

The Best Time to Claim Social Security? It Depends

Delaying Social Security benefits until age 70 offers the best return for retirees, but there are instances when it's helpful to claim as early as possible.

Christine Benz: Hi, I'm Christine Benz for Morningstar. Deciding when to claim Social Security benefits is a hugely complicated process, and it's compounded when you're trying to plan for two spouses. Joining me to share some recent research into this area is David Blanchett. He is head of retirement research for Morningstar Investment Management.

David, thank you so much for being here.

David Blanchett: Thank you for having me.

Benz: David, you took a look at optimal ages at which to claim Social Security. This is obviously a very complicated topic. There have in fact been new software tools that have popped up to help seniors make sense of this decision-making. Let's first cycle through some of the key factors that should go into making a good decision about what age to claim benefits.

Blanchett: First, this is one of the most important decisions for most retirees. I would advise anyone that's thinking about when to claim benefits to spend a lot of time on this. This is a very, very important issue. There is a lot of kind of unique considerations with Social Security. There is your health; how much you expect to earn if you're married; what your income is from other assets; your portfolio; how you plan to invest. There are all these kinds of unique considerations that make it kind of really hard to figure out what's best for everyone. Every person is different in terms of what is the best approach for each individual.

Benz: Whether you plan to continue to work is also in the mix.

Blanchett: Correct. Because if you claim early, [the Internal Revenue Service] can tax your benefits. There are all these very complicated rules involved with figuring out what is the best time to claim your Social Security.

Benz: And one of the biggies is truly unknowable, that's your expectation of your own life expectancy, because if you have some knowledge that you'll have a much longer-than-average life expectancy, delaying is the better strategy.

Blanchett: Yes. It's like any annuity. The longer you're going to live, the more the annuity pays off.

Benz: Ultimately, you concluded, as some other researchers into this area have, that many people would be better off waiting at least until their full retirement age, possibly even until the latest possible age which is 70, to claim benefits. Let's talk about what factors you determined in your research that point to delaying as being a good strategy.

Blanchett: When you think about Social Security claim age, when you can start receiving benefits, most people over the next five years, their full retirement age is age 66. The earliest they can claim is age 62. You can actually claim past age 70, but there is no benefit to doing so. So, if you wait until 70, you should definitely claim because you don't increase the benefit past age 70.

So the question is, "What age should I claim my benefits?" If you delay from age 62 to age 70, your benefit increases by 72% or 76%, but the problem is you have to fund income for that eight-year period. What I found was that Social Security is a very valuable benefit that is effectively an inflation-adjusted annuity, and the longer you can wait, the better off you usually are because it's really hard to replicate that kind of income with a portfolio.

Benz: One other point that you made that I think is really interesting, David, is that seniors sometimes experience cognitive decline, and that would argue against one of the reasons that people say sometimes you should take it as soon as possible that you can take that money and invest it. Let's talk about your thesis there.

Blanchett: Every study for the most part on Social Security talks about investing the difference. So if you claim at age 62, you'll get some extra income that you wouldn't get if you waited until age 66. You're going to invest those monies and then make up the difference in income over your life span. And I think that's a good idea; it's a good concept.

The problem is that investors' abilities to make good decisions declines as they age. So Social Security is a guaranteed inflation-adjusted annuity. And I think that's very viable for someone who is age 90 or age 95 who really doesn't have the ability to know what is a good investment, how should I be investing, or what can I actually afford to take out from my portfolio. So transferring money into an annuity I think is better the older you are for a host of reasons.

Benz: Let's talk about the thesis behind claiming earlier. In what scenarios would that strategy make sense? What would you want to have in your profile that would make that an effective strategy?

Blanchett: I think the number-one reason for someone to claim earlier is if they need to retire and they don't have savings at all. So if you are age 62 and you simply have to retire, you have no other savings, you have no choice. You can't choose to delay because you can't fund that with your saved assets. So that would be the person in my opinion who is ideal to claim early, or [it could also be] someone who is unhealthy. Delaying benefits is smart if you are going to live to age 85 or 90, but if you're going to live to age 75, you should probably claim as early as possible.

Benz: Last thing I want to touch on, and this opens a whole other can of worms, but spousal strategies for claiming Social Security. It's complicated enough for one person to figure out what to do, and it's even more complicated when you have two spouses, oftentimes of different ages, oftentimes of completely different earnings history. You've got maybe one spouse with a lot of earnings over his or her lifetime, the other one with fewer. Let's talk about some of the variables there and some of the key things that spouses should keep in mind when attempting to figure out the right age to claim benefits.

Blanchett: So a spouse's benefit is not affected by when the primary worker claims their Social Security benefits. It's basically when that spouse claims the benefits. The key benefit for the spouse is the spousal survivor benefit. When the primary worker passes away, the spouse is entitled to a benefit amount that is equal to the either primary worker's benefit or their benefit, whichever is greater.

So if the spouse has a smaller benefit, they get kind of an increase in their benefit when the worker passes away, and that can be significant for someone who didn't work or who is very young. So if your spouse is eight years younger, for example, and you're the primary worker, then if you pass away, the additional income your spouse can receive from your delaying benefits can be significant because the base spousal benefits is half of the primary worker's benefits. So your spouse's benefit can increase by a 100% or more by delaying past age 66 to age 70, for example.

Benz: If you have a much younger spouse, a good rule of thumb is to, if you possibly can, put off the receipt of that benefit because your spouse's benefit hinges on when you do your claiming.

Blanchett: Yes. Obviously the spouse will only receive that benefit if they outlive you, but there is still a definite benefit there if their benefit is a lot smaller than yours and they are a lot younger.

Benz: Let's discuss the thinking behind another common strategy called file and suspend. What goes on there, and where can that strategy make sense for people?

Blanchett: I guess my comment on that is there are lots of very complex, nuanced things you can do with Social Security. And if you're thinking about doing [file and suspend], I would highly recommend talking to a financial planner and get all the nuances in [such as strategy] correct. But the idea is that you can go ahead and start receiving benefits for your spouse and then get your full benefit later. So you can file and suspend benefits. You used to be able to actually claim benefits early and then say, "Wait a minute, I'm going to change my mind and pay them back." There was actually legislation back in 2010 that you can't repay benefits anymore. So Social Security is kind of an ongoing complex decision that is always changing.

Benz: Well, David, thanks for sharing your research. This is such an important area and as you say, such an important component of so many retirees' plans. It's good to hear some concrete strategies.

Blanchett: Thank you.

Benz: Thanks for watching. I'm Christine Benz for Morningstar.

Source: www.morningstar.com