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Delaying Social Security Benefits

Overview: It can be tempting to begin taking Social Security benefits the moment you are eligible. The following discusses some reasons why you may want to delay taking your benefits.

You're ready to retire and have paid a lot into the Social Security system. But now that you're finally eligible for benefits, you might be hearing your advisor and other experts say, "Not yet!" Why should you have to wait any longer?

Reductions and Credits

First of all, if you apply prior to your full retirement age (FRA), you will receive a reduction in your benefits. For example, if your FRA is 66 and your full benefit is $1,000 a month, then you will receive $1,000 month if you claim at 66. However, if you claim at age 62, that benefit is reduced by 25 percent to $750 per month.

On the other hand, you will receive delayed retirement credits for every year you delay taking benefits after your FRA. For individuals with an FRA of 66, this means an 8 percent increase each year. So by delaying to age 70 (or the age at which you would receive the maximum benefit), you would receive a 32 percent increase over your full benefit. Using the example above, you would now be entitled to $1,320 per month ($1,000 x 132 percent) for the rest of your life.

Finally, claiming early doesn't give you any additional benefit, provided you have an average life expectancy. Regardless of your claiming age, your benefits are calculated so you'll receive the same total benefit as long as you live to your average life expectancy. So if there is any chance you might live longer than average, delaying benefits is like buying longevity insurance — something to protect you from outliving your assets.

It's Not Just About You

If you take $1,320 at age 70 instead of $750 at age 62, you'll have to live to age 80 to make that decision worthwhile. So maybe you don't think you'll live that long and choose to claim early. But if you're married and claim early, you could be reducing your spouse's benefit as well.

That's because if your benefit is higher, your spouse receives your benefit in the form of a survivor's benefit should he or she outlive you. For example, if your spouse outlives you by five years, the survivor benefit would be $45,000 (if you claimed at 62) versus $79,200 (if you claimed at 70), which is equal to a 76 percent increase.

The Investment Game

You may be considering drawing benefits early and investing the money so that the gains would offset the benefits of delaying. But remember, for each year you delay past FRA, you earn eight percent per year. That benefit is not only guaranteed but also indexed to inflation. It is unlikely you would be able to find a similar investment vehicle without taking on additional risk.

The Costs of Delaying

For each year you delay, there is a "cost" equal to the amount of the forgone benefit. If you are age 66 and you delay filing for just one year, you've given up $12,000 ($1,000 monthly benefit x 12 months) for a $12,960 annual benefit at age 67. Is that additional $960 per year for the rest of your life (and possibly your spouse's) worth $12,000?

To approximate the cost, you could buy an immediate annuity at age 67 that will give you $960 per year for the rest of your life, is indexed to inflation and has a 100 percent survivor's death benefit. However, such an annuity costs more than $21,000, not $12,000. And while the Social Security benefit is guaranteed by the U.S. government, your annuity relies on the credit quality of the insurance company.

Summary

When considering when to start taking your Social Security benefits, your decision should best fit your situation. If the security of receiving benefits now helps you to sleep better at night, then that may be the right decision for you. This is especially true if you have no other sources of income and can't afford to delay Social Security benefits.

However, if you can afford to delay claiming, carefully consider the benefits of delaying and the costs of claiming early. Make sure that you plan not only for your lifetime but your spouse's as well. And most importantly, try not to focus on what happens by delaying filing and dying early. Instead, focus on the possibility that you and your spouse might live a long time and ensure that you have the right strategy in place.

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