Retirement Readiness Report

Helping older employees get ready to retire successfully

A free report for employers, unions, and pension funds, produced by RetirementWORKS®, Inc.

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Welcome to the second issue of the *Retirement Readiness Report,* offered as a free resource, to help you think about how your organization supports the transition into retirement.

We encourage you to contact us at any time if you have ideas, criticisms, or other comments about this publication, or wish to update your email address (or be added to or removed from the list).

If you missed issue #1:

It's available on our website: http://www.retirementworks2.com/support.asp?id=newsletter

Next month:

How individual personality affects retirement decision-making, and what you can do to accommodate it.

Making the least of Social Security: Should we discourage retirees from collecting benefits at age 62?

In a word, Yes.

> *Note: even if you represent a school district or agency that does not participate in Social Security, many of your employees have spouses who do, and many employees have earned benefits from previous employment, so this issue still matters to them.*

People often like to start collecting Social Security as soon as they can. Over four million retirees below the current Social Security "normal" retirement age of 66 are already collecting. According to a recent survey by Fidelity Investments, nearly half of current 61-year-olds plan to apply for benefits when they turn 62.

In most cases, this is a mistake, and in many cases a serious mistake.

As most of us in the business already know, the benefit amount is significantly reduced when retirees apply before the Social Security "normal" retirement age. Starting four years early reduces the monthly benefit amount by almost 27%.

Of course, this reduction is mitigated by the fact that the retiree will receive payments during those four years, instead of waiting and not receiving anything. But even so, for the average person this represents a net loss, even after taking account of the fact that a dollar received today is worth more than a dollar received in the future.

In the average case, the amount lost by waiting is modest, but still significant. A man age 62 who does not smoke is expected to live until about age 83. The total value of benefits received by waiting until age 66 is nearly 6% higher, compared to starting at age 62.[*] If our male retiree is entitled to $1000 a month at age 62, this is the equivalent of flushing $11,275 down the toilet right now.

[*] All the calculations in this article ssume a 5.5% "discount rate", or annual rate of return on funds. A more conservative assumption would make the differences even more pronounced.

But it could be worse. Women usually live longer, so they get more benefit payments and they gain more by waiting. If our retiree is a non-smoking female, her reward for patience in receiving benefits is almost 9%, and $20,000.

Or suppose it's a married worker with a non-earning spouse. The benefit will be paid as long as either party is alive. Odds are that at least one of them will survive to age 93, if both are 62 today. In this case, the expected advantage to waiting is 13%, and $31,100.

Finally, suppose the non- or low-earning spouse is ten years younger. The combined life expectancy increases by seven more years, and the benefit to waiting is over 15%, and $40,000.

These numbers are not trivial, even for moderately affluent retirees. Why would *anyone* want to simply throw away that amount of cash? But for the typical *non*-affluent retiree, for whom Social Security represents a significant portion of income, the cost of impatience is often simply unaffordable.

The examples given above suggest the situations in which it is most advantageous to wait: when because of gender, habits, or health one's life expectancy is better than normal, when one has a spouse whose benefits will depend on one's own benefits, and especially when that spouse is younger.

"For a worker with a non-earning spouse, the expected advantage to waiting to age 66 before collecting Social Security benefits is 13%, or the equivalent of $31,000 today."

Of course the opposite is true, as well. If one's life expectancy is low (especially if one has already been diagnosed with a serious illness), and if one has a spouse whose earnings have been higher and on whom one's own future benefits can be based once the spouse starts collecting, then one is smart to sign up for one's own benefit as soon as possible. The same is true if you can reliably get a high rate of return on investments for the rest of your life – but as many of us have learned recently, such an assumption usually proves to be illusory.

These are just rules of thumb, of course, and such rules are dangerous. The optimal time to apply for Social Security depends not only on these factors, but also on whether the recipient will continue working, even part-time (which can result in a reduction of benefits) and on how much other income is earned (which can result in increased taxation of benefits).

In reality, you need a pretty sophisticated mathematical model to provide good advice about when Social Security benefits should begin. And as our example suggests, having such a model is well worth it, because the consequences can be substantial.

In the absence of this kind of model, though, the best rule of thumb is: for the average person, the "normal" retirement age as defined by Social Security (currently age 66) is approximately the best time. But earlier or later than that, if the factors previously mentioned come into play in a strong fashion.

Of course, many retirees choose to collect at age 62 because they think they have to. They don't have other income to support themselves between their actual retirement age and age 66.

In most cases, however, they would be better off using other funds they have saved, or even borrowing the money (assuming they can get reasonable terms), and paying it back later out of their higher Social Security benefits. Homeowners could use some form of home equity loan. Many people have life insurance policies against which they could borrow. Or other sources of cash may be available.

Naturally, what makes sense in a specific case requires more detailed analysis.

But those of us who advise employees, or who help structure their benefits, should take this into account.

It is often suggested to employees that they consider 62 to be their target retirement age, because that's when they can start receiving benefits. This can be a serious disservice.

Pension plans sometimes offer inducements to sign up for Social Security at 62, by offering options that pay early retirees higher pension benefits temporarily, but only to age 62. How about options that pay higher benefits to age 66?

Or how about if we just strive to educate older employees who are thinking about retirement what the real consequences of their financial decisions are likely to be? The more financially sound we can make retirement, the better off everyone is.

Recommended Reading for Employees Getting Ready to Retire

The Wall Street Journal Complete Retirement Guidebook, by Glenn Ruffenach and Kelly Greene.

$14.95 (Three Rivers Press, 2007)

Notice: We do not sell books, or have any financial stake in recommending them.

This is one of best all-around books on making the transition into retirement that we have found so far.

It is *not*, as you might expect from its provenance, focused exclusively on money. The first quarter of the book is devoted to the important questions of how the retiree wants to spend his or her time in retirement, whether to work or not, whether to volunteer or not, whether to relocate, and how to take care of one's physical well-being. Although more detailed discussions of these topics can be found in other sources, Ruffenach and Greene have an almost uncanny knack for identifying the key issues and dealing with them intelligently, sensitively, and concisely.

Discussions of financial issues are more extensive, but are similarly well chosen and well discussed. Furthermore, you don't have to be a financial professional to understand what they are saying. Everything is explained clearly, in ordinary language.

Our only gripe about their financial advice is that they repeat the common canards from the financial industry about figuring out how much retirees can safely withdraw from their retirement funds every year. For reasons we will deal with at more length in a future issue of the *Retirement Readiness Report,* this is a question that should not even be asked, let alone answered, because it is the rare retiree indeed who will need to be making constant withdrawals from retirement savings. Those savings need to cover all sorts of variations in cash flows over a long period of time, and starting out with an assumption that the needs will be level (or smoothly increasing) over time is unhelpful at best, dangerous at worst.

But aside from that one common misstep, the authors provide consistently understandable, informative, sensible analysis and advice, and they cover all the important bases. They also scatter the book with small segments containing short quizzes, illustrative examples from real life, details about certain issues, and references to other sources where further information can be found.

We recommend this book very highly. It would be well worthy of being purchased, even at a considerably higher price.

Featured Website and ePublication

MarketWatch Retirement Weekly

https://store.marketwatch.com/webapp/wcs/stores/servlet/PremiumNewsletters_RetirementWeekly

We have been subscribers to this weekly newsletter on retirement issues for several years. Far from getting stale with time, it has grown better and better under its long-time editor, Robert Powell, who also produces "More Than Money" on PBS.

Retirement Weekly comes out at the end of the week, and subscribers receive an email alert each Friday.

It is well worth the $49 annual subscription fee. Although the emphasis is on financial issues, these are not limited to advice about investments and IRAs, but pretty much cover the full gamut of questions and problems that retirees face, and that soon-to-be retirees should be thinking about.

In addition, retirement concerns that are not primarily financial – such as health care, retirement home selection, vacationing, and other leisure and lifestyle matters – increasingly are coming within the scope of *Retirement Weekly*.

We recommend it for professionals who want to keep up, and also for any consumers/employees (or retirees) who are inclined to be do-it-yourselfers.

A free trial is available at the website we have linked to, above.

About RetirementWORKS®, Inc.

We are the consumer subsidiary of Still River Retirement Planning Software, Inc., of Harvard, Massachusetts, which has specialized in retirement plans and retirement planning since 1994.

Our philosophy is that retirement needs to be viewed from the retiree's point of view, in all of its complexity. So we offer the most powerful and useful software available anywhere for retirees and near-retirees, and advice concerning non-financial aspects of retirement. But we do not sell any financial products or services other than software, and have no financial stake in any advice that is offered.

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