Approaching Social Security Claiming Decisions

The Social Security system helps protect individuals and couples against a variety of risks. For those with modest means and limited outside sources of income, Social Security retirement benefits can become a very important source of retirement income. Payments arrive monthly, like clockwork, deposited directly into the recipient's bank account. The benefit amounts are inflation-protected to some extent, as annual Cost of Living Adjustments (COLAs) are declared based on movements in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). Benefits continue for the lifetime of the claimant and, in the case of married couples, may also continue for the remaining lifetime of the surviving spouse. In this way, Social Security may constitute an important source of protection against the possibility of outliving one's assets.

How Benefits are Determined

The most important factors in the size of one's benefits are:

- **The individual's Social Security earnings history.** The formula looks at the individual's highest 35 years of earnings that were subject to Social Security taxes. These amounts are indexed for inflation and averaged. If you have fewer than 35 years of Social Security earnings, then zeroes are included for the missing years when determining the average.
- **The age at which benefits begin.** The Social Security Administration uses a "carrot and stick" approach to retirement benefits: using Full Retirement Age (FRA) as a baseline, benefits claimed earlier are reduced, while benefits delayed until after FRA are increased. For people born between 1/2/1943 and 1/1/1955, FRA is age 66.
- **The availability of spousal benefits.** It is possible for a married person to claim spousal benefits under certain circumstances. This is where things become complicated, and also where opportunity lies. There are literally dozens of combinations of benefits available to many married couples, based on their earnings histories and the various times each chooses to claim benefits.
- The complexities and opportunities expand exponentially when some of the following are taken into account: **divorced spouse retirement and survivor benefits; dependent benefits; child-in-care benefits; disability benefits; widows and widowers benefits**. In addition, there is an **Earnings Test** which can reduce or negate benefits claimed before FRA while the claimant continues to work and earn money.

The Impact of Mortality Assumptions on Social Security Claiming Decisions

Claiming decisions for individuals who are not, and have never been, married tend to be much simpler and more straightforward than those faced by married couples. Therefore, this article focuses more on married couples.

We all face a variety of risks that have financial implications. If one spouse dies "too soon," the survivor may experience a reduction in the income and in the accumulation of assets that he or she had anticipated. On the other hand, if one or both spouses live "too long," especially in the context of chronic illness or cognitive impairment, there is a risk that their assets could be depleted and that their standard of living could suffer in later years. A variety of financial vehicles are available to protect against these risks; your financial advisor knows all about them and how they might apply to your situation.

In the world of Social Security, the selection of claiming strategies is dictated by our financial goals, our overall financial situation, and decisions about where we will accept risk and where we will insure against risk. **Social Security is really a form of insurance**. You may be familiar with the acronym "OASDI," which is actually the "official" name for Social Security: *Old-Age, Survivors, and Disability* ***Insurance***.

Claiming benefits early is for some people a strategy designed to protect against dying early and thus "leaving money on the table" that could otherwise have been added to the family coffers. Delaying benefits is a form of **longevity insurance**, which protects against outliving one's assets. If we only knew when we were going to die, we could all make very intelligent decisions about when to claim our benefits – just as we could be very smart about acquiring life insurance and annuities. For example, if a couple believed that one of them was going to die within 7 years, that spouse might be tempted to start receiving Social Security benefits at the earliest opportunity; and they might use some of that cash flow to buy term life insurance – IF they could qualify. This would be particularly true if it was the lower wage earner with the short life expectancy. If the higher wage earner (assume the husband)had 7 years to live, life insurance could still be a very good idea, but he might want to delay claiming his own benefit until age 70 to maximize his wife's survivor benefit over the rest of her life, which might mean as much as 20-30 years.

Since most people don't know when they are going to die – and if they do, they will typically not qualify for life insurance – most sound claiming strategies are not designed to protect against dying too soon. In fact, if you are not confident that one of you could thrive financially if the other spouse died early, you could still hedge that risk with life insurance and/or other products and strategies. On the other hand, longevity risk can be even more challenging – and Social Security can be used to help build a formidable first line of defense against longevity risk.

Virtually all the flexibility in Social Security claiming decisions occurs before age 70. That means that if there is significant change in expected mortality within the next year or two, your situation should be revisited with a view toward possible change in strategy. After you reach age 70 "the die is cast" – there is virtually nothing you can do to switch claiming strategies.

Social Security is NOT a Stand-Alone Decision

While understanding your Social Security claiming options is important, it is strongly recommended that you consider those options **in the context of your overall retirement**

planning, which involves working closely with your financial advisor. The feasibility of pursuing certain strategies may hinge on the availability of other assets and sources of income. Your financial advisor is best equipped to help you integrate your Social Security claiming decisions into this Big Picture planning approach, which includes both financial considerations and other factors that go far beyond the laws of mathematics.

Your Social Security claiming decisions may be among the most important financial decisions you will have an opportunity to make. The difference between the “worst” and “best” decisions may amount to hundreds of thousands of dollars over your life expectancies; a sound approach can make a material difference in the amount of income – and the quality of life – available to you in retirement.

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