THE FINANCIAL VALUE OF DELAYING SOCIAL SECURITY

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A common argument made among many investment experts is that retirees would be better off claiming Social Security early to leverage their investment portfolios for greater long-term growth. For early retirees, claiming Social Security benefits as soon as possible provides an opportunity to leverage stronger investment portfolio growth by reducing short-term portfolio distribution needs. The argument is that it makes no sense to delay Social Security, because a financial advisor can invest the benefits and earn a higher return for their clients over the long run.

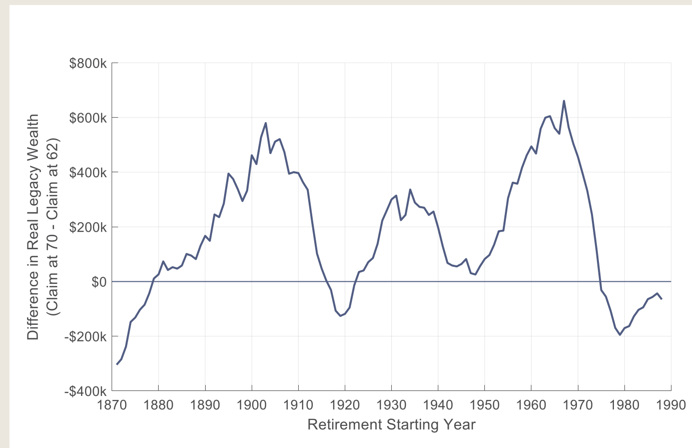
But this is not the whole story, as the investment position assumes that investment portfolio returns will be larger than the implied returns provided through Social Security delay credits. For Social Security, the primary insurance amount (PIA) measures the monthly benefit available at the full retirement age (FRA), which is now age 67 for those born in 1960 or later, today's Peak65 generation.[1] Social Security benefits can be claimed starting at age 62, and additional credits are available for delaying benefits up until age 70.[2] These monthly benefits will be 77% larger in inflation-adjusted terms for those who claim at 70 instead of at 62.[3] The actuarial factors supporting that 77% increase were designed in 1983 when longevity (likelihood of living a longer than anticipated life) was shorter and interest rates were higher, suggesting at the very least that delaying Social Security and meanwhile spending down other fixed-income assets has a better than even chance of improving retirement outcomes. Delaying Social Security can also be framed as longevity insurance that helps to support the increasing costs associated with living a long life beyond average life expectancy. This delay is a particularly important consideration for women who have statistically longer lives. Social Security provides inflation-adjusted lifetime benefits for a retiree and a surviving spouse.

Proponents of delayed Social Security claiming emphasize that the retiree will ultimately get more income, that the ongoing payments act as an insurance benefit that covers the tail risk of longevity, and that delayed filing helps to avoid negative tax consequences such as seeing a higher percentage of their Social Security benefits taxed or facing income-related monthly adjustment amounts (IRMAA) to their Medicare premiums. The view of Social Security as insurance is to delay claiming and to take advantage of the delay credits to obtain the maximum inflation-adjusted lifetime income.

In 2023, Steve Parrish, Professor of Practice and a Scholar in Residence at the Cary M. Maguire Center for Ethics in Financial Services at the American College of Financial Services, and I

1. https://www.protectedincome.org/peak65/
2. https://www.ssa.gov/benefits/retirement/planner/agereduction.html
3. https://www.ssa.gov/pubs/EN-05-10147.pdf

Figure 1: Case Study Results for Single Individual with $1 million Comparing the Claim Social Security at 70 to the Claim Social Security at 62 Strategies With a 50% Stock Allocation, Net Real Legacy (SocSec at 70—SocSec at 62)



published an article in the *Journal of Financial Planning* which put these competing ideas to the test.[4] In the article, we explore the financial implications for claiming Social Security benefits at age 62, full retirement age (67), or delaying until age 70. Which strategy maximizes financial outcomes in terms of meeting lifetime spending goals and providing the largest legacy at death? This analysis, grounded in historical market data since 1871, weighs the long-term financial outcomes of these decisions in the context of retirement income security and legacy maximization. We find that simple extrapolations about suggesting that claiming Social Security early and investing the benefits to earn historical stock market returns misses several important points about retirement income: retirees may not invest this aggressively, and retirees must also fund spending from their assets which creates risks around being forced to sell assets at a loss.

We investigated case studies for individuals who have recently retired after celebrating their 62nd birthdays. For their retirement finances, the priority is to build a financial plan that will cover their spending goals through age 95. Retirement success is measured as having any investment assets remaining at age 95. When success is achieved, a secondary priority is to maximize the after-tax surplus of investment wealth as a legacy to their beneficiaries. Their investment assets are all held in a balanced fund of stocks and bonds. We consider three different stock allocations for the investments: 25%, 50%, and 75% stocks.

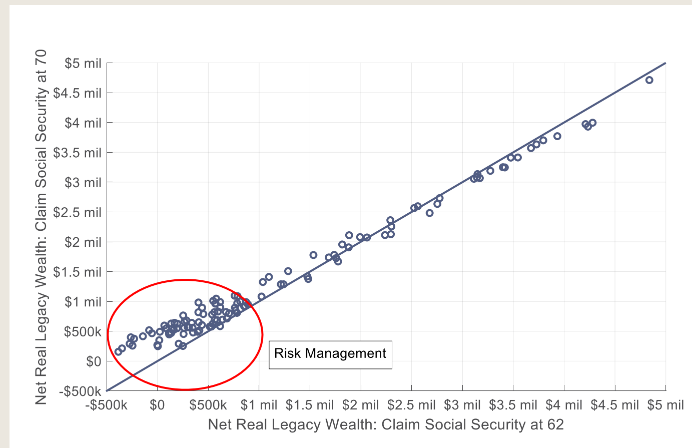
The research used historical data from 1871 onward to model retirement outcomes under varying market conditions. The purpose of using historical data is to provide a range of experiences for stock returns, bond returns, interest rates, and inflation.

As we increase from a 25% stock allocation to 75% stocks, we notice several trends. Retirement plan success rates tend to improve with higher stock allocations. In our first case study, the percentage of historical simulations in which claiming at 70 outperforms claiming at 62 is 89% with 25% stocks, 76% with 50% stocks, and 64% with 75% stocks. Even with 75% stocks, delaying Social Security increases final wealth about two-thirds of the time, and these percentages are even higher with low stock allocations.

Figure 1 provides a deeper look at the comparison between claiming at age 70 and at age 62 when using a 50% stock allocation in retirement. Delaying from 62 to 70 provides larger net legacy wealth at age 95 in 76 of the historical cases. These are reflected by the points above the horizontal axis in Figure 1. The exceptions

4. Pfau, Wade D., and Steve Parrish. 2023. “Which Social Security Claiming Strategy Generates the Highest Legacy Value?” *Journal of Financial Planning* 36 (1): 66–82.

Figure 2: Case Study Results for Single Individual with $1 million
Comparing the Claim Social Security at 70 to the Claim Social Security at 62 Strategies
With a 50% Stock Allocation, Net Real Legacy Values



for when claiming at 62 paid off include in the 1870s, around 1920, and in the period from the mid-1970s into the 1980s. These were periods in which market returns were strong during the first eight years of retirement when the delay happens, which lays a foundation for additional funds left in the investment portfolio to provide greater growth. Otherwise much of the historical period shows stronger increases to legacy when delaying benefits to age 70.

In terms of risk management, the delay strategy avoided asset depletion, and when legacies were otherwise smaller for both strategies because of poor market returns, the delay strategy consistently provided more legacy. Median legacy wealth at the end of retirement is higher in all cases when delaying Social Security. It is only in limited cases in which market returns were strong during the early retirement years that we observe claiming early to support greater lifetime wealth. But these are cases when any claiming strategy will still support a large legacy because of those strong market returns in the early retirement period. Otherwise much of the historical data supports seeing bigger increases to legacy when delaying benefits to age 70.

Figure 2 confirms the idea that delaying Social Security works to manage retirement risk using the example of a 50% stock allocation. This figure plots the net real legacy wealth for the early-claiming strategy on the horizontal axis, and the net real legacy wealth for the delay strategy on the vertical axis. Not only does this highlight that in all historical cases, the delay strategy avoided a negative legacy, but also that when legacies were otherwise smaller for both strategies because of poor market returns, the delay strategy consistently provided better outcomes. This is demonstrated with all the circled points that are above the diagonal line. Because net legacies are larger with delay when both strategies result in relatively low legacies (the circled outcomes under $1 million), we can see the risk management benefits of delayed claiming. It is only when net legacies are otherwise quite large (beginning around $1.5 million) that the delay strategy starts to fall short. But legacies were still quite large either way; the early claiming strategy only consistently wins after $2.5 million, and the relative differences between the two outcomes are quite small.

Risk averse retirees will tend to prefer strategies that provide more protection on the downside, even if that means sacrificing some upside growth. This analysis clarifies that there is risk-management value in spending down other investment assets during the first eight years of retirement to enjoy a permanently higher Social Security benefit after that point.

Though it is reasonable to expect that delaying Social Security may give up some upside potential if financial markets perform extremely well in retirement, that happens much less frequently than investment experts

may commonly expect. Claiming early can lead to a better outcome, but it is not common and should not be expected. Such scenarios are rare and typically require sustained strong market returns during early retirement years.

Most arguments in favor of claiming early tend to assume a fixed rate of return for investments matched to historical average stock market returns, providing little context to what might happen with real-world investment portfolios during the pivotal early retirement years. Many retirees will not otherwise be investing anywhere near this aggressively in retirement. And retirees become more vulnerable to the impact of market volatility in their early retirement years if they need to sell assets at a loss to meet retirement expenses. This idea is known as sequence risk, as having to sell from a declining portfolio to meet retirement expenses means that those assets are no longer available to enjoy any subsequent market recovery. This uncertain quest for upside growth means giving up a valuable, lifelong, inflation-adjusted income stream.

To generate the returns needed to beat the benefit of delaying Social Security, there would need to be a high tolerance for risk and an aggressive asset allocation, not to mention plenty of discretionary wealth. We found evidence using the historical data that it is uncommon for investment returns to beat the implied benefit of delaying Social Security for long-lived retirees even with aggressive asset allocation strategies.

It is also important to note that the increased value of inflation-adjusted lifetime income that accompanies Social Security delay would allow the retiree to feel more comfortable with using a higher stock allocation with the investment portfolio and to spend more aggressively to cover discretionary goals that maximize lifestyle. If one is comfortable thinking about Social Security as a fixed-income asset, then delaying Social Security provides a higher present value of fixed income assets on the household balance sheet. Delaying Social Security can increase risk capacity and reduce risk exposure for the household, which could justify a higher stock allocation and more aggressive distribution rate from investments than otherwise. This is the license to spend.[5] A willingness to invest more aggressively alongside Social Security delay, subject to the retiree's risk tolerance and risk capacity, could also be an alternative way to achieve more market growth for those who are comfortable taking on greater risk for investment upside.

AUTHOR

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