Claiming Social Security at 70 Can Cost You: T. Rowe Study

DECEMBER 4, 2013

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Waiting to make sure you maximize your benefits may undermine retirement income. Yes, you read that correctly.

(Photo: AP)

For all of Social Security's solvency problems, Americans, who are notorious for claiming benefits early and therefore leaving lots of money on the table, are doing their part to sustain the program.

But the savvy and disciplined Americans who delay claiming till age 70 to maximize their benefits may also be undermining their retirement income.

Yes, you read that correctly. It is almost a cardinal rule among financial advisors that their clients (in good health) should delay claiming—even past full retirement age of 66—to capture the 7% to 8% annual benefit increase that comes with each year's delay till age 70.

But T. Rowe Price has crunched some numbers and found that what it calls a "split strategy" may hold the greatest advantage for an average couple.

In that approach, the lower-earning spouse claims Social Security benefits as soon as possible — currently age 62 — while the higher earner takes spousal benefits at full retirement age of 66 while delaying taking his own benefits till age 70.

How can this be better than both waiting to claim maximum benefits at 70?

The reason, according to T. Rowe's Christine Fahlund, who performed the calculations, is that there are two key financial inputs in the financial equation: Social Security benefits and the couple's retirement savings.

"You don't want to dip into savings more than you have to," she said in an interview with ThinkAdvisor. "If you use the maximize strategy, chances are that's exactly what you'll be doing."
The finding came about as a result of the feedback T. Rowe gets from investors, who typically want to retire early.

"Although we espouse working till 70…most people are going to choke on that, saying "It's a nice idea, but not for me,'" Fahlund says. "You want to retire early, we get it."

Fahlund's recent study is based, as it must be, on various assumptions about the age, income and mortality of a retiring couple, but T. Rowe Price's free online tool allows people to customize their retirement for their own goals and finances.

But in the fairly conventional scenario of Fahlund's study, the maximize strategy (i.e., wait till both are 70) forces an average couple to dip into their savings in order to hang on till age 70, resulting in $80,000 more in retirement account withdrawals, on average, than the split strategy.

"It [the study] should be a head turner because the mantra is so clear: 'Your client should wait, your client should wait,'" Fahlund says, adding that "the majority of tools say 'we can get you more…over your joint lifetime.'"

But the senior financial planner at T. Rowe Price says that more is not always best.

"You need to consider this as part of a larger strategy. It's not only about taking Social Security. It's also about taking withdrawals, and what year you take withdrawals.

"An advisor can control with the client the actual year you begin taking withdrawals…Make sure that the higher-earning breadwinner works until 70," but she continues, if a couple plans on retiring early, "I better have some Social Security [from the lower-earning spouse] or I'm going to have to withdraw from my savings. And that's not healthy."

So the split strategy, in essence, is all about integrating Social Security claiming with retirement account withdrawals.

A further reason why this approach is crucial to sound planning is that advisors do not know the date of their clients' death, and therefore cannot control for that.

"So it's important to focus on front end [by delaying dipping into savings]. And what you're doing about back end is that making sure whoever survives gets the highest possible benefit from Social Security for the rest of their life," Fahlund says. "You want to optimize for the survivor."

In Fahlund’s hypothetical case, survivors in both the maximizers and optimizers (using the split strategy) get the same high benefit since the highest-earning couple started claiming at 70 (and a survivor can claim her spouse’s benefit after his death).

But on the front end, the split strategy resulted in a hypothetical $3 million in joint lifetime withdrawals versus a higher $3.1 million in the maximize strategy.

Ironically, the split strategy resulted in higher joint income from Social Security as well ($1.5 million vs. $1.4 million for maximizers) since withdrawals for one spouse started at an earlier age.

While a split strategy may be advantageous over the maximize strategy, both are significantly preferable to the early strategy, where Social Security benefits total just $1.1 million and savings withdrawals a whopping $3.4 million in T. Rowe’s hypothetical.

Unfortunately, however, that approach is by far the most prevalent today, Fahlund notes.

The principal reason for that, according to the feedback Fahlund gets in her work, is the widespread fear that Social Security will go broke.

But Fahlund says that fear is based on a misunderstanding. “Your benefit will be cut by 25% [when Social Security reaches its current estimated depletion date of 2033]—if nothing more is done in the system to tweak it. That’s the worst-case today,” she says, adding that this misunderstanding “justifies what they want to do anyway.”

Fahlund says upwards of 70% of Americans are claiming Social Security benefits at age 62, and only about 5% wait till age 70.