SOCIAL SECURITY AS A LONGEVITY HEDGE

GREAT NEWS! CLIENTS ARE LIVING LONGER. ONE PROBLEM, HOW WILL THEY PAY FOR IT? PROPER SOCIAL SECURITY PLANNING CAN HELP

By **William Meyer**

Social Security Solutions
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www.SSAnalyzer.com

The overwhelming risk for much of human existence was dying too young; no longer, now it's living too long.

Average life expectancy for a man in 1900 was 46.3 years and for a woman it was 48.3 years. A century later found a man's average life expectancy at 73.8 years and a woman's at 79.5 years.[1]

Not only has life expectancy increased, but so has the speed at which the increase has taken place. In 2014, a man can be expected to live on average to age 76.07 and a woman to 82.04.[2]

Of course, these are simply averages, and a host of complicated variables arise when attempting to solve for perhaps the greatest unknown-when we will die.

Why is this important?

The best Social Security strategy for you depends on a number of factors: the need for income, marital status, age, health considerations, and retirement resources (investments and savings). It also depends on what you believe your life expectancy will be.

In financial planning, and Social Security planning in particular, the ultimate question becomes, "When will I die?" Dates of birth, benefit amounts, and other pieces of the Social Security puzzle can be determined with great certainty. The great unknown: how long will you live to collect benefits?

The National Vital Statistics Reports, published by the Centers for Disease Control and Prevention, present average life expectancies for Americans. You'll see that, the longer you live, the longer you can be expected to live. And according to a report released in 2012 by the Society of Actuaries, four in 10 retirees underestimate their life expectancy by five or more years.

So, what's the significance of life expectancy?

Plenty. You must consider how a Social Security claiming strategy will perform given various life expectancies for you and your spouse. While claiming early may give you more income now, it will give you less income later in life when your savings may be running dry.

Second, because the longer you live, the longer you can be expected to live, it's important to create a hedge to protect you and your spouse in the event one or both of you live a very long life. Remember, the life expectancies shown in the table above are averages; half of the people can be expected to live longer. Keep that in mind as you develop your claiming strategy.

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ESTIMATING YOUR MORTALITY

According to the Society of Actuaries, there is a 50/50 chance you will live beyond the "average life expectancy." But estimating exactly how long is virtually impossible. However, that doesn't diminish the importance of making an educated guess about your life span.

You might want to begin by considering your ancestors. How long did your parents live? Your grandparents? Did they have any serious or chronic illnesses that shortened their lives? Did they practice healthy habits that lengthened their lives?

But genetics play only a part in the equation. Other factors, specifically your own choices in living a healthy lifestyle, matter. There are a number of life expectancy calculators available on the internet; some are free, others carry a fee. Most of them ask about your age, weight, habits, tendencies and more.

The benefit of using such calculators is that some of them (not all) use years of scientific

1 Life expectancy in the USA, 1900-98. .demog.berkeley.edu.
2 data360.org

research based on hundreds of thousands of data points to give you a reasonable estimate of how long you might expect to live.

THE AGE OF THE SECOND TO DIE

It perhaps sounds odd to think about which one of you will be the "second to die." But when you and your spouse are creating a Social Security claiming strategy, the most important factor in your planning should be related to which of you will live the longest.

Consider Sam and Susan, both aged 62. Sam is the higher earning spouse and has a primary insurance amount (the amount he will receive if he claims benefits at his full retirement age) of $2,000, while Susan's is $1,200. They will both reach full retirement age at 66. Sam believes his life expectancy will be about 75, and Susan thinks she will live to 95.

Let's assume that each of them chooses to start benefits at 66, full retirement age. Sam will collect $2,000 and Susan will collect $1,200. These benefits will continue until Sam dies at age 75. At that point, Susan's own benefit will cease and she will begin receiving the $2,000 monthly Sam had been receiving. So, the lower benefit lasts only until the first spouse dies.

If Sam waits until age 70 to begin his retirement benefits, it will ensure that Susan will receive $2,640 monthly in survivor benefits because of delayed retirement credits his benefit will have earned. This benefit amount continues as long as Susan lives.

Assuming Susan does indeed live to 95, that's 20 years of retirement after Sam's death. The difference in the survivor benefits for Susan between Sam starting his own benefits at age 66 and waiting until 70 is $640 every month. Over those 20 years, that will produce an extra $153,600 in survivor benefits.

The key takeaway: When to begin Social Security benefits should be determined based on which of you will live the longest. In order to maximize survivor benefits, the higher earner should wait until age 70 to begin benefits.

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WHY BREAKEVEN AGE MATTERS

While none of knows the exact date of our death, we can make reasonable assumptions about life expectancy. Whether we use an online calculator or simply base our estimate on a gut feeling, we have to put a stake in the ground about the age at which we think we'll die.

Doing so allows you to make comparisons between strategies to determine trade-offs based on starting dates and cumulative payouts.

Comparing two strategies side-by-side is critical. It's important to understand how much in additional benefits one strategy may generate over time based on a particular life expectancy. Often, a couple will want to begin benefits as early as possible believing that collecting benefits for a longer period of time will mean the most in cumulative benefits. But knowing the additional money you can garner by implementing a particular strategy can change your decision.

Whether in retirement income planning or in business planning, a "breakeven analysis" has long been a powerful tool to compare two streams of income. Conducting a breakeven analysis is an important way to compare two Social Security strategies side-by-side.

HERE IS HOW IT WORKS

Whether you use our software to generate claiming strategies or you've set up estimated payments in a spreadsheet, you can choose two strategies to evaluate head-to-head over the time horizon defined by the life expectancies you've selected. Think of this as setting the distance of the race—it's the time period over which you are going to compare. The "break-even" point is the time one strategy begins to pay more than the other. In Social Security planning, one strategy typically pays more benefits early and is then surpassed by another strategy over time. Think of the tortoise and the hare.

Once you've determined the breakeven age, you can decide if beginning benefits at a particular age outweighs the possibility that you will live to a particular life expectancy. If you truly think you will die before the breakeven age, you should use a strategy that pays more before that age. If you think you might live a long life, choose a strategy that pays more later in life. Remember, four out of five pre-retirees underestimate their life expectancy. Delaying your claim is a bet on a longer life expectancy.

USING SOCIAL SECURITY TO PROTECT AGAINST LONGEVITY RISK

The best Social Security claiming strategy for you balances your cumulative lifetime benefits with income protection should you live longer than you expect—or live long enough to exhaust your savings. This concept is known as "longevity risk."

The reason this is such an important part of your Social Security claiming decision is that, the longer you live, the longer your retirement savings have to last. As you determine a strategy, consider these two important factors:

1. Which starting ages for you and your spouse will maximize your cumulative lifetime benefits?

2. Which starting dates for you and your spouse will minimize the risk that you will deplete your financial portfolio before both of you have passed away?

Sometimes, couples will approach the claiming decision thinking that maximizing cumulative benefits is the most important criterion in selecting a strategy. But it's important to note that your claiming decision can significantly impact how long your retirement savings will last. Judiciously choosing when to begin your benefits can add years to the longevity of your savings. Getting more from your Social Security benefits means that you will need to withdraw less from your savings over the years, which, in turn, gives your savings time for continued growth. END

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About William Meyer

Bill Meyer is founder and managing principal of Social Security Solutions, a leading Social Security software firm with patented technology that is dedicated to educating and assisting financial advisors and their clients in optimizing their Social Security claiming strategies. More information is available at www.SSAnalyzer.com.

About Social Security Solutions

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