Retirement Options in a World with Simplified Social Security Annuities[i]

Old World: Deciding When to Retire After Age 66 (Full Retirement Age):

Maria is about to turn 66 and is thinking about retirement. She is eligible for an annual Social Security benefit of $20,000. However, if she decides to wait until 68 to retire, her annual benefit will increase to $23,200. *She thinks of all of this as one calculation, as if the decision to retire and draw Social Security benefits, and effectively "buy" a higher Social Security benefit are one and the same, when they really are three different decisions.* She will also consider them lump-sum decisions: she can't just pick the amount of Social Security benefit to defer, and she doesn't have enough control over her work prospects to control the amount of additional annuity under Social Security she can buy.

Thus, crudely, she thinks of her two options as fitting the following categories (although she could pick alternative ages to draw Social Security benefits).

Age	SS Benefit	Additional Income from Social Security Annuity
66	$20,000	$0
67	$20,000	$0
68	$20,000	$0
69 + thereafter	$20,000	$0

Age	SS Benefit	Additional Income from Social Security Annuity
66	$0	$0
67	$0	$0
68	$23,200	$0
69 + thereafter	$23,200	$0

New World: Deciding How to Invest, Retire, and Receive Social Security after Age 66 (Full Retirement Age)

(1) Maria is about to turn 66 and is thinking about retirement. As before, she is eligible for an annual Social Security annuity benefit of $20,000. Her financial planner tells her that if she takes her Social Security benefits up to age 68 and invests them in a higher annuity from Social Security, her annuity payments will go up to $23,200. But Maria thinks she wants to receive her Social Security benefits now, but she agrees with her financial planner that it would be better to have a higher, more secure DB benefit and less in a more risky DC account. So, she invests $40,000 from her 401k to buy an additional Social Security Annuity, from which she expects to receive a 16% return.

Age	Base SS Benefit	Additional Income from Social Security Annuity	Reduction (Conversion of Other Saving)
66	$20,000	$0	-($20,000)
67	$20,000	$0	-($20,000)
68	$20,000	$3,200	$0
69 + thereafter	$20,000	$3,200	$0

(2) Instead of investing out of her other saving, of course, Maria could have decided to use her Social Security benefits for the same purpose. This is almost identical to the option available under old law, with the major exception that she can easily change the rate of investment at any time regardless of whether she works or not

Age	Base SS Benefit	Additional Income from Social Security Annuity
66	$0	
67	$0	
68	$20,000	$3,200
69 + thereafter	$20,000	$3,200

(3) Maria now wants to think more broadly. She wants to think about a bridge job, perhaps through part-time work. She thinks she wants some Social Security now, but she also sees the need for higher annuity protection in old age. Therefore, she decides to take half of her benefit

for two years and invest the other half in a higher Social Security annuity after those two years, for which she expects to receive a 16% annuity return, effectively bumping up her add-on at age 68 and thereafter to $11,600.

Age	Base SS Benefit	Additional Income from Social Security Annuity
66	$10,000	$0
67	$10,000	$0
68	$20,000	$1,600
69 + thereafter	$20,000	$1,600

(4) Maria's employer has abandoned defined benefit plans because it doesn't want to incur the risks, nor does it want the administrative hassle of dealing with retired employees for decades to come. But it does believe that its employees need more annuity protection. So it sits down with employees at an early stage to help them plan for retirement. It approaches Maria, who decides to retire at age 63, and lays out a plan for her whereby she can receive a minimum level, guaranteed, annuity payment stream of $21,600 for every year thereafter, even though she would be eligible only for a Social Security payment of $16,000 from Social Security at age 63. It achieves this goal by setting up a mechanism to pay her $21,600 out of her 401 (k) account until she reaches age 66, then at ages 66 and 67 paying her $11,600 out of her 401 (k) account and letting her receive $10,000 from Social Security. (It could also have achieved this result in other ways by making deposits to Social Security directly.)

Age	Base SS Benefit	Additional Income from Social Security Annuity	Planned Withdrawal from 401 (k) for Minimum $21,600 Income
63	$0		$21,600
64	$0		$21,600
65	$0		$21,600
66	$10,000		$11,600
67	$10,000		$11,600
68	$20,000	$1,600	$0
69 + thereafter	$20,000	$1,600	$0

An Additional Note on the Earnings Test

Under current law, Maria might have considered working and receiving Social Security benefits starting at 63. But she became worried she might face the earnings test if she continued to work. Her expected Social Security benefit at 63 would be $16,000. If she were to work and earn over $46,000, her Social Security benefit would be reduced to $0. Under current practices, she might see this as a tax on working and simply decide to retire at 63 to avoid it. Under the proposed new law, she would see this as an increase in the annuity protection she was buying and likely would be more positive about the prospects of additional work.

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[i] Note: Delayed Social Security benefits do not compound in an actuarially fair manner, and the various adjustment in benefits are not actuarially fair at different ages (they are more generous at earlier ages and less generous at later ages). Also, there is often little or no credit for taxes paid if one works as opposed to simply delaying benefits. We have done all these examples as if those aspects of current law remain unfixed. But in some cases, they would be easier to handle if the adjustments were all done on a more actuarially sound basis, with adjustments for compounding, age of drawing benefits, and perhaps taxes paid. We do not pursue those issues further here.