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Considering Early Retirement? Social Security Primer – Part 2

In our last issue we addressed the importance of the decisions we must make about when to start taking Social Security benefits and introduced certain strategies available to married couples. While many people wish to retire as soon as they can, and the number of Americans who begin receiving Social Security benefits early has increased since 2008, good planning should involve an analysis of the earning and investment power we relinquish when we stop working at age 62.

In this article, we review the principal reasons to delay the onset of Social Security benefits until "full retirement age" (FRA) and discuss how to maximize benefits for the surviving spouse.

First, it is important to refer to the charts provided by the Social Security Administration. These charts help you identify your individual FRA, which is based on your year of birth. The longer you refrain from accessing benefits, the greater your monthly benefit will be. If you begin receiving Social Security benefits before FRA, you forfeit the additional monthly income that you would have received had you waited until your FRA to begin receiving benefits. For instance, if you forego taking your benefit until FRA, the benefit will be as much as 33% higher and, if you delay taking benefits until age seventy, your benefits will increase another 32%. Your annual cost-of-living adjustment is also based on your benefit. Your adjustment will be permanently lower if you take benefits early.

If you are contemplating retirement, you must consider a variety of factors: leaving a job with good pay at age 62 means that you are not likely to replace that income if you later need to return to the work force; you will not qualify for Medicare until age 65; you will have to pay for private health insurance in the interim. It is interesting to note that the cost of private health insurance is rising faster than inflation or Social Security cost-of-living increases. Thus, by taking your Social Security benefit early you essentially reduce your benefit and then use it to pay for health insurance until you qualify for Medicare. On the other hand, if you keep working past age 62, you can build your retirement savings by taking advantage of "catch-up contributions" to tax-advantaged savings plans. These "catch-up contributions" allow you to exceed the normal limit on pretax contributions to 401(k) plans, bolstering your retirement savings. Also, because the Social Security Administration calculates your benefit on your 35 highest years of pay, if you are earning at the top of your employment history, the benefit amount for which you are eligible is still increasing and delaying retirement can boost your final benefit amount.

What about taking early retirement benefits based on your surviving spouse's work record? When you claim benefits at age 62 based on your spouse's work record, your benefit is reduced by 30% of what it would be at your FRA. The sophisticated strategies, "claim and suspend" and "claim now, claim later," discussed in our last issue are not available until at least one spouse reaches FRA. Moreover, upon your death, your spouse is eligible to receive your monthly Social Security payment as a survivor benefit if it is higher than his or her own. When you take Social Security before your FRA, you are permanently decreasing your spouse's survivor benefits. Delaying your claim provides extra security for your spouse.

The rules for surviving spouses are complicated and it is worth consulting with the Social Security Administration to help frame your options, especially if you plan on marrying again. In a nutshell, if you are widowed, you are entitled to receive the higher of your own benefit, based on your work history, or your deceased spouse's benefit. If you wait until your FRA, you can claim 100% of your deceased spouse's benefit. There are two strategies to consider here too. If you are under 70, you can claim a survivor's benefit and let your own benefits increase to their maximum, at age 70, and then claim under your own work history. The other strategy, which requires that the marriage was at least 10 years of duration, is to claim your own benefit now, as a widower, and switch to a survivor's benefit later. Survivor benefits continue to increase, after a spouse dies, until the survivor reaches FRA.

Retirement planning takes time and energy but it is an investment that will help you maximize your Social Security benefits and have a more secure retirement.