Claiming Social Security

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WEALTH MANAGEMENT INSTITUTE WHITEPAPER

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The choice of when to claim Social Security is among the most important financial decisions that retirees make, yet few seem to give it much thought. The longer one waits to claim, the higher the monthly benefit. In the extreme, claiming at age 70 instead of age 62 can raise lifetime monthly benefits by 76%. For a retiree with pressing financial needs or a short life expectancy, it may be best to claim benefits as soon as possible. But for many others, current research suggests that waiting to claim Social Security can substantially increase expected lifetime benefits and reduce the risk of outliving their wealth.

This paper considers the decision of when to claim Social Security. First, it documents the economic importance of Social Security for retirees. For married retirees, the expected present value of future benefits can far exceed half a million dollars. Next the paper describes the trade-offs related to the decision of when to claim benefits and notes that the vast majority of retirees claim benefits as soon as they become eligible. We then discuss how, for those whose life expectancy is near average, waiting to claim Social Security can enhance retirement security and boost the expected present value of future benefits by as much as $60,000 for single retirees and $150,000 for retired couples. The final section offers conclusions and next steps.

SOCIAL SECURITY MATTERS GREATLY

Social Security is a substantial source of retirement wealth for American families across the economic spectrum. To some families, the level of benefits may at first blush seem modest. In 2013, for example, the maximum monthly benefit for workers claiming benefits at full retirement age (66) is $2,533.[1] Yet even for families whose income is in the top quintile, Social Security benefits represent 29% of household income.[2]

The monthly checks can add up to a tidy sum over a lifetime. Among households whose head is between 65 and 69 years old, the median expected value of lifetime benefits is $230,000 for singles and $470,000 for couples. For high (90th percentile) income families, the expected value of benefits is even greater: $390,000 for singles and $710,000 for couples.[3] Thus, for many affluent retirees, future Social Security benefits are worth more than their retirement accounts or their home and other real estate holdings. To paraphrase Senator Everett Dirksen, "A few thousand here, a few thousand there, and pretty soon you're talking real money." It behooves retirees to do what they can to maximize the value of these benefits.

KEY IMPLICATIONS

When you claim Social Security matters greatly.

For many families, the lifetime expected value of Social Security benefits exceeds half a million dollars. Waiting to claim Social Security can raise the monthly Social Security check by up to 76%.

Claiming early

Those with very short life expectancies, due to poor health or some other reason, should consider claiming benefits at 62, the earliest possible age.

Single retirees

Unmarried people of average life expectancy should consider waiting until age 69 or 70 before claiming. Doing so can boost expected lifetime benefits by some 14%, or $60,000.

Married retirees

Waiting until age 70 to claim can be even more beneficial for couples, increasing expected lifetime benefits by more than 20%, or $150,000. It may, however, make sense for a non-working spouse to claim at age 66 rather than age 70.

Risk mitigation

Waiting to claim has another potential advantage: it can reduce retirees' risk of outliving their wealth.

1 Source: Social Security Administration, Fact Sheet, 2013 Social Security Changes. Available at: http://www.ssa.gov/pressoffice/factsheets/colafacts2013.pdf

2 Source: Congressional Budget Office, *The 2012 Long-Term Projections for Social Security: Additional Information.*

3 James Poterba, Steven Venti and David Wise, "The Composition and Drawdown of Wealth in Retirement," Journal of Economic Perspectives, Fall 2011. The authors compute expected lifetime benefits based on the Social Security Administration life tables. Their estimates are based on the University of Michigan's 2008 Health and Retirement Study and, as such, are slightly low. The CPI has increased 7% from 2008 to 2012, and benefits have risen accordingly.

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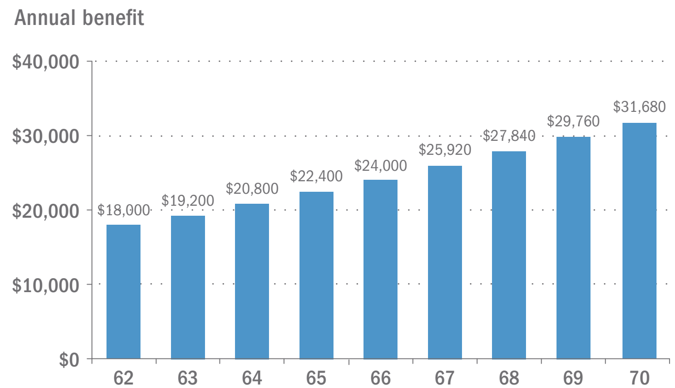
THE CHOICE OF WHEN TO CLAIM

Those who qualify to receive Social Security can, once they retire, start collecting benefits at any age from 62 to 70. The longer someone waits to claim Social Security, the higher the monthly benefits. Someone claiming Social Security at the full retirement age (FRA), currently 66, receives a full benefit, known as the primary insurance amount (PIA). The PIA is based on a retiree's earnings history and therefore varies from person to person. Someone claiming Social Security at age 62 receives 75% of PIA, while someone claiming at age 70 receives 132% of PIA (Table 1).

Thus, someone whose PIA is $24,000 per year would receive annual benefits of $18,000 by claiming at age 62, $24,000 by claiming at 66, or nearly $32,000 by claiming at age 70 (Figure 1). Claiming benefits at age 70, as opposed to 62, raises one's monthly benefit by 76%.[4]

Figure 1: Illustration of the Trade-off between Claiming Age and Annual Benefits



Source: Merrill Lynch Investment Management & Guidance calculations based on Social Security Administration data available at <http://www.socialsecurity.gov/OACT/quickcalc/early_late.html#drcTable>, accessed February 2013.

Table 1: How Monthly Benefits Vary Based On Claiming Age

	Age claimed	Percentage of Primary Insurance Amount
Earliest possible age	62	75%
	63	80%
	64	86.7%
	65	93.3%
Full retirement age	66	100%
	67	108%
	68	116%
	69	124%
Latest possible age	70	132%

Notes: The "primary insurance amount" (PIA) is the level of benefits paid to someone claiming benefits at the "full retirement age" (FRA). This schedule applies to people born between 1943 and 1953. For those born later, the full retirement age is up to one year higher.

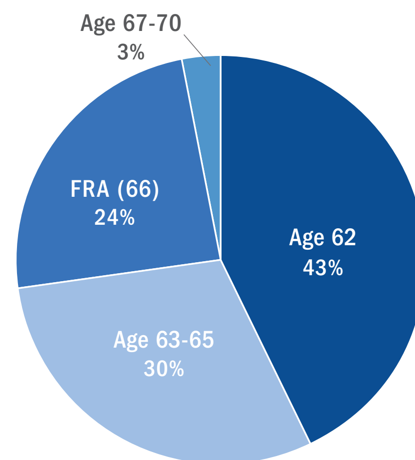
Source: Social Security Administration. Available at *<http://www.socialsecurity.gov/OACT/quickcalc/early_late.html#drcTable>*, accessed February 2013.

WHAT PEOPLE DO

Those who claim Social Security prior to FRA while still working will see their benefits sharply reduced based on their level of earned income.[5] This creates a strong incentive not to claim benefits until one has either retired or reached FRA. On average, people file for Social Security four months after they retire. Three-quarters file for benefits within two months of retiring. Wealthy retirees show no clear tendency to wait longer than others to claim benefits.[6]

The most popular time to claim benefits is at age 62. Many 62-year-olds have either already retired or want to retire and need Social Security benefits to afford doing so. Thus, in recent years 43% of those eligible to claim benefits have done so within a month of their 62nd birthdays (Figure 2).[7] Many others retire between the ages of 63 and 65 and start collecting Social Security at that time. Thirty percent of recipients claim benefits during these years.

Figure 2: Ages at which People Claim Social Security Benefits



Note: Data are for those who reached age 62 from 1997 to 2005.

Source: Government Accountability Office, "Retirement Income: Ensuring Income throughout Retirement Requires Difficult Choices," June 2011, p. 22.

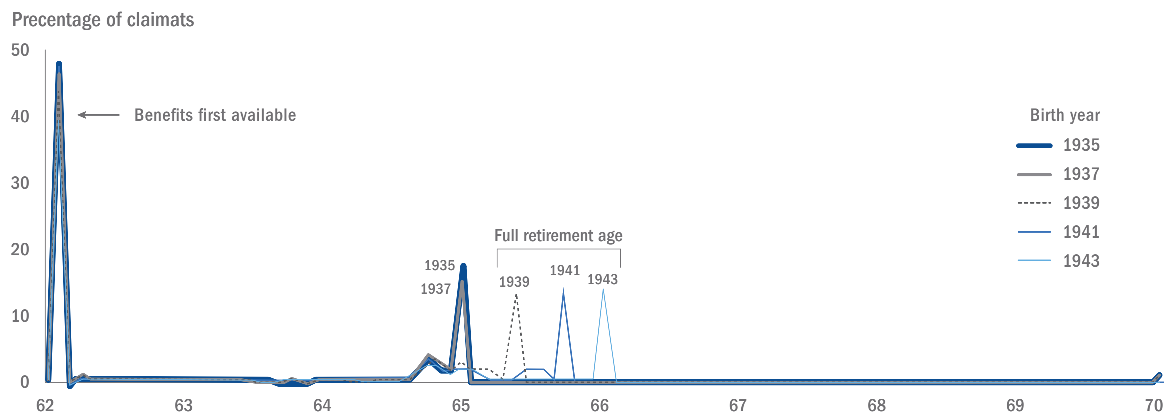
[4] This is because 132% ÷ 75% = 176%. The 76% is in real terms. Because benefits are adjusted each year for inflation, the nominal increase in benefits would actually be more than 76%.

[5] In 2013, benefit payments will be reduced by $1 for every $2 over $15,120 that someone earns before reaching FRA. These benefits are not lost, but deferred. The Social Security Administration compensates for the benefit reduction by increasing the recipient's benefits upon reaching FRA.

[6] John Shoven and Sita Slavov, "The Decision to Delay Social Security Benefits: Theory and Evidence," National Bureau of Economic Research working paper 17866, February 2012, Table 6 and Figure 11. For purposes of this calculation, the wait until claiming for people who retire before age 62 is measured from age 62.

[7] Government Accountability Office, "Retirement Income: Ensuring Income throughout Retirement Requires Difficult Choices," June 2011, p. 22.

Figure 3: Ages at which People Claimed Social Security, by Birth Year, 1997-2009



Note: This graph is based on actual awards of retired worker benefits plus projections of the number of workers who had not taken benefits by the end of 2009. Disability benefit recipients are excluded.

Source: Government Accountability Office, "Retirement Income: Ensuring Income throughout Retirement Requires Difficult Choices," June 2011, p. 23.

Once they reach FRA, Social Security recipients can receive full benefits without any reduction due to earned income. Those who work past age 65 therefore typically claim Social Security at or around the FRA; 24% of recipients claim benefits at this age. The FRA has a magnetic attraction for Social Security claimants: as the FRA shifted from age 65 to age 66 in recent years, so too did the age at which people filed for benefits (Figure 3). Just 3% waited until age 67 or later to file for Social Security. Delaying benefits beyond FRA has been the road less taken.

DECIDING WHEN TO CLAIM

Those who rely heavily on Social Security to pay living expenses have little choice but to claim benefits as soon possible. But those with enough savings can decouple the decision of when to claim Social Security benefits from that of when to retire. For many, it makes sense to retire on one date, and to claim Social Security at a later date.

The key factor in deciding when to claim benefits is life expectancy. The higher one's life expectancy, the more beneficial it is to wait before claiming. Consider, for example, Andy and Bill, two unmarried, newly-retired 62-year-olds with identical income histories. Andy claims his Social Security benefit immediately, while Bill waits until age 66. Because Andy doesn't need to spend the benefits he receives, he deposits them in a savings account whose return matches inflation.[8]

At age 66, Andy, who has accumulated four years of benefits, is far better off than Bill. But then Bill starts to catch up. Each month he receives a benefit equal to 100% of his primary insurance amount, while Andy receives 75% of his primary insurance amount. By the time they reach age 78, Bill's cumulative benefit surpasses Andy's. From then on, Bill's lead over Andy continues to grow.

This example illustrates that someone who waits until age 66 to claim Social Security will collect more benefits if he lives past age 78, but less if he does not. Since the life expectancy for a 62-year-old male is 81 years, it pays for a man with average life expectancy to delay claiming until at least age 66. And since the average life expectancy of a 62-year-old female is 84 years, it makes even more sense for a woman to wait before claiming.[9]

To summarize, those with limited resources or life expectancy well below average (whether due to health, lifestyle or genetics) might benefit from claiming Social Security early. For others, waiting a few years after retirement before filing for Social Security can boost expected lifetime benefits and reduce the risk of outliving their wealth. Next we review some relevant empirical research.

Higher expected lifetime benefits for singles

Shoven and Slavov identify the Social Security claiming age that maximizes the expected net present value (NPV) of future benefits and estimate the extent to which waiting to claim can boost these expected benefits.[10]

[8] Assuming that savings earn a return that matches inflation is equivalent to discounting future Social Security benefits at a zero percent real rate, roughly in line with recent TIPS pricing. For someone who can earn higher investment returns, claiming early may be the more attractive choice. But these higher returns would be uncertain and might never materialize.

[9] "Rich people, women and healthy people live much longer than their poor, male and sick counterparts" according to Mariacristina De Nardi, Eric French and John Bailey Jones, "Life Expectancy and Old Age Savings," American Economic Review, May 2009. Conversely, smoking reduces one's life expectancy by at least a decade, according to Prabhat Jha et al, "21st-Century Hazards of Smoking and Benefits of Cessation in the United States, "New England Journal of Medicine, January 2013. Websites such as www.livingto100.com feature calculators that allow people to estimate their life expectancy.

[10] John Shoven and Sita Slavov, "When Does It Pay to Delay Social Security? The Impact of Mortality, Interest Rates and Program Rules," National Bureau of Economic Research working paper 18210, July 2012. The net present value of a stream of cash flows is the sum of their values, each discounted by an appropriate interest rate.

Table 2: NPV-Maximizing Strategies for Singles and Couples

	Male NPV-Maximizing Age	Female NPV-Maximizing Age	% Gain from Delaying from Age 62	Indicative $ Gain from Delaying from Age 62*
Single man	69	N/A	14%	$55,000
Single woman	N/A	70	18%	70,000
One-income couple	70	66	21%	149,000
Dual-income couple	70	70	22%	156,000

Notes: Analysis is based on 0% real interest rate. For couples, the primary earner is assumed to be a 62-year-old male, and the secondary earner is assumed to be a 60-year-old female. In dual-income couples, the secondary earner's income is assumed to be 75% of the primary earner's.

* Dollar estimates are based on typical lifetime benefits for high-income (90th percentile) households: $390,000 for singles and $710,000 for couples.

Sources: John Shoven and Sita Slavov, "When Does it Pay to Delay Social Security? The Impact of Mortality, Interest Rates and Program Rules," NBER Working Paper, July 2012; James Poterba, Steven Venti and David Wise, "The Composition and Drawdown of Wealth in Retirement," *Journal of Economic Perspectives,* Fall 2011; and authors' calculations.

For single retirees, the decision of when to claim benefits is simply a matter of selecting a date. According to Shoven and Slavov, the best time for a single man of average life expectancy to claim Social Security is age 69. Doing so increases his expected lifetime benefit by 14% relative to one claiming at age 62. For a high (90th percentile) income retiree, this represents a lifetime gain of $55,000 (Table 2). Women, because they have higher life expectancies than men, gain more from waiting to claim. Shoven and Slavov find that it is best for a single woman of average life expectancy to claim at age 70, a year later than her male counterpart. Her expected net gain from claiming at age 70 is 18%, or an estimated $70,000.

Higher expected lifetime benefits for couples

For couples, the choices are more complex because each spouse's timing can affect the other's benefits. Waiting to claim Social Security can benefit couples even more than singles. This is because married retirees can claim *spousal* and *survivor's benefits* in addition to their own earned benefits. A spousal benefit is paid based on the earnings record of one's spouse while the spouse is alive. A survivor's benefit is paid based on a spouse's earnings record after the spouse has died.

Shoven and Slavov consider retired couples whose primary earner is a 62-year-old with a 60-year-old spouse. For single-income couples, the best strategy is for the working spouse to file for benefits at the FRA of 66, and then immediately suspend receipt of those benefits until some future date (see Box). This allows his or her spouse to claim spousal benefits, while the working spouse's benefits continue to grow, until claiming benefits at age 70.

For dual-income couples, the best strategy is for each spouse to claim benefits at age 70. In the interim, the primary earner "files and suspends" and the secondary earner claims spousal benefits upon reaching age 66, before switching to his or her own benefits at age 70.[11] These strategies can increase a couple's expected lifetime benefits by more than 20%. For a high (90th percentile) income couple, this means an additional $150,000 in benefits compared to what they would receive by both claiming at age 62.

The "file and suspend" strategy

The "file and suspend" strategy allows couples to begin receiving Social Security spousal benefits immediately while increasing future benefits. Under current law, someone cannot claim a spousal benefit until his or her spouse claims benefits first. To execute the strategy, someone files for benefits upon reaching full retirement age (currently age 66), and then immediately suspends receipt of those benefits until a future date. This allows his or her spouse to claim a spousal benefit immediately. The primary earner can then wait to claim his or her own retirement benefit, thereby allowing it to grow at 8 percent per year through age 70 (Table 1). This approach offers "jam today" and "jam tomorrow." The couple receives a spousal benefit immediately while realizing the potential advantages of delayed claiming.

Retirement risk mitigation

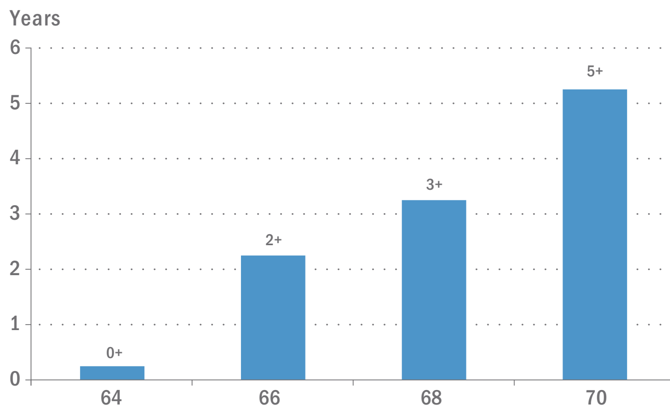
Waiting to claim Social Security can also help mitigate three key retirement risks: longevity risk, inflation risk and market risk. Longevity risk is the risk of outliving one's wealth, possibly because of living longer than expected. Waiting to claim boosts a retiree's guaranteed monthly income, which is especially valuable for those who live long.

Social Security also provides an inflation hedge. This is because, under current law, the level of benefits rises each year to reflect increases in the cost of living.[12] By increasing a retiree's monthly Social Security benefit, waiting to claim Social Security provides additional inflation protection.

[11] To do so, the primary earner must file a "restricted application" to receive spousal benefits while allowing her own benefits to continue to grow.

[12] This cost-of-living adjustment (COLA) is linked to the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) prepared by the Bureau of Labor Statistics. If CPI-W declines or is unchanged in the third quarter of a given year versus a year earlier, the COLA for the following year is zero. The COLA was zero in both 2010 and 2011. For more details, see http://www.ssa.gov/cola/2013/factsheet.htm.

Figure 4: Portfolio Longevity Extension Due to Delayed Claiming



Note: Analysis is for a single client with $1,000,000 of wealth, a full Social Security benefit of $18,000 per year, and a 30-year planning horizon. It assumes a 3.75% annual return including a 2.5% inflation rate, and that all wealth is held in a 401(k). See paper for further details.

Source: William Meyer and William Reichenstein, "How the Social Security Claiming Decision Affects Portfolio Longevity," *Journal of Financial Planning,* April 2012, Table 1.

Market risk, a challenge that all investors face, is especially pronounced for retirees who regularly draw down assets to help cover their expenses. These asset drawdowns magnify the damage done by a market sell-off. By waiting to claim Social Security, retirees increase their share of income from guaranteed sources, thus limiting their exposure to future market volatility.

Meyer and Reichenstein quantify how delaying Social Security benefits can affect the longevity of a retirement portfolio from which a retiree regularly draws down assets over a 30-year planning horizon.[13] By delaying when one files for Social Security benefits from age 62 to ages 64, 66, 68 or 70, a retiree with $1,000,000 of financial assets and a moderate level of Social Security income ($1,500 per month) can extend her portfolio's longevity by as much as five years (Figure 4). According to Meyer and Reichenstein, the more she delays, the more the portfolio's longevity is extended.

CONCLUSIONS

It seems natural to start collecting Social Security benefits immediately upon retiring, and this is in fact what most people do. For many, this is a necessity; they need the income to pay living expenses. But those who can afford to do so may benefit from waiting to claim Social Security.

Recent research suggests that making the right choices about when to claim can have a surprisingly large impact. It can boost the value of expected lifetime benefits by $60,000 for someone unmarried and $150,000 for a couple. Waiting to claim Social Security can also offer protection from inflation and market risk and reduce the risk of outliving one's wealth. In some cases, it can extend the life of a retirement portfolio by five years or more.

Some guidelines to consider in deciding when to claim Social Security:

1. Those who (due to poor health or other reasons) have very short life expectancies should consider claiming benefits at 62, the earliest possible age.
2. Unmarried people whose life expectancy is average should consider waiting until age 69 or 70 to claim. Doing so boosts expected lifetime benefits by an estimated 14%-18%.
3. Many married couples stand to benefit from pursuing a "file and suspend" strategy.
4. Waiting until age 70 to claim can boost a couple's expected lifetime benefit by over 20%. It may, however, make sense for a non-working spouse to claim at 66, not 70.

Next steps

In thinking through your Social Security choices, start by gathering information on your specific situation. At the Social Security Administration website (ssa.gov), you can download a personal Social Security Statement, which provides your earnings history and estimate of your future monthly benefits. You can also estimate the monthly benefits you would receive by claiming Social Security at various ages.

Consider your Social Security choices in the context of your overall financial picture. Because each individual situation is unique, you may want to consult your financial advisor. Merrill Lynch offers tools to help our Financial Advisors and clients think through the potential impacts of alternative claiming strategies.

[13] William Meyer and William Reichenstein, "How the Social Security Claiming Decision Affects Portfolio Longevity," *Journal of Financial Planning,* April 2012.

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