTLY EARNS PER YEAR: $75,000	CURRENTLY EARNS PER YEAR: $75,000	CURRENTLY EARNS PER YEAR: $75,000
STARTS SOCIAL SECURITY AGE: 62	STARTS SOCIAL SECURITY AGE: 66	STARTS SOCIAL SECURITY AGE: 70
RECEIVES $1500 PER MONTH	RECEIVES $2000 PER MONTH	RECEIVES $2640 PER MONTH

[3] Social Security: The Inside Story, 2011 Edition: An Expert Explains Your Rights and Benefits, Andy Landis, 2011
http://www.amazon.com/Social-Security-Inside-Explains-Benefits/dp/1453794670/ref=sr_1_5?ie=UTF8&s=books&qid=1290986861&sr=1-5

Now let's compare the age-66 starter with the age-70 starter, using the same logic. The age-70 starter will catch up to the age-66 starter if he or she lives to age 82½. By age 85, the age-70 starter will be "money ahead" of the age-66 starter by $19,200 and ahead of the age-62 starter by $61,200. If the age-70 starter lives to age 90, he or she will be ahead of the age-66 starter by $57,600 and ahead of the age-62 starter by $129,600. These comparisons are somewhat simplistic, in that they do not take account of other important factors, such as the inflation adjustment in the Social Security Benefit or the time value of money (that a dollar at age 62 is more valuable than having a dollar at age 70). However, these factors move in opposite directions, are largely offsetting, and do not significantly change the overall conclusions.

So for people who think there's a good chance that they will live to at least age 78, waiting to start benefits until age 66 will provide more income from Social Security than starting benefits at age 62. For people who think there's a good chance they will make it to at least age 82½, waiting to start benefits until age 70 will provide more Social Security income.

PERSON C

AGE: 70	AGE: 82.5	AGE: 85	AGE: 90
STARTS SOCIAL SECURITY	CATCH UP TO AGE 66 STARTER	$19,200 AHEAD OF 66 STARTER $61,200 AHEAD OF 62 STARTER	$57,600 AHEAD OF 66 STARTER $129,600 AHEAD OF 62 STARTER

The difference in total benefits is one very important reason why estimating life expectancy should be a critical part of an employee's retirement planning. Two websites that offer calculators to help with this calculation are www.livingto100.com and www.bluezones.com.

These websites will show there's a very good chance people will make it to age 78 or 82½ if they don't smoke or abuse alcohol, keep their weight at healthy levels, exercise regularly, eat a healthy diet, and maintain nurturing social networks. In fact, life expectancy is correlated with education and income, so many employees of large corporations will live beyond average life expectancies. Remember that life expectancies are simply an average — roughly half of the people in a given group will outlive their life expectancy. In planning for lifetime income needs, you should consider the possibility that you will be one of the fortunate 50% to outlive your life expectancy. For most people, deferring the starting date of Social Security benefits is often a cost-effective way of increasing both lifetime income protection and inflation protection.

For many retirees, the increases in retirement income from the delayed retirement credits may mean the difference between poverty and comfort. But the benefits to delaying Social Security go beyond maximizing the lifetime income of workers. Since the delayed retirement credit is reflected in survivors' benefits, delaying the start of Social Security may also improve the financial security of widows and widowers. Poverty among elderly widows is a real problem in America. If the primary breadwinner, often the husband, delays his benefit to increase his Social Security income, in most cases, the Social Security survivor benefit equals the husband's benefit with the delayed retirement credit. The fact is, many workers can help their surviving spouses by delaying Social Security income.

FOR MANY RETIREES, THE INCREASES IN RETIREMENT INCOME FROM THE DELAYED RETIREMENT CREDITS MAY MEAN THE DIFFERENCE BETWEEN POVERTY AND COMFORT.

HOW EMPLOYERS CAN HELP

To help retirees meet their financial needs prior to starting Social Security benefits, employers can educate their employees by distributing examples and analyses that outline the advantages of different spending and Social Security claiming patterns.

Many such communication materials are available from unbiased experts who are not affiliated with any financial institution, such as Dr. Shoven, Andy Landis, or the National Association of Social Insurance. In this case, employers would not be providing advice to their employees, but simply distributing information gathered by nonprofit organizations.

Employers could also take this one step further by providing installment-payment features in their 401(k) plans. Such a feature might pay monthly or quarterly installments of fixed amounts for a set period to enable a retiree to replace the Social Security income he or she is deferring to optimize the benefit. Most 401(k) administrators should have this capability.

Finally, employers could offer alternative work schedules to enable older workers to continue working in their later years and delay starting Social Security benefits. This could allow employees to let their 401(k) balances continue to grow until they fully retire.

The steps described in this article should not cost employers very much, if anything, yet they have the potential to boost the lifetime Social Security payout to their retirees by $100,000 or more and their spouse's payout by $90,000 or more. That is a very good use of employers' resources!

For more articles in the Mercer and Stanford Center on Longevity series, visit www.mercer.com/mercer-stanford

CONTACT:

BRUCE CADENHEAD
+1 212 345 7257
bruce.cadenhead@mercer.com

NEIL LLOYD
+1 604 609 3136
neil.lloyd@mercer.com