

How to maximize your social security paycheck

Social Security retirement benefits are an essential part of our clients' comprehensive financial plans. Not only do these benefits provide for 40% of the average retiree's income,¹ but their unique characteristics cannot easily be replicated by another investment strategy or product.

Social Security offers protection against risks that are otherwise difficult to hedge, such as:

- Longevity risk – the risk of outliving your nest egg
- Inflation risk – due to the erosion of purchasing power of a dollar
- Credit risk – the risk of bankruptcy or insolvency

In order to determine how best to maximize your Social Security benefit, it is important to first understand which types of benefits are available, and then to identify when the most opportune time to begin receiving these benefits will be based on your individual situation.

Three types of Social Security benefits

There are three types of Social Security benefits that you should become familiar with:

- Worker's Benefit
- Spousal Benefit
- Survivor Benefit

Most workers (excluding some government employees) earn Social Security retirement income benefits by working at least 10 years. The Worker's Benefit is affected by the worker's annual income and the length of time in the workforce. This benefit is typically stated as the "Primary Insurance Amount" – the monthly benefit payable at Full Retirement Age.²

Married individuals³ may also be eligible for a Spousal Benefit. This is typically equal to 50% of the benefit paid to the primary worker at their Full Retirement Age. In most cases, if an individual is eligible for both a Worker's Benefit (due to their own working years) and a Spousal Benefit (due to their spouse's lifetime earnings), they must receive the larger of the two benefits. However, a Spousal Benefit can only be paid once the primary Worker's Benefit has started. In this case, the individual whose work record is being used to calculate the Spousal Benefit must begin receiving their own Worker's Benefit before a Spousal Benefit can be claimed.

The Survivor's Benefit provides a surviving spouse with the larger of either of the two Worker's/Spousal Benefits being received at the time of the first spouse's death.⁴

When to begin receiving benefits

Retirees face a complex decision about when to begin receiving their Social Security retirement income. It is essential to consider all of the factors that affect this choice — these include having a full understanding of:

- The benefits and drawbacks of "early," "full" and "delayed" start dates
- Household cash flow needs
- Longevity expectations
- The relationship between spouses' lifetime earnings
- Survivorship expectations
- Inflation rates
- Future rates of return.

As such, it's important that a retiree consult with a trusted advisor to maximize their expected lifetime Social Security benefits. Let's review a few of these key considerations.

Benefit start date options: Early, Full, Delayed

It's assumed that retirees begin their Social Security retirement benefits at their Full Retirement Age (ages 66-67). However, benefits can begin as early as age 62⁵ or be delayed until age 70. In these cases, those receiving Social Security early have their monthly payments permanently reduced (as it's expected that more payments will be received) and those delaying benefits will have their monthly amount permanently increased (to offset the months of foregone income).⁶

If cash flow allows, longevity risk points towards waiting as long as you can

Most married couples may maximize their combined lifetime wealth by delaying at least one (if not both) of their benefits until age 70 if their cash flow permits. This is due to the longevity expectations of the Social Security program and the characteristics of Social Security's Survivor's Benefit.

By using software to project the lifetime value of the Worker's Benefit or the Spousal Benefit, we can calculate that the assumed single life expectancy of a retiree is between ages 77 and 81; this is the range for which the choice of whether to begin benefits at age 62, Full Retirement Age, or age 70 are all roughly equal.

However, we can refer to other actuarial tables to find other viewpoints about today's average life expectancies. In fact, according to current Social Security estimates, the average life expectancy of a female at age 65 is nearly 87, and a 65-year old man is expected to live until at 84.⁷

Keep in mind that these are medians, and that half of the population will live longer than average. According to Social Security, "About one out of every three 65-year-olds today will live past age 90, and about one out of seven will live past age 95."

These facts alone provide us with a bias towards postponing Social Security if cash flow allows. It's also important to consider how a family weighs longevity risk. Many couples would rather postpone their Social Security income today to maximize their retirement income in their mid- to late 90s when their portfolio value may be diminished from decades of retirement withdrawals.

The role of the Survivor Benefit

The Social Security Survivor's Benefit is another compelling reason for (at least one spouse) to delay filing for their Social Security benefit. The Survivor's Benefit provides a surviving spouse with the larger of either of the two Worker's/Spousal Benefits being received at the time of the first spouse's death. In effect, the Survivor's Benefit is an extension of the higher earning spouse's Social Security from his or her individual lifetime to the couple's joint lives. Since a couple's joint life expectancy exceeds either of their own individual single expectancies, this further enhances the lifetime value of delaying some or all a family's Social Security benefits (as these benefits are maximized with longevity).

Age differences between spouses can influence when to take benefits

In some cases, there is another benefit to postponing claiming one spouse's Worker's Benefit. For example, consider a married couple where the older spouse has a larger Worker's Benefit than the younger spouse. As this Worker's Benefit will be paid beyond the older spouse's death (as a Survivor's Benefit), it's advantageous to delay the start of this income until the Worker's age 70 (earning the largest possible permanent increase).

However, if the differences in ages are great enough, the older spouse's life expectancy may occur in a year before the younger spouse's assumed longevity. Since the Survivor's Benefit would replace the younger spouse's Worker's/Spousal benefit at the time of the first spouse's death, it has the effect of reducing the length that that the survivor spouse receives their own normal benefits. Since the timeframe that the survivor spouse received their Worker's/Spousal benefit may now be abbreviated, it's beneficial to elect to receive benefits early (thus receiving more possible payments).

When to take benefits for an unmarried individual

For an unmarried individual, the primary determinant of whether they receive the most Social Security that they're entitled to is their life expectancy. Consider the nonmarried retiree choosing between beginning their benefits at age 62, their Full Retirement Age, or their age 70. In this case, the person with a life expectancy of age 77 or less would be better off beginning their benefit at age 62, while those with life expectancies of age 81 or greater are rewarded by delaying this income until age 70.⁸

Navigating a family's various Social Security claiming alternatives is complex and requires a thorough understanding of the program's rules. With an understanding of our client's individual circumstances, we custom design Social Security strategies to help maximize their long-term wealth.

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Sources and Footnotes:

1 1 <https://www.aarp.org/retirement/social-security/questions-answers/income-replacement-rate.html>

2 Full Retirement Ages range from age 66 (for those born between 1943 and 1954) to age 67 (for those born in 1960 or after). Those born between 1955 and 1959 have a Full Retirement Age of between 66 and 67.

3 Divorced individuals may also qualify for a Spousal Benefit based upon their former spouse's earnings if they were married for at least 10 years and they have not remarried.

4 Assumes that the surviving spouse has attained at least Full Retirement Age at the time of the first spouse's death

5 Social Security is subject to the “Earnings Limitation” for those receiving benefits before their Full Retirement Age. For 2020, Social Security benefits are reduced by \$1 for every \$2 of earned income received greater than \$18,240 (or by \$1 for every \$3 of earned income received greater than \$48,600 during the year Full Retirement Age is attained).

6 Social Security Worker’s Benefits may be reduced by as much as 25%-30% (based upon the year of birth) and increased by as much as 24%-32% (based upon the year of birth). Spousal Benefits may be reduced by 30%-35% (based upon the year of birth). There is no advantage to delaying Spousal Benefits.

7 <https://www.ssa.gov/planners/lifeexpectancy.html>

8 Assumes an average cost of living adjustment of 3% and a rate of return assumption of 3%.

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