Potential Downsides Of Claiming Social Security Benefits At 62

Waiting until full retirement age or longer may provide a significant boost to clients' benefits

When it comes to Social Security, many people find it tempting to take the money and run as soon as they become eligible for benefits—typically at age 62. After all, they have likely been paying into the system for much of their working lives, and they're eager to start receiving their benefits. Plus, guaranteed monthly income is nice to have.

But claiming benefits at age 62, rather than waiting until full retirement age (FRA), can be a costly move that results in reduced lifetime benefits. FRA ranges from 65 to 67, depending on the year in which a person was born. Annual cost-of-living adjustments (COLAs) are based on this benefit. Therefore, clients who begin claiming Social Security at 62 start with reduced benefits, which means their future COLAs will be lower too.

For clients who can afford it, waiting is often the better option. Of course, this decision should be based on how much they've saved for retirement and their other sources of income in retirement. While in general many people would benefit from waiting to their FRA or even longer to start receiving payments, others may need the income sooner and may lack the resources necessary to meet expenses during the delay period.

Consequences of claiming Social Security benefits early:

- Monthly benefits reduced by 25%
- Reduced spousal benefits
- Reduced survivor benefits
- Lost opportunities to use advanced Social Security planning strategies for couples

The Consequences of Claiming Early

Consider the following hypothetical example. Colleen is 62, with an FRA of 66. If she starts taking Social Security benefits at 62, she will receive $1,200 a month. However, if she waits until her FRA to collect, she will receive 33% more, or $1,600 a month in Social Security. If she waits until 70, her benefits will increase another 32%, to $2,112 a month[1].

If she were to live to age 89, Colleen's lifetime benefits would be about $38,000 more (13%) than what she would have earned if she claimed benefits at age 62.[2] (Note: All figures are in today's dollars and before tax; the actual benefit would be adjusted for inflation and would possibly be subject to income tax.)

Clients who are planning to claim benefits based on their spouse's work record would lose even more by taking benefits before age 66. That's because the benefit reduction is greater for a spouse—30% vs. 25%. For example, in the example above, Colleen's spouse would be eligible for only $560 a month at age 62, which is 30% less than the $800 a month he would have gotten by waiting until age 66 to claim benefits.

A client's decision to take benefits early can have serious long-term consequences that could outlive them. When a client dies, the surviving spouse is eligible to receive their spouse's monthly amount as a survivor benefit—assuming it's higher than his or her own amount. But when a client takes benefits early, the surviving spouse's Social Security benefits will be reduced for the remainder of his or her lifetime.

Lost Opportunities For Couples

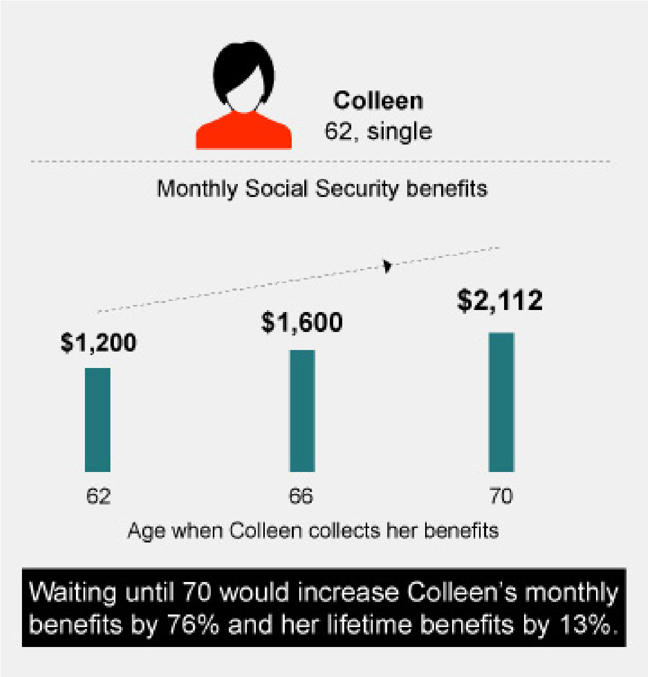
When clients take Social Security early, they also lose out on the opportunity to take advantage of potentially valuable strategies for married couples—which are only available if they wait until their FRA to claim benefits.

For instance, with the "claim-and-suspend option," clients can claim Social Security at their FRA, but suspend actual payments until a later date. This allows a client's spouse to draw spousal benefits immediately, while the other spouse continues working and the value of their future benefits keeps rising. This technique is especially useful if a client's benefits are higher than their spouse's (because they're older or a higher earner), and they're not ready to retire but their spouse is.

For example, if one member of a married couple won't qualify for substantial benefits on his or her own and hasn't reached FRA, he or she can still collect spousal benefits while their own benefits are suspended—but only if they have reached FRA. Meanwhile, future benefits continue to grow.

Using the "claim now, claim more later option," clients can claim spousal benefits now and then switch to their own benefit later. This strategy enables clients to keep building up their Social Security benefits while receiving payments based on the other spouse's work history.

This strategy may be appealing to couples who both want to retire. Instead of the husband and wife each claiming their own benefits, the person with the lower benefit (let's say it's the husband) starts collecting Social Security. His wife claims spousal benefits, which allows her higher benefits to continue to grow. Again, clients can use this strategy only if they wait until they have reached their FRA to claim their benefits.



Note: All lifetime benefits are expressed in present values, calculated using an inflation-adjusted discount rate and life expectancy of 89. The numbers are sensitive to, and would change with, the discount rate and life expectancy assumptions.

Consider Full Impact of Claiming Early

While many clients may dream about retiring as early as possible, it's important for them to consider the earning and investing power they may give up if they stop working full-time and take Social Security at 62.

When someone leaves a job with good pay and benefits, it may be difficult to ever regain that level of compensation if they need to return to work later. Of course, not everyone can keep working, but it is something for clients to consider, especially if they are healthy and have the opportunity to continue working.

Clients should be reminded that while they are eligible for reduced Social Security benefits at 62, they won't be eligible for Medicare until age 65, so they would probably have to pay for private health insurance during the years between 62 and 65. That can eat up a large chunk of their Social Security payments.

The average yearly cost of health insurance for a 62-year-old individual is $10,325, and prices have been rising much faster than inflation or Social Security COLAs[2]. Does it really make sense for clients to permanently reduce their benefits just to pay for health insurance?

But there's even more to the story. As clients approach retirement, they are often at the peak of their earnings—and of their ability to save more for retirement. Those who continue to work can make "catch-up" contributions to a tax-deferred workplace savings plan, such as a 401(k) or 403(b) or a traditional or Roth IRA. Catch-up contributions allow clients to set aside even larger amounts of money for retirement.

Moreover, if clients stay on the job past age 62, their Social Security benefits will increase each year, up to age 70. Delaying retirement for even a few years can offer clients the potential to substantially increase the size of their retirement savings and, at the same time, increase their monthly Social Security income, thus increasing the chances for a successful retirement.

Conversely, when clients stop working at 62, they will forego additional tax-advantaged savings opportunities, cap their Social Security benefits, and may also need to begin drawing down their savings earlier.

For more information, contact your Sales or Relationship Manager.

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1. The hypothetical examples were calculated by Strategic Advisers, Inc., based on Social Security payout tables, as of May 2014. Strategic Advisers, Inc., is a registered investment adviser and a Fidelity Investments company.

2. Lifetime benefits are determined by calculating the present values of the Social Security payments over time. The present values are calculated by discounting the Social Security payouts by an inflation-adjusted rate of return. The illustrations use the historical average yield of U.S. 10-Year TIPS for discounting.

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