



Big Question: When Should I Retire?

MANAGING RETIREMENT DECISIONS SERIES



Big Question: When Should I Retire?

Advertisements frame retirement as an extended vacation, brimming with fulfillment of life-long passions and dreams. But for many people, retirement is more like driving on a long trip with question marks posted in places where road signs would help. One of the biggest questions is when to retire. This Decision Brief examines this all-important issue and includes some examples as well.

The “when-to-retire” question has many companions. They often pop up at the same time as the “when” question. Answering some or all of these companion questions sometimes helps uncover the answer to the big question. Many people often ask:

- Is it best for me/my spouse to start Social Security benefits as soon as possible or to delay taking benefits in order to receive higher payments later on?
- How will age-related changes in my/our health affect retirement?
- What financial resources will be available?
- Will the finances be sufficient to last for my/our entire lifetime?
- What will be my family/household needs during retirement?
- How will I/we be able to realize my/our goals and dreams?
- Would it be a financially sound move to delay retirement?

Reminder: There is no right or wrong answer for everyone. Each person has unique needs, circumstances and retirement goals. A good strategy is to use these questions to spur ideas that fit the specific situation.

Social Security

Social Security benefits include age and employment linked provisions. For example, Social Security benefits can be claimed at age 62. However, the monthly income benefit for a worker increases for higher claiming ages up to age 70, and is about 75 percent higher at age 70 than at age 62.

That can be a very important consideration for married couples as nearly half of widows have no income other than Social Security. Meanwhile, married couples may also have spousal and survivor benefits to mull over.

For individuals or married couples, if sufficient funds are available, it may make sense to consider delaying the claiming of Social Security until some years after retirement.

Health Insurance and Medicare

Medicare eligibility is at age 65. Eligibility can occur even earlier if a person is en-

Big Question: When Should I Retire?

titled to Social Security disability benefits. In this case, eligibility would start 24 months after onset of the disability. (Note: Qualifying for Social Security disability involves meeting stringent criteria.)

People who are Medicare-eligible can look into obtaining supplemental coverage through insurance companies. Often called Medigap insurance, this supplemental coverage fills in gaps that Medicare does not cover. Medicare-eligible individuals can also consider purchasing health insurance plans that substitute for Medicare (such as Medicare Advantage plans).

Some employers offer health benefits to early retirees and may supplement Medicare. In addition, early retirees may consider purchasing individual coverage through health insurance exchanges, which are online marketplaces that allow policy comparison as well as purchase.

Workers under age 65 will need to factor their health care options and the cost of those options into the decision-making about when to retire. An effective approach to decision-making would be to compare options in retirement to the cost of, and access to, health care coverage that the employer provides to active employees. If one option proves to be more attractive than the other, workers may want to move up or delay their retirement date.

Health care coverage options may also continue to be a when-to-retire consideration after age 65. This is becoming a more important consideration as more people work past age 65. Legislative proposals for changing the existing health care system continue to be debated in Congress, so it is wise to keep up with developments and to ask questions when making health care decisions

Pensions

Pension benefits are certainly an important consideration. The plan provisions govern when they are available. The pension amount a person receives generally increases depending on the age of the person when the benefits start.

For traditional plans, benefit availability commonly starts at age 55 and 10 years of service, and benefit amounts usually increase to normal retirement age which is often age 65. Some plans offer increases for claiming after the normal retirement age. However, some plans do not increase benefits after the unreduced retirement age until the worker reaches age 70 1/2. In plans that offer a lump sum distribution option, there can be significant year-to-year changes in lump sums due to changes

Big Question: When Should I Retire?

in the assumptions used to determine the amount of the lump sums.

Savings

Funds in 401(k) retirement plans, IRAs and other savings are important as well. Retirees can gradually draw down these funds during the retirement years. Those who need additional regular income can use funds from these plans to purchase an immediate annuity. These annuities will pay out a monthly amount for the rest of the person's life.

It helps to work out a definite plan for the use of savings during retirement. A good time to do this is when starting to determine whether and when they can afford to retire.

Income and Expenses

Many people experience substantial changes in their income and expenses both when they retire and in the following years. These changes can impact the when-to-retire decision.

Some examples include:

Salary or pre-retirement earnings: In retirement, these are replaced by income sources such as Social Security, annuities, and withdrawals from savings. In the early retirement years, some people may also continue to have income from work on a limited basis.

Expenses: These can go down—and up. For example, those who stop working no longer make Social Security and Medicare contributions. Their work-related expenses also stop. Many stop adding to their retirement savings accounts too. On the other hand, retirees who increase their travel, begin a new hobby and/or participate in more family activities often see personal activity expenses go up. This often happens in the early retirement years. Later on, these costs may decline but their costs for health care and for health care coverage often go up.

Housing costs: These costs may rise if the retiree acquires a second home (not recommended without some careful planning) or the retiree moves into special senior housing with services and assistance included (typically later in life). But housing costs might decrease if the retiree downsizes or moves to a less expensive area. Paying off an outstanding mortgage can help reduce periodic housing out-

Big Question: When Should I Retire?

The RMD Factor

People must start withdrawing their required minimum distribution (RMD) from their pre-tax 401(k) and non-Roth individual retirement accounts (IRAs) by age 70½. The RMD is the government-required minimum amount that people must take out from these accounts each year. RMD withdrawals are subject to taxation.

Source: Rules of the U.S. Internal Revenue Service.

lays. It may make sense to rent, at least temporarily, when changing geographic location. There are also ways to use housing to increase income such as obtaining a reverse mortgage or rentals from one's house or other property.

Income taxes: Taxes may change at the time of retirement, particularly if the retiree now takes systematic withdrawals from investments or required minimum distributions (RMDs) from tax-deferred savings. Social Security benefits may also be taxable and could impact income taxes in other more complicated ways. It is important for retirees to get expert tax advice to understand the overall effect of their withdrawal strategy and their specific tax situation.

Helping family members: Many older Americans provide help and support to adult children, grandchildren and other family members. The support can be one time in response to an emergency, periodically or ongoing. Emergencies may include health problems, unemployment, and unexpected family needs. Ongoing support may include subsidies to divorced or underemployed children or payments for college. Don't forget about family responsibilities when thinking about expected expenses.

Activities During Retirement

Desired activities and passions have substantial impact on the when-to-retire decision. Assessing this impact requires individuals and married couples to think through what they really want to do in retirement, where they will live and in what type of housing. They also need to assess whether the goals are feasible and realistic.

If the employer offers the option to work on a reduced basis, this creates the option to gradually redefine the work commitment and phase into retirement.

Some people wish to retire and start a small business. It is critical that savings needed for retirement expenses be preserved for that purpose. This means not allowing investment in the business to wipe out the amounts available for these retirement expenses.

Family considerations are also important. For married couples, that means coordinated planning. For instance, if the spouses retire at different times, it will help if they develop common expectations about how this will change their relationship and mutual obligations.

In some cases, spouses, siblings, children or grandchildren will require care and

Big Question: When Should I Retire?

support. Some of this caregiving can be planned but not all. It is important to understand that care for older family members needing help is particularly difficult to predict, with needs changing literally overnight.

Key Questions

Questions to ask as part of planning include:

- Do I have enough money?
- What will be the impact of working one more year? Two more years?
- When is best for my spouse and I to claim Social Security benefits?
- Have I identified passions and things I wish to pursue in retirement? Is special travel on my agenda?
- Is my spouse retired? Do we have dreams we wish to pursue together?
- Does my spouse need support and help? Are there other family members who wish to have support and care?
- What are my preferences regarding work, retirement, a different set of activities?
- For how long of a period do I need to plan?
- What is likely to change during retirement and how does that affect my plan?
- Where will I get medical benefits?
- Are plans in place, or in process, regarding family members or family members needing care?
- Have I built enough flexibility into my plans?

When to Retire Examples

Following are simple examples that show the potential impact of delaying retirement.

Single female: Example 1 assumes that Joan, a single female, will have a 401(k) and Social Security for her retirement income. To make the numbers for the different retirement ages comparable, all figures are shown in real dollars (that is, adjusted for inflation). The 401(k) retirement income value reflects an annuity factor for an inflation-adjusted annuity. Thus, the benefits of delaying retirement include both the increase in value of the 401(k) and the annuity factor increasing with age.

Big Question: When Should I Retire?

Example 1: Joan, a Single Female

Retirement Age	401(k) Balance	Annuity Factor per \$100,000	Monthly Annuity	Monthly Social Security	Total Monthly Income	Increase vs. Age 62
62	\$244,567	\$321.70	\$787	\$914	\$1,701	
64	\$266,772	\$341.57	\$911	\$1,078	\$1,989	17%
66	\$289,883	\$365.37	\$1,059	\$1,275	\$2,334	37%

This example uses the following assumptions:

- **401(k) Balance:** This assumes Joan earned \$40,000 per year in real dollars beginning at age 22, and saved an average of 10 percent per year until age 62 and 15 percent per year on any earnings after age 62. The assumed real return on the 401(k) is 2 percent per year.
- **Monthly Income:** The calculations assume that the full 401(k) balance is used to provide monthly income.
- **Annuity Factor:** This is based on estimated rates for an inflation-adjusted annuity as of 11/17/2016. (Annuity quotes provided by Hueler Investment Services, Inc. Income Solutions® platform.)
- **Monthly Social Security:** This is based on Social Security Quick Calculation software, assuming \$40,000 in real annual earnings beginning at age 22. Assumes monthly benefits start at the beginning of retirement.
- **The additional contribution of the 401(k) to retirement income** from delaying retirement reflects: 1) growth from investment returns, 2) growth from additional contributions, and 3) the fact that, because of the delay, the 401(k) will be spread over a shorter number of retirement years.

The example shows that Joan would see a 37 percent increase in monthly income if she delays retirement for four years.

If Joan retires at age 62, does not purchase an annuity, and lives to age 95, she will have a 401(k) balance of \$244,567 to spread over 33 years--in addition to Social Security of \$914 per month (inflation indexed). If she waits to retire until age 66, she will have a 401(k) balance of \$289,883 and she will be spreading this larger amount over 29 years until age 95. She will also have a higher Social Security benefit of \$1,275.

The increases in Social Security in this example mostly reflect adjustments applied to Joan's benefits for taking Social Security before age 66. The example assumes Joan has more than 35 years of earnings at an inflation-adjusted \$40,000 per year. (Note: 35 years is the maximum number of years that Social Security uses to calculate benefits.) Because of this, the example does not show a benefit from Joan having more years of earnings.

Big Question: When Should I Retire?

Husband and wife: Example 2 is an expansion of the previous one, but for a married couple, Paul and Amy. It assumes Paul is two years older than Amy, and that they plan to retire at the same time. The earnings and savings assumptions are the same as above. For the annuity factors, it assumes that at retirement, Paul and Amy each use their own 401(k) balance to purchase an inflation-indexed annuity that pays 50 percent to the survivor.

(Note: Combined annuity factors are not the average for Paul and Amy. The example assumes that each spouse uses his/her own 401(k) balance to purchase an annuity, and that Paul's 401(k) balance will be larger because of more working years.)

Example 2: Paul and Amy, a Husband and Wife

Retirement Age	401(k) Balance Combined	Annuity Factor per \$100,000	Monthly Annuity Combined	Monthly Social Security Combined	Total Monthly Income	Increase vs. Age 62/64
W62/H64	\$511,339	W \$321.70 H \$368.17	\$1,769	\$1,992	\$3,761	
W64/H66	\$556,655	W \$341.57 H \$395.98	\$2,059	\$2,353	\$4,412	17%
W66/H68	\$603,819	W \$365.37 H \$432.63	\$2,417	\$2,789	\$5,206	38%

Notice that although the numbers for Paul and Amy are roughly twice as large as those for Joan in the single life example, the percentage increases from delaying retirement are quite similar—38 percent when Paul is 68 and Amy is 66.

However, in households where one spouse (usually the wife) has a shorter work history, the relative increase from delaying retirement can be greater. Three extra years for someone who worked for 40 years is not as much of an increase as three extra years for someone who worked 20 or 25 years.

The Decision

Actual results for individuals or married couples will depend on the circumstances. Actual earnings and savings histories will play a big part, for example. So will the impact of retiring early on employer-provided benefits like health insurance and pensions.

It also matters whether the person makes an abrupt transition from full-time work into full retirement or takes a phased approach and delays claiming Social Security. Customized financial projections on the impact of delaying retirement can be especially helpful for those who are considering the phased approach.

Big Question: When Should I Retire?

The decision of when to retire hinges on all these elements and many more. For instance, some decisions are irrevocable while others are not; these require careful evaluation. Also, uncertainty over how long the retiree will live is a complicating factor. Some retirees may want to factor in the distinct possibility that they could live in retirement for a very long time.

Fortunately, many publications, experts and financial tools can assist in sorting out all the issues and variables. In addition, some employers provide retirement advice as an employer-paid benefit. This is important to keep in mind, because settling on the optimal retirement date is extremely difficult, if not impossible, to do on one's own with only a pencil and paper.

Some people use retirement planning software to help with the calculations. The advantage is that many such programs help provide an estimate of whether a person will run out of money. In addition, they help people weigh different possibilities by testing alternative scenarios. For example, if considering retiring at different points in time, the software can do the calculations once for each alternative. In addition, the variability of how long one expects to live is important in lifetime planning.

Society of Actuaries research has shown wide variations in results from retirement planning programs, so it is important to use care in interpreting results. Assumptions about investment returns and longevity, in particular, can have a big impact on projections. In general, the best systems provide clear guidance on input items and clear reports that allow checking inputs and tracing the path from input to results.

In the end, those who bring thoughtful study and an inquiring mind to the decision-making task will likely reach the very best solution for their own situation.

Big Question: When Should I Retire?

Additional Resources

For the website entries, please go to the website and enter the name of the article or author into the search box.

- The Society of Actuaries and American Academy of Actuaries jointly developed a Longevity Illustrator. Find the calculator at: <http://www.longevityillustrator.org/>.
- The Society of Actuaries provides a series of infographics on understanding longevity. Find them at: <https://www.soa.org/Research/age-wise>
- The Consumer Financial Protection Bureau website provides information in “Planning for Retirement: Before You Claim”. Find it at: <http://www.consumerfinance.gov/retirement/before-you-claim/>.
- The NASI website provides information in “When to Take Social Security: It Pays to Wait”. Find it at: <https://www.nasi.org/WhenToTakeSocialSecurity>.

The Society of Actuaries Post Retirement Needs and Risks committee has other Decision Briefs providing additional information on the major decisions encountered in retirement. All of the briefs can be located at: <https://www.soa.org/research-reports/2012/research-managing-retirement-decisions/>

The Society of Actuaries would like to acknowledge the work of its Committee on Post-Retirement Needs and Risks in producing this series.

The committee’s mission is to initiate and coordinate the development of educational materials, continuing education programs and research related to risks and needs during the post retirement period. Individuals interested in learning more about the committee’s activities are encouraged to contact the Society of Actuaries at 847-706-3500 for more information. Additional information and research reports may be found at <http://www.soa.org>.

DISCLAIMER

This Decision Brief is not intended to provide advice for specific individual situations and should not be construed as doing so. It is an information tool for general guidance. Individuals needing advice should seek the services of a qualified professional. Keep in mind that the tax code can change, the taxation of products and strategies vary, and individual tax needs and issues are unique. Consideration of tax issues is beyond the scope of this work.



**SOCIETY OF
ACTUARIES**

475 North Martingale Road
Suite 600
Schaumburg, IL 60173