

When to Claim Social Security: An Important Financial Decision

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This article discusses consumer decision-making with respect to the optimal age at which workers should claim Social Security benefits. Ideally, individuals who are making this decision should consider a number of individual case-specific factors. This topic is especially timely because the mass retirement of the baby boom generation is no longer a hypothetical discussion about a distant event. Instead, it is a "teachable moment." Today, the oldest boomers, born in 1946, are eligible to collect permanently reduced early Social Security benefits. In fact, the oldest boomer, Kathleen Casey-Kirschling, born January 1, 1946, applied to receive her first check in October 2007 and started collecting benefits immediately upon turning 62. In total, there are about 78.2 million baby boomers in the U.S., and about 3 million turning age 62 in 2008, who will need to decide whether to take a reduced benefit check before full retirement age (FRA) or wait and collect a full benefit check at their FRA. FRA is steadily increasing and is currently defined to be age 66 (workers born from 1943 to 1954) or age 67 (workers born in 1960 or later) or somewhere in between (e.g., 66 and 6 months for those born in 1957), depending upon an individual's year of birth (Social Security Administration, 2008a). The future increase in the number of baby boomers collecting Social Security has been dubbed a "silver tsunami" (Franklin, 2008).

The decision about when to collect Social Security is important and affects the financial security of recipients and surviving spouses for the rest of their lives. Thus, it deserves careful scrutiny and a complete understanding of the implications of collecting Social Security early versus at FRA or even later. This article discusses five key points related to this decision: (1) the mathematics behind the timing of Social Security benefits (break-even age); (2) key decision-making factors (health, financial need,

marital status, marginal tax bracket, post-retirement employment plans, and emotional and psychological factors); (3) the impact of Social Security benefit decisions on a beneficiary's surviving spouse; (4) resources for decision-making; (5) and implications for consumer educators.

Mathematical Break-Even Analysis

Picture a graph with two intersecting lines. From a purely mathematical standpoint, a key consideration in the timing of Social Security benefits is the "break-even point." This is the age, generally late 70s to early 80s (depending upon the assumptions that are used) when someone receives more from Social Security by delaying benefits to FRA than they would by taking an early reduced benefit at age 62. In other words, the break-even age is the point at which the cumulative amount of early (reduced) retirement benefits received from age 62 through FRA is exceeded by the amount of (full) benefits paid beginning at FRA. Under current Social Security rules, benefits are reduced by 25% at age 62 for persons with a FRA of 66 and by 30% for younger workers with a FRA of 67 (Social Security Administration, n.d.). Conversely, those who postpone benefits beyond FRA through age 70 receive a yearly increase of 8% for both retirement and survivor benefits (Social Security Administration, 2007). Beyond age 70, however, there is no added benefit for further delays in collecting benefits.

The dollar amount of Social Security benefits provided at various ages is designed to be about actuarially equivalent to the dollar amounts provided to beneficiaries with average life expectancies. That is, they will collect roughly the same amount by claiming early benefits or waiting to collect at FRA (Franklin, 2008; Munnell & Soto, 2007). This also means that those with above-average life expectancies, who live beyond their break-even age, are better off waiting to FRA (or later) to collect their first check. Conversely, individuals who die earlier after retirement will not live long enough to reach the break-even point. While the

average life expectancy, conditional on reaching age 65, is 83.7 for all races and both sexes (National Center for Health Statistics, 2006), some individuals will die before this. In addition, there is a greater than 1 in 6 chance for males and a 1 in 9 chance for females of not surviving from age 25 to FRA (Life and Health Insurance Foundation for Education, 2007).

A recommended resource for benefit decision-making is the Social Security fact sheet, *When to Start Receiving Retirement Benefits*, which can be found at <http://www.socialsecurity.gov/pubs/10147.html>. It compares the benefits received from age 62 to age 70. As a hypothetical example, assume that a potential beneficiary is considering a choice between receiving \$1,500 a month at FRA or \$1,125 (a 25% permanent reduction) at age 62. The Social Security benefit calculators available at <http://www.ssa.gov/planners/benefitcalculators.htm> provide a break-even age of 77 years and 11 months (specifically, click on the first calculator called the Quick Calculator). Someone could also manually double-check the math behind the calculation: $\$1,125 \times 191$ months (15 years, 11 months) from age 62 to almost 78 equals \$214,875 versus $\$1,500 \times 143$ months (11 years, 11 months) from age 66 to almost 78, which equals \$214,500. With an additional month, the cumulative value of larger benefits starting at FRA pulls ahead to \$216,000 ($\$1,500 \times 144$ months) as the break-even point is crossed.

The Social Security Administration's online calculator, however, is not perfect. Financial experts recommend adding at least two or three years to the calculated result because it does not account for earnings on savings not withdrawn when early benefits are received, which raises the break-even age (Munnell & Soto, 2007). In other words, there are time value of money implications related to receiving early Social Security benefits (Muskian, 2006, 2004). First, those benefits could be invested to earn income if the money is not immediately needed to pay living expenses. In addition, early beneficiaries may be able to leave their invested assets, especially savings in tax-deferred employer

retirement plans, growing instead of making investment withdrawals if their Social Security benefits, and perhaps a pension and/or a part-time job, are adequate. Since beneficiaries' investment asset allocation decisions and use of Social Security payments vary widely, a national online calculator cannot possibly include these factors, but individual beneficiaries need to consider them. If someone in the above illustration factors in the investment value of early retirement benefits, their actual break-even age is probably around 81.

It should also be noted that an option exists for retirees to change their mind about the age at which they collect Social Security. Those who wish to change the age at which they collect benefits can do so by taking the following steps: (1) withdrawing their application using Form 521 (Social Security Administration 2003), (2) repaying benefits received to date without interest, and (3) reapplying for higher benefits later at an older age. Typically, this is done by beneficiaries who receive some type of cash settlement with which to make the necessary repayment of previous benefits (Greene, 2008).

Decision-Making Factors

Health

Since the break-even age determines the comparative financial advantage of collecting Social Security at age 62 or later, personal health history is a key decision-making variable. If someone has a serious chronic condition or life-threatening disease and is expected to die within five to ten years, or less, taking benefits at age 62 is generally preferable to waiting until FRA. Unfortunately, given a pre-existing health condition, the odds are against living to the break-even age so there is no "pay-off" for waiting to collect a larger benefit check and running the risk of receiving no benefit at all. Putting the break-even age aside, people with severe health problems also may be unable to work and may need a replacement income source, especially if they lack adequate

invested assets. Individuals with a poor family health history may also opt for benefits starting at age 62 (Cochran, 2008).

Those who follow recommended health care practices regarding screening exams, diet, exercise, and not smoking are more likely than others to exceed average life expectancy and may benefit the most by delaying their receipt of Social Security benefits to FRA or later. Conversely, those with poor health habits and/or associated conditions resulting from them are at greater risk of experiencing a shorter lifespan. Three common examples of high-risk health conditions are smoking, obesity, and type 2 diabetes – all of which are associated with reduced life expectancy (National Institute on Aging, 2005). Doll, Peto, Boreham, & Sutherland (2004) found that men born in 1900 to 1930 who smoked lived 10 years less than lifelong non-smokers.

Financial Need

Financial need is another key factor in decisions about when to collect Social Security. Those who are unemployed (or unable to work for health reasons) and lack substantial savings for living expenses may feel that they have no other choice but to collect Social Security as soon as they are able. While Social Security was never intended to be a complete source of retirement income, it is for many people. Two out of three beneficiaries receive over half their income from Social Security, and it is the only income source for nearly one in five (National Committee to Preserve Social Security and Medicare, 2006). Currently, about half of all U.S. workers start collecting benefits at age 62 and 70% collect before FRA (Social Security Administration, 2007). In recent years, the latter percentage has been increasing, not because workers are retiring earlier, but because the age at which workers can collect full benefits has increased (Sahadi, 2007).

Marital Status

Single individuals have no one to depend upon but themselves for their Social Security benefits. For this reason, experts often advise unmarried workers, especially those with

limited retirement savings, to work as long as possible to maximize the amount received (Franklin, 2008). This is especially true if they lack 35 years of earnings, which is the maximum number of years of work used in benefit calculations. In the case of married couples, beneficiaries can either receive the benefit amount that is based on their own earnings record or half of their spouse's benefit amount. In the latter case, if their spouse delays benefits, their benefits also increase. Some exceptions apply, however, such as spouses who are federal employees and affected by government pension offset rules, which limit their potential benefits as a spouse, widow, or widower. Currently, unmarried persons who were married at least 10 years to the same spouse and divorced can collect on that spouse's benefit starting at age 62 (Social Security Administration, 2008b).

Marginal Tax Bracket

An individual or couple's marginal tax bracket affects the amount of Social Security benefits received on an after-tax basis. Before 1984, Social Security benefits were not taxed by the federal government. Since then, if the total amount of taxable pensions, wages, interest, dividends, other taxable income, and tax-exempt interest income, plus one-half of Social Security benefits (referred to collectively as "provisional income") is more than \$25,000 for singles and \$32,000 for married couples filing jointly, then up to 50% of benefits are taxed. If provisional income exceeds \$44,000 for singles and \$54,000 for joint filers, then up to 85% of benefits are taxed (AARP, 2001). Unlike Social Security benefits themselves, these dollar amounts are not indexed for inflation and, thus, affect increasing numbers of beneficiaries over time. Note that taxes on Social Security benefits are likely for married couples where one spouse collects benefits while the other remains employed, because in such cases household income is often pushed over the taxable limits.

Post-Retirement Employment Plans

Due to the Social Security earnings test, taking benefits at FRA is generally recommended for those who plan to continue working, especially workers who will earn substantially more than the annual limit. Otherwise, these beneficiaries will simply have most or all of their benefits withheld. In this situation, the Social Security Administration will recalculate their benefits, which will be subsequently increased at FRA to account for the amounts that were held back.

This year, in 2008, early beneficiaries under FRA lost \$1 in benefits for every \$2 earned over \$13,560 (Social Security Administration, 2008c). Note that a special rule applies for the year in which people reach FRA since many workers earn well above the earnings limit by working part of the year. Thus, in 2008, \$1 was withheld from benefits for every \$3 earned above \$32,120, until the month that FRA was reached (Social Security Administration, 2008d). Since the passage of the Senior Citizens' Freedom to Work Act of 2000, there has been no earnings test for people who reach FRA. At this point, they can earn any amount of salary or wage income without affecting their benefits.

Emotional and Psychological Factors

It has been well documented that baby boomers grew up skeptical of government since the days of the Vietnam War and Watergate. This, too, can color decisions about when to collect Social Security benefits. Baby boomers are well aware that their large numbers require some type of action by Congress to keep the Social Security program solvent. The longer it takes to make these changes, the more drastic changes in regulations are likely to be for future beneficiaries (e.g., additional taxes on benefits, reduced benefits, decreases in cost-of-living adjustments).

Fearful of future legislation that might result in a reduction in benefits, and hoping that they will be "grandfathered in," some boomers have made the argument that it is best to "get while the getting's good" and collect benefits as early as possible (Social Security Administration, 2007). Others have used a similar

rationale based on perceived uncertainty in their personal lives (Cochran, 2008). It is impossible to predict whether existing beneficiaries will be covered under new rules; or those currently in effect. In the past, changes have been gradually phased in with plenty of warning. However, if legislators wait too long to make changes this time, "grandfathering" may simply not be possible.

Impacts on a Beneficiary's Surviving Spouse

The decision to retire affects not only retiring workers but their survivors as well. Surviving spouses are entitled to 100% of their deceased spouse's Social Security benefits. Thus, waiting to collect benefits at FRA may result in higher income for a worker's surviving spouse, unless benefits based on the survivor's own work record are higher. The advantage of delaying benefits to FRA is especially evident for couples with disparate age and income levels. It is often advantageous for older, higher earners to work until at least FRA, or at least delay claiming benefits until FRA, to maximize benefits for their surviving spouse. Since the lower-income surviving spouse receives 100% of the higher earner's benefit after the higher earner's death, his or her benefit will be larger if the higher earner delays retirement. On the other hand, younger, lower earners have the option of claiming benefits early and receiving an unreduced survivor benefit later (Munnell & Soto, 2007). In other words, their decision to claim benefits prior to FRA does not affect the amount of their survivor benefits.

Typically, in many couples preparing to retire, the husband is the higher earner. While it might seem logical for women to collect Social Security benefits at a later age than men because they tend to live longer and are therefore more likely to reach break-even age, Munnell and Soto (2007) have found that just the opposite is true for many married couples. Their results show that couples tend to collect the highest benefits from Social Security during their retirement years together and for the rest of the survivor's life. Specifically, the "optimal claiming pattern" for married couples is to increase the value of the wife's benefits by

delaying the retirement of the higher-earning husband. The reason is that when a husband claims benefits at age 62, both his benefits and his wife's survivor benefits are permanently reduced by 25%. If he waits to FRA, both he and his widow receive full benefits. Thus, one person's decision to retire affects two people, even after death.

Munnell and Soto (2007) also calculated a variety of optimal ages to claim Social Security benefits based on the relative ages and earnings of both spouses. In many marriages, there are age differences between the spouses. In the above scenario, an older husband might want to retire at, say, 68, at the same time that his younger wife retires at 62. However, this could create a conflict in the marriage if one spouse does not want to continue working, but needs to continue working in order to earn higher Social Security survivor benefits for the other. In this situation, alternative plans (e.g., the purchase of life insurance) may need to be made to assure the financial security of the surviving spouse.

Munnell and Soto (2007) also noted that, while there are advantages for married women to claim Social Security benefits early, there are also benefits to remaining employed. By working longer, workers have an opportunity to increase their retirement savings and to postpone withdrawals from invested assets.

Decision-Making Resources

A variety of resources are available to assist baby boomers grappling with the decision of when to start collecting Social Security benefits. A valuable tool is the annual benefit estimate statement mailed to workers over age 25 by the Social Security Administration about three months before their birthday. Benefit amounts available at age 62, FRA, and age 70 are provided and can then be inserted into calculators such as the American Savings Education Council's *Ballpark Estimate* at <http://www.choosetosave.org/ballpark>. Retirement benefit estimates can also be accessed online through the Social Security Administration website at <http://www.ssa.gov/OACT/quickcalc>.

Tools to estimate life expectancy can assist consumers in providing a realistic picture as to whether they will reach the break-even age. For example, Purdue Cooperative Extension's website, *Planning for a Secure Retirement* (<http://www.ces.purdue.edu/retirement/>), contains links in Module 1b to life expectancy calculators found on two insurance company websites. Consumers can also enter the words "life expectancy calculator" into an Internet search engine and find dozens of online tools. Some calculators provide a user's estimated "real age" as well as an estimated life expectancy, reflecting lifestyle habits, health status indicators, personal and family history of disease, and other factors. A Monte Carlo retirement calculator can be another useful retirement planning resource (e.g., <http://budgeting-investing.ameriprise.com/budgeting-and-forecasting/>). This type of calculator estimates the probability of having sufficient assets throughout retirement. With this said, users should be cautious when using any type of online calculator since results can vary according to the design and underlying assumptions of the calculator.

Helpful Tips for Financial Educators

This article described how the decision to take Social Security benefits at age 62 or later should be based on consideration of both objective (e.g., break-even age) and subjective (e.g., projected longevity) factors. As noted by Coile, Diamond, Gruber, and Jousten (2002), delaying benefit claims can be beneficial in many cases. Below are some helpful tips for financial educators who are providing information and education to their students or clients about the timing of Social Security benefits.

1. Utilize available tools, such as calculators for break-even age and life expectancy to illustrate with students and clients the important role that key decision-making factors can have on future retirement security. Include a discussion of annual Social Security benefit estimates as part of monitoring a client's ongoing progress. Have a realistic discussion about

break-even age. While it may be a moot point for those unable to work who lack other retirement income sources and need the money, some individuals might be persuaded with relevant data to work longer to increase their financial security and that of their spouse.

2. Educate students and clients about studies (e.g., Muksian, 2004, 2006; Munnell & Soto, 2007) that demonstrate the financial advantages of waiting until FRA or later to collect Social Security, especially for married couples. Undoubtedly, many people take early benefits at age 62 because people they know do this or as part of a "take it while you can" mindset. Assuming no immediate financial need or health issues, advantages of delayed benefits should be explored. Educators can also incorporate frequently proposed changes to Social Security into their presentations and analyses, which will provide a meaningful range of possible outcomes.
3. Address emotional, as well as financial issues, related to the timing of Social Security benefits. Some workers who dislike their jobs may not want to "hang on" just to earn a higher benefit. Financial education and counseling may involve a discussion of alternative employment options or starting a business, as well as life insurance to protect survivors.
4. Use the discussion of Social Security break-even age and life expectancy as an entrée to discuss relationships between health and wealth and to gently prod clients to adopt recommended health practices (e.g., diet, exercise, and non-smoking) to positively impact their financial status. For additional information about health and financial behavior change, visit the *Small Steps to Health and Wealth™* website at <http://njaes.rutgers.edu/sshw/>.
5. Prepare a checklist for clients summarizing situations where it pays to take benefits early and when it pays to wait to FRA or later. The following table provides some key comparison points.

Take Social Security Benefits at Age 62	Take Social Security Benefits at FRA or Later
Plan to stop working completely or will earn less than annual earnings limit (\$13,560 in 2008)	Plan to keep working and will earn more than the annual earnings limit and have benefits withheld
Desire to claim early benefits with the ability to receive a higher survivor benefits later	Desire to increase benefits for self and/or surviving spouse by working longer
Poor personal health status and/or family health history (e.g., obesity, diabetes, smoker)	Family history of longevity and/or a high life expectancy calculator score
Have inadequate amounts of retirement income (e.g., pension and savings) before FRA and need the money immediately	Have adequate amounts of income from pension, savings, and earnings and can afford to wait until FRA
Have adequate amounts of other retirement income (e.g., pension and savings) and are not concerned about the early benefit reduction	Have inadequate amounts of other retirement income (e.g., pension and savings) and need to increase benefit amount for self and/or surviving spouse

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