ACTION PLANNER SERIES

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Coordinating Social Security benefits with lifetime income from annuities

Exclusive whitepaper for Corebridge Financial by

Michael Finke
Ph.D., CFP
Professor of Wealth Management
The American College of Financial Services

Wade D. Pfau
Ph.D., CFA, RICP
Professor of Practice
The American College of Financial Services

Take action today for a more carefree tomorrow

When preparing for the future, the first key question people may need to ask themselves is "How much do I need to live on in retirement?" Most retirees have basic expenses they need to pay for such as Medicare, food, property taxes, or transportation. These inflexible expenses constitute an essential lifestyle that you may want to consider funding with savings and investments whose value does not rise and fall over time. More flexible expenses can be covered with savings and investments that are more volatile, but that offer the expectation of higher returns over time.

Social Security can provide a solid foundation of income that can be used to fund stable expenses

- A retiree can "buy" more Social Security income through a technique known as delayed claiming. Instead of claiming Social Security retirement income benefits when you retire, it is possible to instead fund early retirement using savings and investments in order to delay claiming to as late as age 70.
- Since those who start collecting income later won't have as many expected years of benefit payments, Social Security provides retirees with a higher income for each year they wait.

In addition to retired worker benefits, Social Security also provides spousal, survivor, and dependent benefits based on a worker's earnings record.

Optimal Social Security claiming decisions could result in more than $100,000 of additional retirement income, relative to less effective claiming choices. It is vital to understand that the Social Security claiming decision should be made independently from the decision to leave the labor force. Claiming decisions should not be taken lightly. Be sure to consult with your financial professional, along with a qualified tax professional or attorney regarding your specific situation.

For some households, the value of lifetime Social Security benefits could exceed $1 million over a sufficiently long lifetime.

Consider the case of Elaine

To understand the value of using a delayed claiming strategy, let's use the hypothetical example of Elaine.

- Elaine is 65 years old and newly retired.
- She has saved carefully during her working years and recently received a small inheritance from her parent's estate, leaving her with total savings of $1 million.
- Her savings is invested in a blend of 60% bonds and 40% stocks.
- She is considering claiming Social Security immediately.
- She is eligible for an annual Social Security retirement income benefit of $25,680.

Let's consider the wealth Elaine can use to fund her retirement spending. She has $600,000 invested in bonds and $400,000 invested in stocks.

This isn't her only wealth. She must also consider the value of her future Social Security payments.

- At age 65, a healthy woman can expect to live another 25 years on average.
- 25 years of monthly payments that begin at $2,140 and rise each year with inflation has a value.

We can look at inflation-protected government bonds (TIPS) to see the market price of future inflation-adjusted income and estimate the value today of the future income she can expect to receive. Her Social Security income has a non-guaranteed, estimated value today of $573,000.[1]

[1] Based on TIPS yields on January 30, 2023 and expected longevity using the 2012 Society of Actuaries annuity mortality table.

Figure 1 illustrates the present value of Elaine's retirement wealth based on her Social Security claiming strategy. Delayed claiming may allow her to increase the overall wealth she can expect to use to fund a lifetime of spending.

Figure 1:
Present value of retirement wealth at age 65 by claiming strategy

	Claiming at age 65	Claiming at age 70
Bonds	$600,000	$600,000
Stocks	$400,000	$400,000
Social Security	$573,000 (claim now at age 65)	$648,627 (claim at age 70)
Total retirement wealth	$1.573 million	$1.649 million

- Elaine can increase her retirement wealth by over $75,000 simply by waiting until age 70 to claim her Social Security benefits.
- The opportunity to increase wealth through delayed claiming exists because the increase in lifetime income from waiting until age 70 is based on dated actuarial assumptions. Today's retirees are living longer than they did in the past. This means that a retiree is more likely to receive payments into their 90s.
- The formula was developed as part of the 1983 Amendments to Social Security—these calculations are now 40 years old.

If Elaine had claimed her income from Social Security at age 62, its value would be $528,581. Alternatively, she can wait to claim and create a Social Security delay bridge using her savings and investments. Each year she delays claiming by using her savings and investments to fund her spending she increases her total retirement wealth. How? While she draws from her savings to fund spending for a year during her 60s, each year in the future she will receive a higher income. This means she will withdraw less money from her savings throughout retirement, and can ultimately spend more each year from the same amount of retirement savings. Bridge spending is like an "investment" that buys a higher future Social Security income, reducing the pressure on savings to fund lifestyle expenses 5, 10, and 20 years down the road.

Since the government uses a shortcut to estimate the increase in income from waiting an additional year, the benefit is not the same by age. Elaine receives the greatest increase in wealth by waiting an additional year to claim from age 64 to 65 when the benefit increase rises from 5% to 6 2/3% per year, and by waiting a year at age 67 to claim at age 68, when the lifetime income increase rises again to 8% per year. At age 70, her estimated Social Security wealth is now $648,627, or more than $120,000 more than if she had claimed at 62.

Differences in expected longevity also affect the benefit of delayed claiming. The value to healthy men is slightly less than for healthy women, and the benefit to the average American man and woman is lower because they will have a lower expected lifespan than wealthier Americans. Although healthy individuals receive the greatest benefit from delayed claiming, the total benefit continues to be positive for all groups even if benefits are cut by 20% in 2034.

It's also important to consider that a higher-earning husband or wife can pass on the higher Social Security benefit to their spouse, resulting in an additional increase in total wealth that easily surpasses $50,000.

Creating a Social Security Delay Bridge

Bridging Social Security is a way to create more lifetime income, and greater wealth, that can be used to create a base of income to fund inflexible expenses in retirement.

Elaine's situation

Let's assume, for example, that Elaine hopes to spend $65,000 each year between age 65 and 70. She estimates that her essential or inflexible expenses represent $40,000 of this amount. $25,000 will be spent on flexible expenses.

- If Elaine claims Social Security at age 65, she will receive an annual lifetime income of $25,680—and her inflexible spending gap will be $14,320 ($40,000 - $25,680).
- Alternatively, if she claims at 70, her annual Social Security lifetime income benefit will be $36,806—and her inflexible spending gap will be just $3,194 ($40,000 - $36,806).
- In order to bridge her inflexible spending from age 65 through age 69 so she can delay taking Social Security and receive her maximum benefit at age 70, Elaine can use roughly $200,000 (i.e., $40,000 each year for five years) of her bond portfolio to create the bridge and also withdraw $25,000 from her remaining savings and investments to fund flexible spending.

Once Elaine reaches the age of 70, she begins receiving a much higher Social Security benefit of $36,806 in today's dollars. This will cover the majority of her $40,000 of inflexible expenses and the remainder of her savings and investments can be used to fund her flexible expenses.

The disadvantage of using investments to fund flexible expenses is that she will need to cut back on her spending if stocks and bonds perform worse than expected.

A consequence of funding the bond-like future Social Security income with bond investments is that her remaining investments will have a higher stock allocation and a greater exposure to risk.

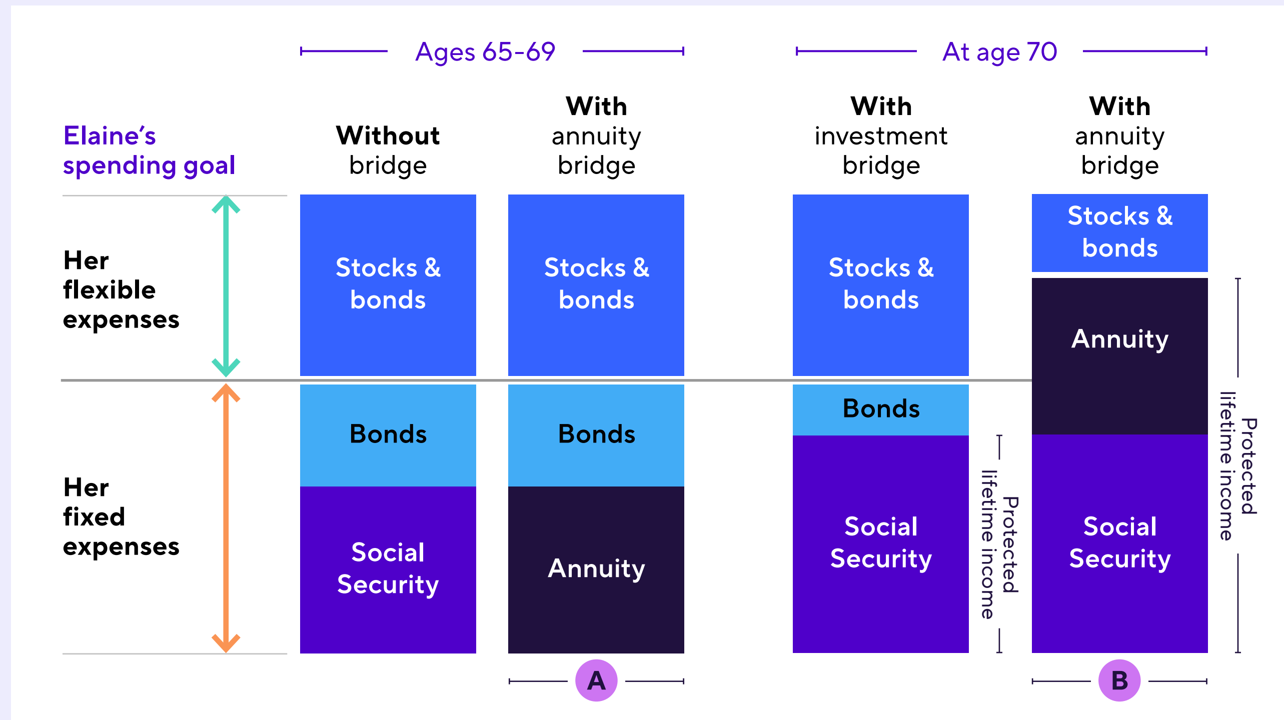
Where an annuity can help

An alternative to spending $200,000 from her bond portfolio to create the bridge is to use an annuity.

- Elaine allocates $361,691 of her savings and investments to an annuity with a guaranteed lifetime withdrawal benefit offering annual income of 7.1% at age 65.
- This approach provides the ability to replace the $25,680 of income she would have received at age 65 if she had claimed Social Security at retirement.
- After her higher Social Security payments of $36,806 begin at age 70, she can continue to withdraw $25,680 each year from the annuity for the rest of her life.

When using an annuity to help create the delay bridge, the annuity's income rate/withdrawal rate will determine the annuity allocation amount needed to replace the Social Security benefit being delayed. The higher the annuity's income rate/withdrawal rate, the smaller the annuity allocation amount will need to be.

Figure 2:
Elaine's options for generating the retirement income she needs beginning at age 65



A With the annuity bridge approach, at age 65, Elaine will start receiving annual income from the annuity of $25,680. During the bridge period from age 65 to 69, $14,320 of Elaine's $40,000 of inflexible spending can be funded with bonds from the portfolio for 5 years ($71,600). She can fund her flexible expenses during the bridge period with a portion of her remaining $566,709 of stocks and bonds.

At age 70, the annuity bridge approach can provide Elaine with more protected lifetime income to help cover her spending goal in retirement.

B In this hypothetical scenario, at age 70, Elaine now has a base of $36,806 of inflation-protected Social Security income plus $25,680 of annuity income.

The annuity and Social Security will provide protected lifetime income that covers $62,486 (96%) of her $65,000 annual income goal, and the majority of the protected income will rise with inflation thanks to Social Security cost-of-living increases.

A unique benefit of the annuity bridge approach is that Elaine can withdraw far less, only $2,514 each year, from her portfolio of stocks and bonds to fund her annual income goal after age 70. This helps take pressure off of her investment portfolio moving forward. She can keep more of her portfolio of stocks and bonds invested for long-term growth potential to potentially help cover her health care costs in late retirement or provide a legacy.

An alternative retirement funding approach using only stocks and bonds leaves Elaine with just Social Security as a source of protected lifetime income. While she can use bonds to fund her remaining inflexible spending gaps and a blend of stocks and bonds to fund her variable spending, she must continue to face the risk of poor market performance and a potentially long life which leaves her exposed to the possibility of completely depleting her investment portfolio and having to rely on Social Security alone in her later years.

Conclusions

Social Security retirement benefits are inflation-adjusted and government backed. With lifetime cash flows, they help to mitigate longevity, inflation, and market risk for retirees. Social Security also provides spousal and survivors benefits. Since a higher-wealth retiree can expect to receive higher future income payments than the average American, delayed claiming will likely increase the total wealth available to fund spending in retirement. It is possible to maintain one's spending goal during the so-called bridge period between retirement and Social Security claiming by spending from savings and investments.

A retiree can build a base of protected lifetime income through annuities to help cover fixed expenses during the bridge period. Once the higher lifetime income from Social Security begins, total protected lifetime income from the annuity and Social Security may help meet a significant portion of a retiree's spending goal for life. This allows the retiree to avoid the two risks faced by those who fund spending with an investment portfolio alone—living too long and experiencing lower than expected investment returns.

Coordinating Social Security benefits with lifetime income from annuities can be a powerful way for retirees to help enhance their retirement income security and reduce their worries about retirement spending.

ACTION PLANNER Action steps

- [ ] **Take the time to carefully consider** your Social Security claiming strategy.
- [ ] **Find out if incorporating an annuity** into your overall income strategy may make sense for your retirement spending goals
- [ ] **Talk to your financial professional** today to see what an annuity can do for you.

Action today can lead to great things tomorrow. Action is everything.

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