How to Maximize Your Social Security Benefit

Claiming Social Security in the right way can maximize your retirement income. Adviser Anthony Bartlett provides the details.

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By Anthony Bartlett

Social Security is complicated. Claiming benefits in the right way can maximize retirement income. If the best claiming strategy isn't used, benefit payments will be less than optimal and the quality of retirement, which can last 25-30 years, will be seriously impacted. Thousands of dollars may be left on the table, adding up to a significant sum of money over the years.

Benefits can only be claimed once—there's no do-over. Once you claim, that is the benefit you receive for the rest of your life. And while Social Security staff can give information and answer questions, they can't give advice. They won't tell someone about options unless they're asked.

Nine out of ten people over age 65 receive Social Security benefits. For 32% of them, it represents 90% of their total income. How and when to begin receiving benefits is one of the most important decisions they'll make. Qualified individuals can begin receiving benefits from ages 62 to 70. There are nine options for a spouse, giving a total of 81 possible start date options. With three different strategies, it gives 243 options, more than enough to confuse anyone except an expert.

Social Security retirement benefits are calculated using the highest 35 years of earnings. If the earnings history is less than 35 years, zeroes are used in the benefit calculation which reduces payment amounts. The more a person earns, the more they pay into Social Security, and the higher their benefit will be.

A wage index factor is applied to adjust earnings forward to show in current dollars. The sum of these indexed earnings is divided by the total months worked (12 months times 35 years or 420 months) and generates the Averaged Index Monthly Earnings (AIME). Once the AIME is determined, Social Security uses a formula to calculate the Primary Insurance Amount (PIA).

PIA is the sum of three different percentages of portions of the Average Indexed Monthly Earnings (AIME). For example, if an AIME is $6,000, the PIA is: 90% of first $960 or $806, plus 32% of the amount between $960 and $5,785 ($4,101) or $1,312, plus 15% of the amount over $5,785 or $185. Therefore the PIA is $2,170. The maximum monthly benefit is $3,775.

Starting in 1983, an adjustment began for determining the full retirement age (FRA). For every year of birth, it increases by two months. For example, for someone born in 1956, the FRA is 66 years and four months. For someone born in 1957, the FRA is 66 and 6 months. For those people born between 1943 to 1954, the FRA is 66.

When determining the best age to begin collecting, life expectancy must be considered. Based on current statistics, there is a 50% chance of one person in a couple living to age 92. If a person begins collecting at age 62, they will receive a smaller benefit for a longer period. Conversely, someone who doesn't claim until age 70 will get a larger benefit for a shorter period.

If there is a lower-earning spouse, at FRA he or she can get 50% of their spouse's primary insurance benefit. The lower-earning spouse’s benefit at FRA must be less than 50% of the higher-earning spouse. This is reduced pro-rata between ages 62 and 66. At age 62, the lower-earning spouse would get 35%, not 50%. The higher-earning spouse must be receiving benefits for the lower-earning spouse to also collect.

A divorced spouse can claim benefits based on their ex-spouse’s earnings record. To do so, the marriage must have lasted 10 years or longer. The claiming spouse must be 62 years of age or older and not be currently married. If the claiming ex-spouse is married, he or she cannot collect benefits on their former spouses’ record unless their current marriage ends by death, divorce, or annulment. If the second spouse is deceased, benefits can be claimed on the first marriage if it lasted 10 years or longer or on the second spouses’ record as long as the marriage lasted at least nine months. If the ex-spouse is deceased, benefits can be claimed at age 60. A claiming spouse is eligible to receive 50% of the ex-spouse’s retirement benefit. If he or she dies before the claiming spouse, the full retirement benefit can be received. If the claiming spouse claims the benefit before their full retirement age, the benefit amount will be reduced.

If retirement benefits are claimed at age 62—the earliest age possible—it is a permanently reduced benefit. It is generally 75% of what an individual is entitled to based on their earnings record. If the individual waits until full retirement age—which is dependent on the year in which they were born—they will receive their full benefit. If they delay even longer, they get an 8% increase for every year they wait until age 70. That provides a potential increase of up to 32%.

If a person is under their full retirement age and continues to work while receiving benefits, there is an earnings penalty which is a reduction of $1 in benefits for every $2 earned. In the year they reach full retirement age, for every $3 earned, $1 is deducted from a person's checks. However, starting from the month in which they reach full retirement age, there are no earnings restrictions.

Each person contemplating receiving Social Security benefits should establish an account on the Social Security website. Through it, they will be able to see their benefit estimates at ages 62, full retirement age, and age 70. The earnings history and latest statement are also available. If they prefer, they can visit a local Social Security office.

It is vitally important that a Social Security claiming strategy is aligned with an individual's financial portfolio. If it is not, it will possibly have an adverse impact on that person's overall financial situation, including retirement asset placement and the sequence of withdrawals. By making intelligent decisions, the longevity of their portfolio will increase. Their standard of living in later years will be better and, by taking advantage of coordinating income sources, help minimize taxation. With the Social Security election strategy, a bucket distribution strategy, the sequence of distributions from specific assets, must be considered.

There are several ways to file for benefits:

· You file, spouse files

· You file restricted, spouse files if date-of-birth is before January 1, 1954

· Spouse files restricted, you file if date-of-birth is before January 1, 1954

· Widow files on deceased spouse's record

· Widow files on deceased spouse's record and switches to their own benefit

· Divorced files on ex-spouse's record

· Divorced files on ex-spouse's record and switches to their own benefit

A unique strategy for persons born before 1954 is the ability to receive a lump sum equal to six months' benefit receive the benefit at full retirement age. It's an "eat your cake and have it too" scenario.

Social Security, and a financial advisor who is performing a software analysis, need this information to calculate the options for receiving benefits:

· Single or Married

· Birth Years

· Client's Monthly benefit

· Spouse's monthly benefit

· Client Life Expectancy

· Spouse Life Expectancy

· Investment ROR

· Cost of Living Adjustment

In today's complex environment, a three part process is necessary to realize the most advantageous retirement income. The first part is determining the optimal Social Security claiming strategy. The second part is assessing asset placement which includes using qualified money with non-qualified money. Essentially, it is determining what type of account should hold what type of investment to maximize return and minimize taxes. The third part is determining a distribution strategy utilizing a buckets approach. In the past, asset placement and distribution strategy were completed with Social Security treated as a necessary step but not part of a comprehensive process. Times are far more complicated now than in the past and a Social Security optimization strategy must be determined before any other parts are completed since that income is, in many cases, the cornerstone of retirement income.

Other distributions strategies include the 4% withdrawal rule, fixed dollar withdrawal, fixed percentage withdrawal and systematic withdrawal.

The 4% rule is that a retiree withdraws 4% of their retirement savings in the first year of retirement. In each subsequent year, an additional 2% is added to adjust for inflation. This strategy is simple and provides a set income each year. Market volatility is not considered and could adversely affect retirement savings.

Fixed dollar withdrawal is also a simple strategy that provides a fixed dollar amount over a certain period. It does not account for inflation and may require liquidation of more assets to meet the required amount in a down market.

A fixed percentage withdrawal requires the withdrawal of a fixed percentage of assets each year. While simple to follow, the income will vary as the amount of assets shrinks.

A systematic withdrawal is withdrawing the income produced by the investments allowing the principal to continue to grow. The amount withdrawn each year will vary and may not keep pace with inflation.

As you can see, claiming Social Security benefits is more complex than many people think. The time spent determining the most advantageous claiming strategy is well worth it. However, an individual relying on only available information may still make a strategy that is not the best. With the right planning, Social Security benefits are maximized, which allows for a more secure and comfortable retirement. Working with an expert on Social Security claiming is one of the wisest things a person can do.

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