New Year's Retirement Resolution to Keep: Develop a Social Security Strategy

January 30, 2015

On January 31, 1940, Ida May Fuller made history as the first American ever to receive a monthly Social Security benefit check.[1] On the 75th anniversary of that historic event, Gail Buckner, vice president and national financial planning spokesperson, Franklin Templeton Investments, discusses the importance of developing a strategy about Social Security, including a thoughtful examination about when and how to claim benefits. Buckner says this can make a big difference in one's future income stream and act as a cornerstone of a retirement income plan that can help pre-retirees feel more confident about what comes next. While many new year's resolutions have already come and gone by the end of January, it's still not too late to make some investment-related resolutions.

Many Americans don't think much about Social Security, other than to worry whether it will be there when they retire. Of course, the most savvy have a broad menu of retirement planning vehicles in addition to Social Security to help ensure their financial future, but that's a subject for another piece. If you are thinking of filing for Social Security benefits this year it is worth taking time to think through your strategy. While most people understand that the age at which you start your benefit will affect your retirement income, few understand that *how* you take your benefit can have an even bigger impact.

In one sense, the rules that surround Social Security are fairly straightforward: The earlier you start, the smaller your monthly check. This reduction is *permanent.* Despite this fact, nearly two-thirds of people start taking benefits before Full Retirement Age (FRA).[2] In addition, women tend to file for benefits earlier than men—which can have serious, unintended consequences.[3] On average, a woman's lifetime earnings tend to be lower than a man's, resulting in a smaller Social Security benefit, even at FRA. Filing for benefits *before* FRA reduces benefits even further, which is one reason why the average monthly amount paid to women in 2012 was 22% less than what men received.[4] Due to divorce and the fact that, on average, they live longer than men, nearly one out of five single women over the age of 65 is living at or below the poverty line.[5]

See Social Security in a New Light: As an Asset

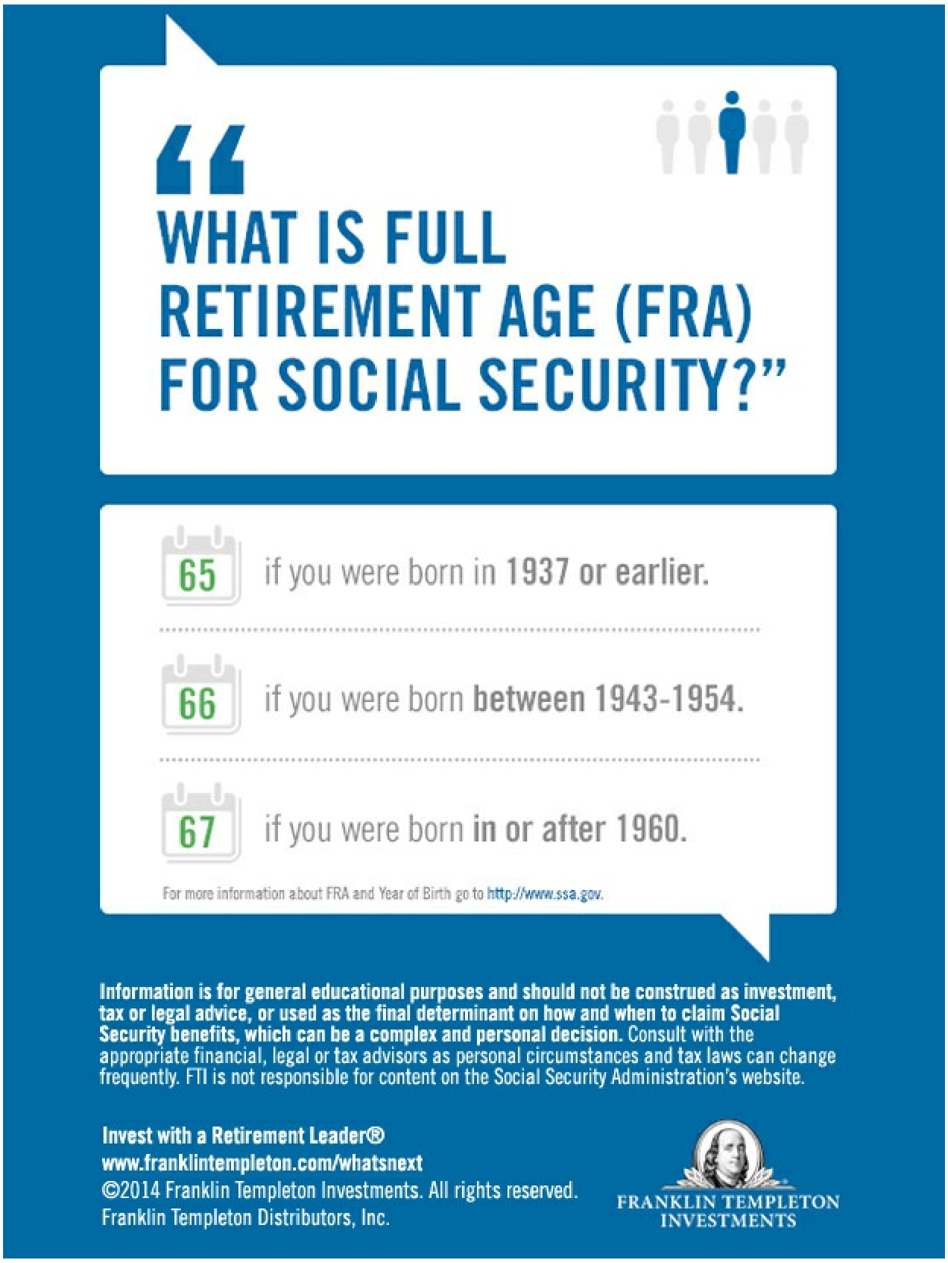
In essence, Social Security is often thought of as a monthly governmental I.O.U., which diminishes how the true value of this unique asset is perceived. While there can be no guarantee that the future program will operate as it has in the past, when you consider Social Security in investment terms, it represents a government-sponsored, inflation-adjusted, lifetime *retirement income*. Most Americans have made contributions to it for decades. There is not a single product in the financial services industry that can readily duplicate Social Security. That is why it's so important to develop a strategy that incorporates Social Security benefits into your overall retirement plan. The larger your Social Security benefit, the less you need to withdraw from other assets to finance your retirement. In other words, maximizing the amount you get from Social Security can help extend the life of other assets you own, increasing the chances they can potentially be there for an emergency or to leave to heirs.

The Importance of FRA

Let’s look at a hypothetical example using simple assumptions that can illustrate the impact of when you file for Social Security. Assume an individual was born on June 15, 1955, and has earned a monthly benefit of $2,561 at FRA (which is defined as an age of 66 and 2 months).[6]

For this individual, filing to begin benefits at age 62, the earliest age possible (rather than waiting until FRA age 66 and 2 months) results in a significant reduction in monthly benefits. He or she winds up with a monthly check of $1,653. Conversely, delaying benefits until age 70 produces a significantly higher monthly benefit check of $3,854. In fact, on average, waiting until age 70 to begin receiving Social Security results in a monthly benefit that is 76% greater than the amount an individual would receive at age 62, according to the National Academy of Social Insurance.[7]

This is the first eye-opener. Most people don’t realize how big a difference eight years can make. Another common surprise is that this reduction in monthly benefits is permanent. Some people assume that once they reach FRA, their reduced monthly benefit will jump up to the amount they would have received had they waited until then to file. That is not the case. Another important thing to remember, not only the year, but the month you choose to begin receiving benefits can make a big difference.



Let’s look at another scenario, with a younger individual. For Social Security purposes, anyone born in 1960 or later has a FRA of 67. Because the early retirement age remains unchanged, these individuals can still begin benefits at age 62. However, since they would be receiving benefits *five* years prior to FRA (instead of the current four), the reduction in their benefit amount would be about 30% instead of the current 25%. Again, this is *permanent.* Even if this individual plans to delay claiming until age 65, they will still be two years below their FRA in terms of Social Security. As a result, their Social Security benefit will be reduced by more than 13%.

For this reason alone, we think the old adage of “save 10% of your paycheck” in a retirement account is outdated for anyone who is age 54 or younger. If you expect to start Social Security at the “traditional” age of 65 or 66, you will take about a 13% haircut. Saving more through a retirement plan not only makes sense, it’s a *necessity* if you want to make up for this difference.

Here’s a summary of the reduction for starting benefits at various ages for individuals born in 1960 or later:

- For age 62 the reduction is about 30%
- For age 63 the reduction is about 25%
- For age 64 the reduction is about 20%
- For age 65 the reduction is about 13%
- For age 66 the reduction is about 7%

The “Break-Even” Question

Many people believe that although starting benefits early results in a smaller monthly check, they still come out even—or perhaps ahead—because they receive that lesser benefit for a longer period of time. They believe it will take a long time for individuals who wait until 66 or 70 to “catch up” on the cumulative benefits received (even with those “early” benefits being spent rather than invested).

In our example for the individual born in 1955, we saw that waiting to claim at age 66 and 2 months (FRA) translates into $908/month more income than claiming early, at age 62. By age 80, if this person waited until FRA, the difference could represent tens of thousands dollars more than filing at age 62. What if this person lives to 90? You can see how this adds up over time.

The purpose of this exercise is not to suggest that everyone should wait until age 70 to start Social Security, or that waiting will definitely get you more than if you begin taking benefits early. Decisions regarding when to begin your benefit are highly personal and depend on a number of factors, including your health, family longevity, whether you plan to work in retirement or have other income sources, as well as anticipated future financial needs and obligations. Potential tax consequences should also be considered. Some people simply need the income and cannot afford to wait. On the other hand, if you are among those who have assets invested in a 401(k) or a defined benefit and/or an IRA, you might consider the possibility of tapping these accounts before age 70½ (when required minimum distributions start). This approach could provide the income you need so that you can postpone taking Social Security benefits until FRA.

Instead of thinking about Social Security simply in terms of “monthly” income, think of it in terms of *cumulative* income, that is how much you may receive *for as long as you live.* In addition, if you are married, you want to consider how you and your spouse can coordinate claiming your benefits to maximize the collective benefit you receive as a *couple.* Once you see Social Security as a valuable “asset” that you have been contributing to for years, it makes more sense to think strategically about when and how to claim it, in the context of your other retirement income sources. What’s the best way to work out a personal retirement roadmap, including an appropriate Social Security strategy? Talk to an advisor.

Learn more about Social Security claiming options for divorced or widowed spouses in the brief video below.

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1. Source: US Social Security Administration.

2. Sources: US Social Security Administration; Franklin Templeton Retirement Income Strategies and Expectations (RISE) Survey, 2014. Full Retirement Age is 66 for those born between 1943 and 1954. Each year thereafter, FRA is gradually increased until it reaches 67 for individuals born 1960 or later.

3. In 2012, 43.3% of women began receiving Social Security at age 62 compared to 38.0% of men. Source: US Social Security Administration Annual Statistical Supplement 2013, Table 6.B5.1.

4. Source: US Social Security Administration, *“Fast Facts & Figures About Social Security,”* SSA Publication No. 13-11785, August 2013.

5. Source: National Women’s Law Center, September 2012. The poverty rate for women 65 and older living alone rose to 18.4% in 2011 from 17.0% in 2010.

6. Example for hypothetical and illustrative purposes only; individual Social Security benefits will vary. Taxes have not been taken into account. For this example, we assume the individual is currently earning $80,000 a year, was born on June 15, 1955, and, as a result has a full Retirement Age of 66 and 2 months. The calculations make certain assumptions about earnings and assume future increases in prices or earnings so the estimated benefit is in future (inflated) dollars.

7. Source: National Academy of Social Insurance, “*When Should I Take Social Security Benefits,*” NASI, Feb. 2014.

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