BMO Retirement Institute Report

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Retirees not maximizing Social Security retirement benefits

For about 60% of the retiring population, Social Security retirement benefits provide the majority of their retirement income.[1] With factors such as the volatile stock market, chances of living longer, rising health care costs and fewer defined benefit pensions; these factors all contribute to reducing a retiree's nest egg. Social Security may play an even bigger role in ensuring retirement security for the next wave of retirees. Unfortunately, based on the evidence, retirees are taking their benefits too early, are not making informed decisions and are not aware of options and strategies that could result in higher benefits. This can cost them and potentially their spouses tens of thousands of dollars in the long run. That is why it is so vital that retirees do some research and seek advice so they can make an informed decision about when to claim their Social Security benefits.

The impact of timing

The decision of when to take Social Security has an impact that can last a lifetime, and it can be especially significant for couples. In a situation where one spouse has a significantly higher benefit, when they claim will have an effect on the combined lifespan of both. In particular, if the main breadwinner claims too soon, then the spousal benefit will be 50% of a smaller monthly check and the widow's benefit would be 100% of the smaller check for the survivor's lifetime.

While you can start receiving Social Security as early as age 62, you will receive a reduced amount for the rest of your life. By waiting until your full retirement age ("FRA"), which varies based on your year of birth, or even later, you will receive a higher amount for the rest of your life.

The BMO Retirement Institute was established to conduct research and provide thought-provoking insight and financial strategies for those individuals planning for, or currently in, their retirement years.

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Example of benefit reduction for an individual with a FRA of 66[2]	
Age	**Monthly benefit**
62	$1,500
66	$2,000
70	$2,640

Know your full retirement age	
Year of birth	**Full retirement age**
1943–1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 or later	67

In this example, taking Social Security at age 62 results in a reduced benefit of $1500/month, typically a 6%-7% per year reduction.

In the example shown in the table above: taking Social Security at age 62 results in a reduced benefit of $1500/month, typically a 6%–7% per year reduction. By waiting until FRA (in this case age 66), the benefit will be $2,000. Waiting until age 70 and using what are called "delayed retirement credits" results in the highest lifetime benefit. For this example: $2,640, a 32% increase (8% for each year of waiting). This is a substantial amount, given today's low-interest-rate environment; where else can you get a guaranteed 8% return on your money? Therefore, by waiting until FRA, a person could receive an additional $25,000 in total Social Security benefits over a life expectancy of 85 years, and more than $61,000 if he or she lives to age 90.[3]

With the exception of a 12-month window, during which all benefits can be paid back and the decision to begin to collect Social Security benefits reversed[4]; the choice to receive benefits is irreversible and can have a long-term impact on the lifetime benefits received – so choose wisely.

91% agreed that waiting to take benefits increases the monthly amount they will receive. However, 48% are currently collecting or planning to collect before full retirement age.

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What is influencing people to take Social Security when they do?

The impact of taking benefits early is fairly well known; in our survey, people were aware that if you file a claim early, then you would get a reduced monthly income amount. Furthermore, 91% agreed that waiting to take benefits increases the monthly amount they will receive. However, 48% are currently collecting or planning to collect before full retirement age. There are many reasons why retirees may take their Social Security retirement benefits early.

1. Too many variables

Retirement comes with a series of decisions:

- At what age will you retire?
- At what age will your spouse retire?
- Will you work part-time during retirement?
- How much will you spend?
- How should you invest your savings?
- When to collect Social Security benefits?

The decision on when to collect Social Security should not be made in isolation, as it may be influenced by many of these questions. For instance, claiming early and living beyond normal life expectancy may result in lower total lifetime payments than claiming at or past FRA. On the other hand, given a lack of personal savings or employer pensions, some people might require Social Security for their daily living and cannot afford to delay. From a behavioral economics perspective, we know that having too many options can result in confusion and paralysis, and often the default mentality in such a case is to simply take the benefits early.

2. Lack of knowledge

Such an important decision should be given careful consideration, particularly in the case of couples, where the impact of not maximizing benefits has the greatest impact. However, in our survey, 52% of respondents were not knowledgeable about strategies to maximize Social Security benefits in general and 62% had not actively looked for information regarding Social Security. As many as 80% said that the Social Security Administration website would be their primary source of information and only 25% mentioned a financial advisor as a source of information and guidance. Most surprisingly, 61% have not discussed their Social Security decision with anyone! Such a "go it alone" approach comes with some risk. While the Social Security Administration may be very helpful, their primary focus is to explain the rules, rather than provide advice on maximizing lifetime benefits.

Individuals should not base their decision on fears that Social Security is running out of money. In our survey, 83% were concerned about the viability of Social Security: which could easily lead to thinking that "a bird in the hand is worth two in the bush."

3. A bird in the hand...

Individuals should not base their decision on fears that Social Security is running out of money. In our survey, 83% were concerned about the viability of Social Security: which could easily lead to thinking that "a bird in the hand is worth two in the bush." Currently, however, there is a large surplus credited to the Social Security Trust Fund. The Brookings Institute estimates that even in 2022, the Social Security Trust Fund will have a surplus of $3.7 trillion in reserves. It's true that as more and more baby boomers retire, the annual amount of total revenue received will exceed the inflows from taxes, and barring any changes to the system, the surplus is expected to run out in approximately 2036. For someone turning 66 now, that will be when they are 90. Even then, however, without any changes, Social Security will still be able to pay close to 80 cents for every $1 of benefit.[5]

The claiming decision appears to be often based on employment status rather than on any strategic long-term approach to lifetime income.

4. Retirement = Social Security (But shouldn't always)

Unfortunately, Social Security benefits have become synonymous with retirement. Part of that could be a short-term outlook based on the attitude, "I want to get my Social Security benefit back as soon as I retire, because I've paid into it for so many years". The reverse is also true: those who wait to take benefits generally do so because they have continued to work. In fact, our survey research shows that 64% of those taking their Social Security benefits past FRA were doing so because they worked past FRA. Therefore, the claiming decision appears to be largely based on employment status rather than on any strategic long-term approach to lifetime income.

The decision to delay is easier for some. For instance, those able to access other income sources or personal savings after retirement have the option of waiting to tap into Social Security and that should be considered a viable strategy. Also, those who continue to work

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past FRA, even part-time, may be able to delay taking their benefits while continuing to work, and enjoy a higher benefit later.

Besides the Social Security consideration, it is important for retirees to know that there is no such thing as early Medicare. When employees retire, they are no longer covered under their work plan for health insurance, and if they retire at 62 they will have to buy an expensive out-of-pocket policy for ages 62 to 65.

For most, **Retirement = Social Security claim**

For those claiming early, 69% said it was because they were no longer working (46% retired early, 23% lost job/forced to retire)

For those who waited past FRA, 64% said it was because they are still working.

What about spousal options?

One of the least-known benefits is spousal options. Based on our survey results and other research, it appears that retirees are not fully aware of all their options. For example, almost half of respondents said they were not knowledgeable regarding spousal benefits.

By not being aware of the benefits, a spouse could be throwing away thousands of dollars each year for the rest of his or her life – and if the surviving spouse happens to be a woman, there is even more concern, because women have a longer life expectancy, and they tend to have lower incomes and lower Social Security benefits.

A strategy known as "restricted application" allows one spouse to make a claim on the other's benefits, while his or her own benefit earns delayed retirement credits. Another strategy, called "file and suspend," is used by the main breadwinner (let's assume the husband) to file a claim for benefits so that his spouse can claim spousal benefits, but then suspend his own benefits to earn delayed retirement credits.

49%: not at all or not very knowledgeable about spousal benefits.
56%: not at all or not very knowledgeable about widow benefits.
39%: not aware they can receive up to 50% of spouse's benefit.
47%: not aware a widow gets 100% of spouse's benefit.

Ex-spouses too

As discussed in a previous BMO Retirement Institute Report, Single in Retirement[6], statistics point to the importance of being prepared for the possibility of being single in retirement. Research for that earlier report found that 27% of those 65 and older were widowed and 12% were divorced. Therefore, almost four in ten will be able to make a claim on a spouse or former spouse's benefit, so it is important to know the basic benefit rules for widows and divorced spouses.

A widow receives 100% of her spouse's benefit, (technically called a "survivor's benefit") if she is at FRA and if that benefit is greater than her own benefit. If the widow takes benefits prior to FRA, then she gets a reduced benefit (similar to the reduction seen earlier). The same rules apply as with spousal benefits; while taking the survivor benefit, widows can allow their own unclaimed benefits to increase in monthly amount by earning delayed retirement credits and switch to that benefit later.

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Divorced spouses need to be aware that they can apply for the same benefits as married spouses. The basic rules for divorced spouses are that the marriage must have lasted for 10 years, they must be at least age 62 and not currently married. There is actually more flexibility for ex-spouses than married spouses as to when they can claim benefits. For instance, as long as they have been divorced for two years, then they only need their ex-spouse to be eligible for benefits; they don't have to wait for them to actually file for them. Furthermore, assuming they have not remarried, divorced spouses are eligible for the 100% widow benefits.

Have a financial plan

Ideally, Social Security benefits should be part of a financial plan that includes other income sources, and it should be discussed as a strategy just like investments. Social Security is one of the few retirement income sources that comes with a built-in cost-of-living-adjustment (COLA), which is a big advantage when it comes to combating inflation's erosion on buying power. Therefore, it is vital that couples discuss their strategy for taking Social Security as part of their retirement plan. Our survey, however, revealed that only 54% of retirees have a financial plan. While those aged 45–54 are the least likely to have a financial plan (only 42% have one), they are in a perfect position to start thinking about where their retirement income will come from and to identify any shortfalls in savings well in advance of their retirement dates. In fact, in our survey we asked those who had already retired what advice they would provide to pre-retirees, and 69% of those already in retirement recommended that pre-retirees make a financial plan.

What advice would those already retired give to those nearing retirement?

As many as 69% recommended that they make a financial plan.

Conclusion

With the reality of longer lifetimes, maximizing retirement income, including Social Security benefits, becomes more and more important. To maximize their benefits, individuals should better understand their options and the impact that taking Social Security at various ages will have on their lifetime income. Couples in particular need to discuss a strategy for Social Security and be aware of the options available to maximize their benefits. Retirees should educate themselves on the various aspects of Social Security and get advice on what's best for their particular situation. Lastly, a financial plan for retirement should incorporate Social Security benefits along with other retirement income sources to provide a comprehensive roadmap for covering lifestyle needs, wants and wishes.

1 Source: Economic Policy Institute, "Social Security provides the majority of income for three fifths of Americans age 65+," July 20, 2011.
2 SSA.gov Retirement Planner: Benefits by Year of Birth.
3 Based on hypothetical case. Calculation for lifetime Social Security payments only, not including investment returns, and based on annual COLA increase of 3%.
4 SSA.gov Retirement Planner: If You Change Your Mind.
5 Gary Burtless, Brookings Institute, "Social Security Went 'Cash Negative' Last Year But Private Pensions Went 'Cash Negative' 25 Years Ago," November 17, 2011.
6 BMO Retirement Institute Report, Single in Retirement, US Edition, March 2012.

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