FirstPoint Financial

Social Security Distribution Strategies

According to U.S. census data, there are approximately 75 million Baby Boomers on the verge of retirement. And over the next 20 years, roughly 10,000 people will be turning 65 years old each day. For many of these people, questions surrounding Social Security and when to begin taking benefits will be a major factor influencing their retirement decisions. Unfortunately, the concept of a Social Security distribution strategy is something few have considered.

It Pays to Wait

As more people become eligible to claim Social Security, the topic of maximizing benefits has become increasingly popular. Most strategies to maximize Social Security benefits are designed for couples who are married or divorced, and these strategies often provide increased benefits the longer one waits to claim them. And, while everyone eligible to claim Social Security benefits may do so as early as age 62 (60 for a widow or widower), one of the most important rules to remember is that distribution strategies intended to maximize benefits don't work as well if either spouse has taken benefits before full retirement age, which is currently age 66. In fact, for each year you delay taking Social Security benefits between age 62 and 70, you increase your benefits by 5% to 8% annually.

With regard to the age at which people claim their Social Security benefits, many people are not taking advantage of maximization strategies. According to 2011 statistics provided by the Social Security Administration, approximately 44% of benefits claims were by people age 62. Roughly 60% of claims beneficiaries were age 65 or younger. Less that 2% of claims were made by people age 70 or older.

While some people claim benefits out of necessity, other people simply claim benefits because they are eligible and do not fully understand the ramifications of claiming benefits early. Following are considerations and strategies to keep in mind as you seek to maximize Social Security benefits.

Spousal Benefit Assumptions

Social Security was created at a time when men typically worked full-time jobs and women stayed at home to raise children. While the demographics of married couples have changed, the underlying assumptions regarding Social Security benefits still reflect the demographics of when the program was created in 1935. As a result, when considering different benefit strategies, it's important to understand spousal benefits. Spousal benefits were created when Social Security was amended in 1939 to be more family-centric and help protect spouses and dependents who may not have had an earnings record of their own. Understanding how these rules work is critical to maximizing the longevity of a retirement plan.

A married individual is eligible to receive spousal benefits once he or she reaches age 62 years old and has a spouse who has filed to receive his or her own benefits. It is important to note, however, that individuals who file for Social Security benefits before turning full retirement age (66 years old), will automatically receive the greater benefit amount based on their own earnings record, or spousal benefit, assuming they have a spouse who has filed for benefits. This is an important consideration because distribution strategies are predicated on the assumption that individuals can choose to claim either spousal benefits or their individual benefits, but this choice only becomes available when an individual has waited until full retirement age before filing for benefits with the Social Security Administration.

File and Suspend

Using the "file and suspend" strategy, a higher wage earner files for benefits at full retirement age and immediately suspends payments. This allows benefits to continue to earn credits until the individual reaches age 70, while allowing the spouse to claim spousal benefits. The file and suspend strategy tends to be most effective for couples in which one spouse is the higher wage earner and the other spouse will be claiming a spousal benefit versus a benefit from his or her own work record. It also is most effective when the spouse claiming spousal credit is age 66, because he or she will be able to earn the maximum number of spousal credits based on the higher earning spouse's earning record. Once the higher earning spouse turns 70, he or she can begin receiving benefits that would have been growing at a rate of 8% per year from the time that individual reached age 66.

As an example, assume Joe is 66 and Jane is 64. Joe is still working and would rather delay taking Social Security benefits until he turns 70. Joe's monthly benefit at age 66 would be $3,000, which would grow to $3,960 should he delay benefits until age 70. Jane is a homemaker and has not established enough of an earnings record to qualify for her own Social Security benefits. Joe and Jane decide to have Joe "file and suspend" at age 66, which allows his benefits to continue to earn credits while also allowing Jane to receive spousal benefits. Because Jane elects to receive spousal benefits at her current age of 64, she receives a permanently reduced amount of $1,251 per month. Should Jane elect to wait until age 66 to receive spousal benefits, she would receive the full monthly benefit amount of $1,500. Over a 20-year period, assuming a 1.7% annual cost of living adjustment, waiting to take benefits at age 66 as opposed to 64 would result in a $26,645 difference in cumulative benefits.

Claim Now, Claim More Later

The "claim now, claim more later" strategy allows a higher earning spouse to suspend his or her benefits in favor of taking spousal benefits. This allows the higher earning spouse to earn credits until age 70, at which time he or she switches from taking spousal benefits to taking his or her own benefits. This strategy works best for couples who will both be drawing Social Security benefits based upon their own work records. To maximize the strategy, both spouses must file for benefits at age 66.

For example, assume Joe is 66 and Jane is 66. Joe and Jane both plan to retire and want to maximize the earnings of their Social Security benefits. Joe's monthly benefit at age 66 would be $3,000 but would grow to $3,960 if he were to wait until age 70. Jane's monthly benefit at age 66 would be $2,500. They decide to both file for benefits, and immediately suspend Joe's while taking spousal benefits based on Jane's earnings record. This means Joe's monthly benefit will be $1,250 and Jane's will be $2,500 for a combined benefit of $3,750. When Joe turns 70, however, he begins taking benefits based on his own record, at which time, his monthly benefit $3,960, for a combined benefit of $6,460.

A common question that arises from this strategy is why both spouses don't claim spousal benefits on each other. Under current law, spouses are restricted from taking spousal benefits on each other at the same time.

Single and Divorced

People who were married to a former spouse for 10 years or longer are also entitled to receive benefits based on the earnings record of their former spouse, as long as they have not remarried. This means that as long as an individual is age 62 and has not remarried, he or she may file for spousal benefits based on a former spouse's work record, regardless of whether or not the former spouse has filed for benefits or is remarried. A two-year period must pass from the time of the divorce until an individual can claim benefits on a former spouse. The two-year period is waived if the former spouse is already receiving benefits.

As an example of how a "claim now, claim more later" strategy works for a divorced couple, consider Joan, 66, who was married to Jim for 15 years. Three years ago, Jim and Joan divorced and Joan is preparing to retire. Because Joan was married to Jim for more than 10 years, she is eligible to claim benefits on Jim's work record. Joan is also eligible to claim benefits on her own work record which, at age 66, would be $2,500. Joan decides to file for the spousal benefit at $1,500 monthly, allowing her own benefit to continue earning credits. When she turns 70, she switches to her own monthly benefit, which has at that time increased to $3,300.

Survivor Benefits

Another important factor to consider when analyzing Social Security distribution strategies is survivor benefits. While many people delay taking benefits to increase distribution amounts in anticipation of living longer, one commonly overlooked consideration is what happens to a spouse's distributions when the other spouse dies. In the "file and suspend" strategy outlined previously, Joe suspended payments until age 70, at which time he receives a monthly benefit of $3,960. His wife, Jane, elects to take an early spousal benefit at age 64 of $1,251 monthly. If Joe, however, were to die at age 75, Jane would receive his monthly benefit $3,960 as opposed to her previous monthly amount of $1,251.

Conclusion

Many people do not view Social Security distribution planning as a retirement strategy. However, many factors including age, life expectancy, marital status and earnings history play a critical role in identifying an appropriate distribution strategy. Choosing the right Social Security distribution strategy for your particular situation can impact your overall retirement planning strategy. If you have questions or would like to discuss your particular situation, please contact your advisor at 1-855-579-6910 or visit our website at www.firstpointfinancial.com.