Episode 62: The Six Steps for Effective Social Security Claiming

00:00
Bob French
The purpose of Retire With Style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to Risaprofile.com/Style and sign up to take the industry's first financial personality tool for retirement planning. Todays episode delves into the intricacies of Social Security. With Alex on the mend after knee surgery, it's up to Wade to keep the conversation on track. Welcome to Retire with Style. Let's find out.

00:54
Alex Murguia
Hello, everyone. Welcome to retire with style. I'm Alex, and I'm here with Wade, my trusted companion. We've got a show for you today, right, Wade?

01:06
Wade Pfau
That's right, Alex. We're going to dig into Social Security today and how to think about claiming or how to actually work through the process.

01:13
Alex Murguia
I should say dig in or dig out of it?

01:16
Wade Pfau
Both, I suppose. Are we going uphill or downhill with this?

01:20
Alex Murguia
Right? No, that's good. Like I said, we concluded our investing arc of what not to do, so feel free to

check that out. We wanted to start bringing in more planning components to Wade's point. If not, we'd have to change the podcast to invest with Style as opposed to Retire with Style. We thought, what better way to start this off than security of the.

01:42

Wade Pfau

Social getting back into retirement income? We should let the audience know your dedication to the podcast. You had knee surgery just the other day, and you're in a lot of pain right now, but yet your dedication, you're here, you're ready to go. You may be a little loop eating.

01:58

Alex Murguia

Probably not as much pain as the folks listening to me today, but that goes with the territory. Yeah, I had a partial knee replacement surgery from an old soccer injury that came back to haunt me. So, yeah, I'm in that balance. Everything was fine, but I'm in that balance between the right amount of pain medication versus just gutting it out and dealing with it. So let's see how it goes. I would imagine this actually will benefit me since I probably run fast. This will slow me down to the needed cadence.

02:34

Wade Pfau

We're not going to talk much about Social Security disability today, but that is one of the major parts of the program that you may have to think about at some point with your withering knees. Not that you necessarily need them for podcasting.

02:47

Alex Murguia

Withering knees. That's kind of a harsh word.

02:52

Wade Pfau

I hear. You didn't even make it up the stairs when you got back home from the hospital.

02:57

Alex Murguia

Oh, my goodness. That was terrible. Yeah. I got out of the van with a minivan. My wife were going up the steps, and I didn't make it past the first step. Gravity took control after that one, but lo and behold, we're fine. We're fine. Landed on my b***. Nothing wrong with that. And off we go.

03:19

Wade Pfau

But, yeah, getting into the topic today. This is where we're starting a new series on Social Security. It's hard to know in advance how many episodes it will take, but we're thinking four episodes should get us through what I'm hoping to cover for the most part. The only thing right before then Wade, this is my usual, oh, before we get started kind of thing. I think it's important to just really walk through what's involved and then in subsequent episodes, some of the points we're talking about more briefly today. We'll dig in more deeply in subsequent episodes, but this is the overview of what you need to know.

03:57

Alex Murguia

The only thing right before then Wade, this is my usual, oh, before we get started kind of thing. By the way, one of the reasons why I think this is a cool topic is a lot of folks, when they look at Social Security, obviously it depends what your income level is or whatnot it becomes an add on to retirement. It's not something that's given a lot of thought in terms of the significant impact that it could make, but getting Social Security correct, the present value of that paycheck over the course of your retirement is one of the most significant assets that most people will have. I think it's one of those that people make a lot of reflex decisions on this without recognizing that if you take a second and really think about this in a measured manner, it will make a huge impact in terms of that floor.

04:50

Wade Pfau

Yeah, absolutely. Like if you're a couple who's had relatively above average earnings over your career and somebody lives into their ninety s from that couple, there's an opportunity for that lifetime value of Social Security benefits to exceed a million dollars. You think about assets on your balance sheet, Social Security a million dollars. The difference between a bad claiming decision and a good claiming decision potentially being worth more than $100,000 in terms of lifetime financial assets, this is huge. It's definitely worth spending a couple of hours to make the right decision to earn more than $100,000 of extra benefits over your lifetime in the context of planning for potentially a long lifetime in retirement.

05:37

Alex Murguia
I just wanted to lay that out there.

05:40
Wade Pfau
This is the $100,000 episode.

05:44
Alex Murguia
There you go. I'm going to go to my last line. So that's step one. We got six of these bad boys.

05:50
Wade Pfau
Yeah. We won't list out all six in advance. We'll just go through them one by one. Step one, get your Social Security statement. This is something you can do through the Social Security website at SSA gov MyAccount. That's SSA gov MyAccount all one word. We could probably put that link in our show notes as well. You need to just sign up now. You will get them in the mail every five years or so. I think at some point, as you get closer to traditional retirement ages, they may send them more frequently, but it's worthwhile to get that account going so that you can just every February it's mid February, they release your updated Social Security statement, and you want to make sure you're getting those, and you want to double check. Well, a couple of things on the statement, they'll give you the projections of what your benefits might be should you claim at different ages.

06:48
Wade Pfau
As we'll get into more in this episode, you can claim between ages 62 and 70 for your retirement benefits, and they'll show you a projected benefit for each of those ages based on when you claim. On the second page, they show your lifetime earnings from Social Security covered earnings. You want to double check and make sure they have an accurate record of your earnings. Now, those earnings only go up to the maximum taxable amount for Social Security. So in 2023, that would be $160,200. That one wouldn't show up on your statement because we don't know your 2023 earnings yet. In 2022, that was a maximum of $147,000. Any earnings above that, they would just show the cap, but you want to make sure they're not otherwise missing any earnings from throughout your career.

07:41

Alex Murguia
The other piece, why it's good to even check this out. Even like myself, I'm not right now interested in the Social Security claiming decision for my own personal standpoint, but I do like to reference it when I'm doing like a financial plan for myself because it's the latest and greatest information there.

07:58
Wade Pfau
Like were saying, this is a huge asset. If you're doing your financial planning but ignoring Social Security, you're ignoring what could potentially be depending on if single or couple, and then your lifetime earnings. We could be talking about 2030, 40, 50, even $60,000 a year of inflation adjusted lifetime income that for most people is going to be worth taking advantage of or considering it's a big amount of income. When we talk about the sequence of returns risk and everything else, having that layer of reliable income and having a big chunk of your expenses covered through Social Security can really change the dynamics of how you think about other things in your financial plan, how you think about your risk, capacity for investing and everything else. It's definitely something that should be part of the planning process, is keeping track of your Social Security benefits as part of the financial plan.

08:59
Alex Murguia
Okay. Once you look at it, once you actually step one, go to the site, get your number, that's ultimately, what do you do with that information then, as the secondary step?

09:12
Wade Pfau
Well, you can think about whether that number is reasonable or if you think your benefits may be different from that. That's where we should talk because this is actually good news for younger people, for somebody who's in their forty s and who's worried Social Security may be cut in the future. Actually, the statement may be missing out on the fact that your benefits could be higher than what the statement shows, and that could offset any future benefit cuts. Maybe the statement does have what does that mean?

09:44
Alex Murguia
Why would it be missing out? If I just heard you say that, I would be like, wait, what are you talking about?

09:48

Wade Pfau

Yeah, we need to unpack that . What the Social Security statement assumes is they'll show your future earnings projection. It's usually going to be whatever your earnings were in the previous year, projected out for the rest of the future until your retirement date at those different ages that they're projecting those benefits at. Now that's just if you're a higher earner and so you were above $147,000 in 2022, they'll just show $147,000 for all subsequent years. Well, already in 2023, I would say have a chance to contribute more than that because the cap is higher this year and it could be higher in the future as well. If your earnings are going to be higher, that's one reason why you may get higher benefits. The other is importantly, the statement assumes no future inflation and no future wage growth in the economy. So it's just inflation.

10:49

Wade Pfau

No inflation is okay in the sense that today what you see is your benefits. Well, that's in today's dollars. The no future wage growth is important because historically wages have grown faster than inflation by somewhere in the ballpark of 1% a year. In the Social Security Trustees reports, usually their long term projections are that wages grow faster than inflation. It's usually somewhere in the ballpark of projecting inflation at 3%, projecting wage growth at 4%. You get about a 1% real wage growth, and that real wage growth counts it's because when you calculate your benefits, you calculate something called your average indexed monthly earnings, and that indexing is done with wage growth. There's real wage growth, it means your benefits will be higher in the future than what the statement projects. The statement is effectively projecting that wage growth is going to be zero in the future, and so you don't get any real increase to your benefits above and beyond inflation.

11:51

Wade Pfau

In reality, if we do see positive real wage growth, your benefits will grow faster than what the statement is projecting. Plus if you couple that in with if your earnings are going to be higher in the future as well, your benefits will be higher than what the statement is showing. If you're in your you're worried your benefits could be cut 25%, well, you don't necessarily need to assume your benefits will be 25% less than what's shown on your statement, because if with 1% real wage growth per year, that's going to offset the benefit cut. Your statements showing you approximately what your actual benefit may end up being, even after a cut to benefits in the future, which we'll have an episode where we talk about the status of Social Security as well as potential reforms, and one possible reform is benefit cuts. There's probably ultimately going to be some package of reforms that we'll dig into in one of the episodes in this series.

12:51
Wade Pfau
So did you get all that?

12:54
Alex Murguia
I think so. Well, the assumptions are effectively your earnings are fixed for this year. There's no wage growth in the economy, there's no inflation, so it's locked in the delta of that has been probably 1%. So if there was, you're doing good. That's kind of the gist, right?

13:16
Wade Pfau
Yeah. If wages grow faster than inflation and doesn't mean your personal wages here, if the average wage index grows faster than inflation, there you go, your benefits grow faster than inflation. The statement is just effectively assuming your benefits are constant in today's dollars. That's good news in terms of when we talk about the concerns people have that Social Security may be cut in the future. Well, you may also have a higher benefit than what your statement is showing, so it could offset each other good news. The other aspect, and this is probably less important, but Social Security, the statement assumes you work up until the year that the benefit is shown for. It shows your benefit if you retire or claim at 62. Claim at 63, claim at 64 all the way up to 70. It's assuming you just earn that same amount up until and it's interesting I reverse engineered for myself with my birthday being in May.

14:17
Wade Pfau
For some of the ages, they assume you stop work in December of the year before you turn that age. In other cases, I had to assume I had the earnings from January through April to match the benefit on the statement. It's either up until the end of the year before you turn that age or up until the month before you turn that age. It seems random how they decide which one to use for each age, but they're assuming you work up to that point. If you just simply wanted to know, for example, what if I retired at 62, but I don't claim benefits until 70? Well, looking at the benefit at 70 might be a bit misleading because it assumed I'll have earnings between ages 63 and up to 70, whereas I may not. An easy fix to

get a sense of, well, what if I retired at 62, but claim at 70 if your full retirement age is 67, which is anyone who was born in 1960 or later.

15:15

Wade Pfau

Anyone who's turning 63 this year in 2023, as we record, you could take your age 62 benefit and multiply that by 124 over 70 or approximately 77%. That would give you a projection for your age 70 benefit should you stop working at 62.

15:41

Alex Murguia

Sorry, for the benefit of everyone here, no pun intended. Yes. Actually, I didn't even catch that. 124 divided by 70.

15:53

Wade Pfau

Those numbers are well, that gets into the you'll get 100% of your primary insurance amount if you claim it your full retirement age. If you delay past your full retirement age, you get a credit 8%. Simple. Every year I delay past my full retirement age, I'm getting an 8% adjustment to my benefit increase. If I claim at 70, that's 124% of my primary insurance amount, and then I can claim before my full retirement age. If I claim before, I get a reduction to my benefit. If my full retirement age is 67, there's two different reduction factors. We won't get into all the details, but effectively what it means is if I claimed at 62, I'll get 70% of the primary insurance amount. That's where the two numbers come from.

16:42

Alex Murguia

Your point was this is if you're going to delay it till 70, you can't look at the Social Security printout that says at age 70 because it's going to assume you've been working through 70. Yeah, through 70. And you very well may not have. You may have just stopped working at 62, but you didn't claim your benefits.

17:00

Wade Pfau

Because Social Security, you look at the top 35 years of earnings, and so to the extent that their assumed earnings between 63 to through 69 were part of the top 35, you'd get a higher benefit because of that. This is a way to factor that out. It's a simple adjustment in terms of, okay, I want to claim it 70, but I don't necessarily want to work until 70. That's really just a sense. Now at Amber Hodges Retirementresearcher Academy, we have created, I think, is a really cool spreadsheet that lets you assume whatever you want in terms of future inflation rates, future wage growth, and also future wages for yourself. So that you can decide. I want to retire at 55 or whatever the case may be and actually project out your benefits in an exact manner in terms of today's, presently, legislated rules. You can also factor in a benefit cut if you'd like as well.

18:02

Wade Pfau

You can also factor in if you continue to work past 70. This is an important point. Every year, Social Security recalculates your benefit based on your top 35 years of indexed earnings. If I'm working when I'm 80, when I turn 81, they'll recalculate my benefit. If my age 80 earnings are part of the top 35 earnings of my lifetime, that would give me a new increased benefit. Our calculator would also let you see how an additional year of work could impact your benefits as well. That is a tool that is part of the retirement Research Academy that otherwise. There are some calculators on the Social Security website if you start playing. Their most detailed calculator is called Nepia, and it's meant to do something similar to the spreadsheet we created. I never had a lot of success working with that tool because the web based version requires you to enter earnings year by year in a manual manner that you can do.

19:03

Wade Pfau

If I'm entering 50 years of earnings, it's kind of a pain. The downloadable software for it is still from Windows 3.1 style, if you remember back to the 1990s. You can learn more about Retirement Researcher at retirementresearcher.com and subscribe to our newsletter where you'll receive weekly actionable information for your retirement planning. Their detailed calculator can do the same sorts of things our spreadsheet does, just in what I find to be a much less convenient manner.

19:27

Bob French

Let's take a moment to let the audience know that this show is sponsored by Retirement Researcher. Retirement Researcher online community devoted to helping you create the retirement income plan geared towards your goals. Retirement Researcher is an online community devoted to helping you create the retirement income plan geared towards your goals.

19:54
Wade Pfau
Okay, so that being said, I think we made it through step two at this point. Did we ever say were into step two? Step one was the journey of 1000.

20:05
Alex Murguia
Miles, I think we said. And then what do you do once.

20:07
Wade Pfau
You get yeah, so step one was get your statement. Step two was understand of what your statement was assuming and how to make some adjustments to that to get a better sense of your benefits. One other quick comment on your Social Security statement. If you're impacted by the Windfall elimination provision, or that's really the only relevant one here, but the government pension offset, those are things that can reduce Social Security benefits for people who have pensions from jobs that are outside the Social Security system. That can be teachers in states like I know Texas and Ohio as two examples, where there's a pension that you don't have to pay into Social Security when we have that job later. You may have part of your career in a Social Security covered job, but these are reduction factors so that people don't get to double dip. Since Social Security is progressive, the lower your lifetime earnings look, the higher the replacement rate is.

21:06
Wade Pfau
These are attempts to make adjustments so that people don't spend part of their career in one job, part of their career in another job, which makes it look like they have these two different jobs with low lifetime earnings. Therefore it would get disproportionately higher pensions than someone who had an entire career either in a Social Security covered position or a non covered position.

21:29
Alex Murguia
You're effectively saying the statements, they're not going to factor that in.

21:34

Wade Pfau
Right? The statements do not make any adjustments. The statement does not have any information suggesting that it knows anything about whether you were working outside of Social Security at some point in your career, you see zeros for the earnings in those years, but you don't see anything that says, okay, but you have a pension from some other position. Yeah.

21:58
Alex Murguia
Okay, so step number?

22:01
Wade Pfau
Well, step three, that is understanding claiming Philosophies, and starting to get into the issue of the whole philosophy around when should I claim? Should I claim as soon as I can at the age 62. Should I claim at my full retirement age, which used to be called the normal retirement age. I know Jason Fickner, he's been on the show in the past, and we hope to have him back as part of one of these upcoming episodes. He was at the Social Security Administration and helped change the language so that we stopped saying normal retirement age. We now say full retirement age. Even that, I think he feels it doesn't go far enough. He'd like to say age seven.

22:40
Alex Murguia
He's going to have to be on the show now.

22:41
Wade Pfau
Wait, yeah, I guess he hasn't actually replied yet.

22:47
Alex Murguia
We said, you're going to be on it, you got to come now. I like that.

22:51
Wade Pfau
Yeah, now he's got to be on it.

22:52
Alex Murguia
You give him that guilt.

22:54
Wade Pfau
I love it, being called out publicly.

22:56
Alex Murguia
He's a great guy, Jason, good guy. He'll come on. Not formally booked for claiming philosophies, I think you hear this a lot, and people could even be listening in on the podcast, and they could just shut it off by saying, yeah, delay it, call it a day and don't worry about this again. That kind of thing. No, I mean, right, it's like you don't need four episodes, just delay. And let's move on. Next topic.

23:23
Wade Pfau
Yeah.

23:23
Alex Murguia
What's your response to that?

23:25
Wade Pfau
Well, for people who are already knowledgeable on the topic, they may be familiar with what I would generally argue is the point that, yes, at least for the high earner in a couple, not necessarily both people, but the high earner usually has a pretty strong case for delaying to age 70. That's what our next episode will dig into the arguments for and against delaying your Social Security claiming so we can keep the conversation shorter in this episode. But there's two general philosophies. One is more investment framed it's with breakeven ages. Well, if I'm thinking about to keep it simple, should I claim at 62 or should I claim at 70? If I claim at 62, I get eight more years of benefits, but they're less. If I claim at 70, my benefit would be 77% higher. How long do I need to live to break even so that it's worthwhile to delay, so that I get more lifetime benefits through delay?

24:25

Wade Pfau

It depends on the exact interest rate assumed for discounting these things, but usually it's your lower 80s. You'd have to live beyond your early eighty s to benefit from delaying Social Security and then when people frame it that way, actually, yes. That's actually less than life expectancy. You have a pretty good shot at living past the age where you're going to benefit from delay. People start thinking about kind of the regret of, well, what if I don't live that long? I'm worried I won't live that long, and therefore I should just claim early, make sure I get something out of Social Security. So that's one philosophy. The other is just treating Social Security more as insurance, that you have this inflation adjusted lifetime income backed by the US. Government with survivor benefits, something you cannot get from a commercial annuity provider. It provides this inflation adjusted protection against outliving your assets.

25:25

Wade Pfau

Wade, I love how you frame this because I think this is one of the things that folks make mistakes on, advisors included. The frame here is think of it more as this insurance, this longevity protection, this inflation protection, this protection against market risk. Based on the fact that I want to build a financial plan that will work to an advanced age, part of getting a better outcome out of that financial planning process would be to delay my benefit.

25:53

Alex Murguia

Wade, I love how you frame this because I think this is one of the things that folks make mistakes on, advisors included. Maybe every once in a while I catch myself right where, what is the purpose of this particular solution? The first break even refers to of an investment thing, something you didn't bring up that folks also say is, well, I'm going to claim early. I'm going to take that money and reinvest because I don't need the money anyways. They tell themselves, and when I reinvest, I'm all of a sudden Warren Buffett and I'm going to get a 12% annualized return for that time period, that kind of thing. And so hence, break even. It makes total sense for me to claim early. In fact, a lot of newsletters, a lot of stock newsletters give why you should claim early Social Security. Your Social Security.

26:49

Alex Murguia

The reasoning is that, like, you get the money in your hands earlier and then fine, you don't need to spend it at the Piggly Wiggly for groceries, but you effectively reinvest it, and then your reinvestment is always on point relative to waiting. And I think it's a mistake. That's not how I would interpret it. My own framing, my own personal life has led me to consider it as the option number two that you just spoke about.

27:17
Wade Pfau
Right.

27:17
Alex Murguia
Which I think is great.

27:18
Wade Pfau
Yeah. In a past episode I think this was a week, I don't remember where you were, but Bob and I put together an episode on an article that Steve Parrish and I wrote that's in the Journal of Financial Planning earlier this year where we tested this idea in the historical data of could I claim at 62. Usually it's framed as could I claim at 62 and invest my benefits? Really what it means is, could I claim at 62 and then leave more money in my investment account because I don't have to withdraw as much to cover my spending? Would that give me a better outcome than going ahead and spending down my investment account faster until age 70, but then having a higher benefit for the rest of my life? We quantified that in historical data and found sometimes you're better off by, quote, unquote, claiming early and investing it.

28:07
Wade Pfau
Much more often than not, and to the extent that you're not investing as aggressively anyway, a pretty strong case can be made that financially, you're generally going to better off by spending down other investment assets to support delaying Social Security, to get your spending goals, and have a larger legacy at the end of that retirement as well.

28:31
Alex Murguia
I think there's so much of your life in retirement from a retirement income standpoint that's heavily

influenced by chance outcomes when you have the opportunity to actually structure something in a very manageable and successful way. I don't know, I hold on to those opportunities and make the most of them.

28:50
Wade Pfau
Yeah. We haven't formally studied this with the Risa and the retirement income style awareness, but I have a pretty good hunch that claiming Social Security early is going to correspond more closely with a probability based preference. Delaying Social Security is going to appeal more to those who have a safety first preference because it's really a way to build more reliable lifetime income.

29:14
Alex Murguia
Now, the only caveat of all of that, which I agree with you 100%, is the let the meat cake kind of syndrome that we may fall into, that we may be falling. Listen, if you need the money, if this is all you have, if there is no magic tree that you can get like dollar bills from, then I get it. You may not have a choice. Absent of that, though, there's dynamics to consider.

29:39
Wade Pfau
Yeah. In our next episode, we'll look at the arguments for and against delayed Social Security claiming, and one of the arguments against it to preview next week's episode is exactly that point. Like, if you have no other alternative, there's not much you can do. You may have to claim early to meet basic expenses.

29:59
Alex Murguia
All right, what's step number four?

30:02
Wade Pfau
Well, step number four is fact finding, and this is the process of figuring out not just what your own benefit would be, but are there other people who are eligible for benefits based on your earnings record? Are you eligible for benefits based on other people's earnings records? Developing a coordinated strategy around all of that to figure out what's going to be the strategy that gives you the

best outcomes for the lifetime benefits that can be earned both from your own. Earnings record as well as the benefits you may be eligible for from other people's earnings records. This is just a matter of making sure you don't overlook anything. Another reason why you might not always want to delay Social Security is if you have minor children who might be eligible for dependent benefits when you're in your 60s, but at some point they age out of that eligibility and those benefits would be lost forever.

31:00
Wade Pfau
Now we'll talk later. Step five is going to be test your strategy with software. Because really it is too complicated to try to do any of this in your head. This fact finding process is just making sure what benefits are going to be out there so that you can enter them into the software and incorporate them into the claiming decision. It's just a matter of Social Security. There's four types of benefits. There's retirement benefits, there's survivor benefits, there's disability benefits, and then there's benefits for dependents other family members, which includes not just minor children, but spouses raising minor children. And so Wade, you're saying when you're getting to make that claiming strategy, be aware of what benefits are on the table at that point versus other points to make sure that you're maximizing all the potential benefits that could accrue to you. Parents even who are dependent on you for the majority of their income may be eligible for a benefit based on your earnings record.

31:56
Wade Pfau
Also children who became disabled before age 22 can be eligible for dependent benefits potentially for the rest of their life based on your earnings record.

32:09
Alex Murguia
Wade, you're saying when you're getting to make that claiming strategy, be aware of what benefits are on the table at that point versus other points to make sure that you're maximizing all the potential benefits that could accrue to you.

32:26
Wade Pfau
Right. Making sure that you don't overlook these types of dependent benefits that are just going to be gone forever if you're not claiming them. Now in some cases the benefits of delay and of creating that larger survivor benefit for a spouse may outweigh what you've given up by not claiming earlier and missing out on some of these dependent benefits. The point is making sure you're aware of all the

benefits that are out there and incorporating them into the decision about when you should claim Social Security.

33:00

Alex Murguia

Okay, you said there's four types of benefits. Are there any potential dependent benefits that are out there?

33:06

Wade Pfau

There are, yes. If they're in secondary, it can the exact ages, like if they're still being educated, potentially up to ages 18 or 19, spouses who are caring for dependent children up to the age of 16, disabled children again, dependent parents. All these different potential options where you would have to claim yourself for them to be eligible for those benefits. Or there's also the whole world of the survivor benefits and then dependents who are eligible for a benefit if you've passed away. What we're talking about right now is more relevant for dependent benefits where you would have to claim your own retirement benefit for them to be eligible for these dependent benefits based on your retirement benefit. It's not a retirement benefit for them, it's a dependent benefit. That's where if you have a younger spouse raising and you have children who are 16 or under, the spouse could receive a spousal benefit as a dependent until the children reach 16, then that benefit stops and then later on the spouse can receive a benefit as a spousal retirement benefit.

34:22

Wade Pfau

It's two different types of spousal benefits and you just want to make sure you're aware of all that. That's really what this fact finding is about because when you use software, you need to be aware of this so that you can enter the appropriate information so that those types of benefits get incorporated into the claiming decision.

34:45

Alex Murguia

Okay, so again, this is where I try to put myself in the consumer head on listening to the podcast. I'm listening to all of this. If I'm listening this to the first time, I think it's a lot of balls that I have now in the air trying to juggle and I'm going to be thinking, okay, I can listen to this the last 30 seconds ten more times, or is there a resource in your book? It's fine as well. I'm just trying to think what we can arm them with. Two days after listening to the podcast, they're not going to remember this by rope memory. What would you suggest that they could make these references to?

35:26

Wade Pfau

Well, yeah, I mean the big secret is I am using my book for the kind of organization for a lot of these episode NU the Retirement Planning Guidebook, second edition. The chapter on Social Security is covering all the things that we're talking about and also when we get to step five with the software, absolutely. It's important to run this through software and we'll talk about that shortly. Some options that are out there.

35:51

Alex Murguia

As you can see, right, it's more than just about delaying or waiting to your full retirement age or this or that. It depends on what is the range of benefits you have available to you based on your financial planning situation and that's what you're really trying to maximize. And it's hard just to keep all.

36:10

Wade Pfau

Of that in your head because there's also the survivor benefits and for people who've been married more than once, they may be eligible for survivor benefits and also divorce ex spouse benefits. Two tricks that are out there that are worth probably mentioning. We're not getting into a lot of depth about all the exact rules for claiming today, but to be eligible for an ex spouse benefit, the marriage does need to last at least ten years precisely. If the divorce is finalized after nine years and 364 days, there's no ex spouse benefit. You need to have that ten years or longer.

36:50

Alex Murguia

Could you imagine that happened in real life.

36:52

Wade Pfau

Yeah, and it could be an issue. Like if people are aware of this and if they're getting along, they can purposefully delay the divorce finalization. Maybe if they're not getting along, one spouse is wanting to get that finalized before the ten years is outside just out of the roses.

37:11

Alex Murguia

He all of a sudden throughout the entire marriage, that person never did anything on time and all of a sudden he's fast tracking the divorce.

37:20

Wade Pfau

Also for somebody who remarries before the age of 60, they lose the right to an ex spouse benefit. Now, if that ex passes away, that person can I'm getting to a lot of pronouns here. If the ex spouse passes away, you can still be eligible for the survivor benefit from their record. If you remarry before 60, you lose your right to the spousal benefit from an ex spouse's record. S that are worth mentioning. Again, we're not getting into full depth about exactly how these benefits work, but it's worth mentioning those two.

37:58

Alex Murguia

These are examples that are beyond just delay or not. You're bringing to light all the potential wrinkles.

38:07

Wade Pfau

Yeah, there's lots of strategies with that. Also just what else is worth saying here in terms of your spouse has a claim for you to be eligible to receive a spousal benefit. If you're eligible for a Survivor benefit, you can file a restricted application for just a Survivor benefit, but you cannot. This is one of the things that changed a few years back. Now Wade, what is the right cadence for somebody? Again, I think for this series right now, we're probably not going to do an episode getting into the weeds on all these exact claiming rules, but we might revisit that again in the future. It's definitely a complicated area, but it's also something that if you're using a good software program, you don't necessarily have to become an expert on all these rules either.

39:04

Alex Murguia

Now Wade, what is the right cadence for somebody? Because, I mean, assume that someone doesn't want to open up another software program or this or that, this person is just not into that. How proactive should somebody be in terms of contacting the Social Security office just actually just picking up the phone and running through some of these issues with regards to, hey, look, there's eligible dependence, there's a previous marriage, what do I do, et cetera.

39:32
Wade Pfau
Yeah, that's a great question and actually something I forgot to really bring up today. The Social Security Administration is not allowed to provide advice on how to claim and also many of their case workers, we hear many anecdotal stories that their case workers don't understand these rules at all and generally assume the reason you're contacting them is because you want to claim. This idea of delayed claiming is a completely foreign concept. You're not going to get advice on the proper claiming strategy from the Social Security Administration. This is something that you need to do on your own. If the strategy involves something that's more esoteric, you may have to show the documentation of the case worker that what you want to do is allowed because they may simply have no idea about this.

40:23
Alex Murguia
Wow, that made me feel good.

40:27
Wade Pfau
Yeah. You're not able to rely on Social Security office case workers to help you develop your claiming strategy. You've got to do this well, either with a financial advisor or on your own, whichever scenario you're more comfortable with.

40:42
Alex Murguia
Got you.

40:43
Wade Pfau
On your own is definitely going to involve using software. That's going to be our next step that we get into here shortly. Or I guess we may really be there. Pretty much.

40:56

Alex Murguia
Yeah. Far away.

40:58
Wade Pfau
Yeah. We're not getting into detail about this, but like a couple of quick, very basic points. If you are on Social Security disability, that will automatically transfer over to your retirement benefit when you reach the full retirement age. If you're still working, there's an earnings test that applies before full retirement age that could reduce your benefit, but then that is later translated into it's like you didn't claim as early because you get credits for that. However, if you're still working, it's generally not a good idea to claim before full retirement age because then if you passed away before full retirement age, the survivor benefit from your record is going to be lower. That's just something to be aware of. In that regard, we already mentioned the windfall elimination provision in the government pension offset are relevant. If you worked outside of the Social Security, outside of a Social Security covered position for part of your career, other factors that will impact your claiming strategy.

42:03
Wade Pfau
Are you concerned about a benefit cut in the future? Although that's an issue that the knee jerk reaction is, I think Social Security will be reduced in the future. Therefore, I better claim as soon as possible that knee jerk reaction is usually wrong. Because yes, benefits might be cut in the future, but they'll be cut for everyone. Whatever you claim today is also going to be cut in the future. It's very unlikely that they would just grandfather in that anyone who had already claimed doesn't get a cut, but anyone who hadn't claimed yet will get a cut such that a benefit cut is not going to have too big of impact on the best claiming age. It could have a small impact, but it's generally not going to overwhelm decisions to delay. Do you have resources to support delaying Social Security? That gets into the point of if you absolutely have to claim because you have no other alternative, then so be it.

43:00
Wade Pfau
Financially, there's no other alternative at that point. And your risk capacity, how reliant. Are you on those benefits to support your spending? This gets into this idea of also with the risk tolerance, the idea that, oh, if I claim now and quote, unquote, invest my benefits, could I do that and have greater upside potential? Possibly, but you'd have to be quite risk tolerant to really have that pay off for you. And you'd have to invest quite aggressively. If you're claiming early and just investing that in bonds, that's really a losing approach because you have that bogey.

43:40
Alex Murguia
You have to get over.

43:40
Wade Pfau
Yeah. The Social Security delay credits were designed in 1983 when people weren't living as long and when interest rates were a lot higher. It assumes a 2.9% real interest rate, which right now Tips yields are more in the ballpark of like, a interest rate. It's really a losing proposition to claim early, but be investing just in bonds. Definitely it's better to spend your bonds today and delay Social Security if you're going to live to your life expectancy.

44:13
Bob French
Are you getting close to or are you in retirement? Download Retirement Researchers Eight Tips to Becoming a Retirement Income Investor by Heading Over to retirementresearcher.com/eighttips again get Retirement Researchers Eight Tips to Becoming a Retirement Income Investor by Going to retirementresearcher.com/eighttips That's the number eight tips. Your investments are there to help you pay for retirement and now is when they need to earn their keep. To make sure you're on the right track. Download retirement Researchers Eight Tips to Becoming a Retirement Income Investor by Heading Over to retirementresearcher.com/Eighttips again get Retirement Researchers Eight Tips to Becoming a Retirement Income Investor by Going to retirementresearcher.com/Eighttips That's the number eight tips.

44:52
Wade Pfau
Okay. That being said, software, I would really encourage everyone to run their information through software to see if because it's just too complicated to do this all in your head, especially in any scenario where you have dependence or other more esoteric situations. Now there's a free option that I think works really well, and that's Mike Piper. He runs the oblivious investor blog. And he created OpenSocial Security. It's OpenSocialSecurity.com and it's free It's an open source online calculator that you have to hit the tab for being able to add in more detailed inputs, but it can cover most of the types of scenarios we're talking about and it'll give you a claiming strategy based on your inputs. If you like to double check another software that is available to consumers, that last time I checked, was $39. I don't know if that's still the price today, this inflation and everything, but we're talking about a relatively low price

compared to the possible benefits of having a better claiming strategy and that's Larry Kotlakov created maximize my Social Security.

46:17

Wade Pfau

Now, we don't have affiliations with any of these programs, and especially that open Social Security is free. It's an online open source calculator. We don't provide any disclaimer here.

46:31

Alex Murguia

Our compliance is just a courtesy kind of information.

46:35

Wade Pfau

You do have those are two great options. At a personal level, I think that you can try your strategy with both to double check, you'll generally get the same answer. Now you might get a slightly different answer and it would just be related to different assumptions for interest rates and different assumptions for longevity. The lower the interest rate assumption, the higher the longevity assumption, the more the calculator would point you to delay. If you're talking about a couple, you've got a high earner in the couple and a low earner in the couple, which is simply who's got the higher primary insurance amount from Social Security. These softwares would generally in most scenarios agree that the high earner delay to 70. Especially when you start to get to slightly different assumptions about interest rates or life expectancies, you might see a different answer about the low earner.

47:28

Wade Pfau

You might say the low earner claim at 62, or the low earner claim at full retirement age, or the low earner claim at 70, or it's some random number in between. When you get to that point for the low earner, really, the impact on the lifetime benefits is going to be pretty small. You have some flexibility for the low earner and a couple about when they claim. The software would generally point to the high earner claiming at 70 some flexibility for the low earner. Still the difference between strategies that are nearly optimal are going to be small. That's why you just may see these differences between different software packages. When you compare that to the strategy of, okay, both people claim at 62, that's where the differences can be huge. If you have, again, someone from that couple living to their 90s, we can be talking about more than $100,000 in difference for lifetime benefits from Social Security.

48:27

Wade Pfau

When we compare the scenario with the high earner claiming at 62 versus the high earner claiming at 70, just get so much more benefits out of Social.

48:36

Alex Murguia

Security through delay and wait just for the benefit, pun intended this time of the retirement researchers, our membership site, retirementresearcher.com, how does that spreadsheet differ from these? Just to make it clear to them so they know what's there, right?

48:55

Wade Pfau

The spreadsheet we created lets you be very flexible in calculating what's your primary insurance amount going to be. But we're not a claiming software. These other software programs, they take as an input. They ask you what is your primary insurance amount? That's where you can get that from your Social Security statement. If you're comfortable with all the assumptions in the Social Security statement that we talked about with our spreadsheet in the retirement researcher academy, it gives you the flexibility to adjust inflation, to adjust the average wage index, to adjust your wages, to get a better estimate of your primary insurance amount, which you then take as an input into their software. Open Social Security maximize my Social Security. They help design an optimal claiming strategy where an input is, what's your primary insurance amount? With our spreadsheet help, you figure out what do you want to assume for your primary insurance amount, which you would then take and enter into their software.

50:06

Wade Pfau

So it's a two step process. You'll be much more sophisticated with determining the primary insurance amount. But we don't offer the claiming strategy. They require the primary insurance amount as an input. They don't calculate that for you, at least not open Social Security maximize. My Social Security may have some flexibility for that. Anyway, the main idea is they then take that primary insurance amount and determine the appropriate benefit for you.

50:38

Alex Murguia
How do we put a bow on all of that?

50:42
Wade Pfau
Yeah. Step six was just more like putting everything together. If it's pointing to if you're retired potentially before you're claiming Social Security, it's really just that the bow is, well, how do you fill the gap? How do I fund the missing benefits before Social Security gets started up? You're doing this as really part of a comprehensive financial plan. One of the big directions of the tax planning for efficient retirement distributions is just this idea of if I'm retired but I'm delaying Social Security, I could have a great opportunity to do some Roth conversions. That potentially lower required minimum distributions in the future. Potentially Social Security benefits are taxable, and it's a really complicated process to determine how much of your benefit is taxed. If you're thinking strategically, it may be possible that you're not necessarily having to pay tax on up to 85% of your Social Security benefit.

51:46
Wade Pfau
You might be able to pay taxes on less of your Social Security benefit. That's all part of this strategy around how do I fit claiming into my overall financial planning strategy, how do I think about these tax issues, but also how do I build that bridge? If you simply delay Social Security, but you have a diversified portfolio and now you have to spend at a higher distribution rate until Social Security starts, that increases sequence risk. Usually you do want to build some fixed income styled bridge to not have to use a higher distribution rate from your portfolio while you're waiting for Social Security to start. Whether it's a bond ladder, go ahead.

52:33
Alex Murguia
No, I think this is a significant point, as opposed to just delay or claim now it's how this impacts the tax strategy, the distribution strategy and so forth. It's really bringing that together that impacts this decision greatly.

52:53
Wade Pfau
Yeah. It might sound like time segmentation, but it's not to just say, okay, I'm 62, I'm retired. I'm going to delay Social Security to 70, so I'm going to build an eight year bond ladder to fund my missing Social Security benefits to 70. That might sound like time segmentation, but it's really not. It's a way to have a

relatively safe asset supporting the missing Social Security benefit to help get you to that point where you then have that higher Social Security benefit for the rest of your life. You can do it with a bond ladder, you could do it with a period, certain income annuity. You could potentially fill the gap with part time work as another option. You could use it with something like a reverse mortgage. That's one of the interesting strategies there. Or with what otherwise might be a buffer asset like a life insurance, permanent life insurance policy, or just spending cash instead of a bond letter.

53:51

Wade Pfau

You could have a big pile of cash that you might use as a resource to fill in the gap from the missing Social Security benefit. Those are all options around how do I build this bridge so that I can delay Social Security, but not just have to spend at a higher rate because I don't have those Social Security benefits for those early retirement years from a volatile investment portfolio. I want to carve something out of my investment portfolio and build a secure delay bridge or I want to use some other asset like a reverse mortgage that's not part of the investment portfolio to build some delay bridge. As a part of that as well, thinking about the tax planning and that's really how to think about Social Security is part of a more complete retirement plan.

54:41

Alex Murguia

No, again, this is where to me, this is where the question is. I think folks that ask themselves just delay or claim now and that's it, there's nothing else to it. I think that falls short of the mark. The last thing I'll leave you with, Wade, and I'm curious what your answer is. How does your Social Security claiming decision play within the overall aspect of your retirement income strategy? I think that's where it becomes a question of layers as opposed to just a binary kind of thing. The last thing I'll leave you with, Wade, and I'm curious what your answer is. I mentioned it in a previous podcast, but there's a lot of commercials out there. There's a lot of, let's say, leads, lead magnet articles clickbait that will say, hey, there's 5000 Social Security claiming decisions that are available. Make sure you don't mess that up.

55:31

Alex Murguia

Yeah, obviously if you take into consideration all the potential ways that you can go, it's exponentially. You have an exponential number of alternatives that you can hit. Really, I don't want people leaving this podcast thinking, oh my goodness, this is something that is incomprehensible. It actually is very doable as long as you take care of the big picture directional decisions and maybe you want to just talk about that real quick and send us off.

56:02

Wade Pfau

Right. The chapter on Social Security in the retirement planning guidebook, it's about 40 pages and it's really my effort to provide everything that you need to know except for maybe very specialized cases. Yeah, it's definitely worth spending a few hours to work through. This six step process that we talked about doesn't require even necessarily paying any money if you're using the open Social Security open source software that's available online. Again, you want to get your statement, you want to understand are there any dependent benefits that are eligible on your record? If there's not, that makes things a lot easier. Dependent benefits can make things more complicated. Disability benefits require a few extra quirks to make sure you've got that solved for. If you did spend part of your career outside of Social Security, or if a spouse spent part of their career outside of Social Security, you have to be aware of the impact of the Windfall Elimination Provision and the government pension offset if those factors don't apply.

57:07

Wade Pfau

If you're a single person, it's just when do I claim? If you're a couple, you do need to coordinate better about when do I claim? When does my spouse claim? How does that impact spousal benefits and survivor benefits as well? Once you have that information collected, once you have your statement and you have a primary insurance amount you're going to use, then you run that in one of these software packages. It tells you when people should claim. You use that information to then at the appropriate time contact the Social Security Administration. You can generally do this online and file a claim for the benefits at that point. At the end of the day, that's the basic strategy around claiming. Now there's a couple of other interesting quirks about filing suspended benefits or suspending your benefits, but at the end of the day, that's not going to apply to most people and that's I think, a pretty good overview about.

58:04

Wade Pfau

Again, we didn't get too far into the weeds on some of this, but I think we got far enough into the weeds that we provided a good framework for people to work through these six steps and have a claiming decision for themselves. To the extent you want to do more background reading, it's still something that can be done within a reasonable number of hours. It's not a huge time suck to work through this process we described.

58:28

Alex Murguia

No, I think you gave them a good framework of the questions that they need to consider and that's kind of what we can realistically accomplish in this podcast. I think that's great. Thank you, Wade, for kicking off this Social Security arc. We'll see where it takes us, right?

58:44

Wade Pfau

That's right. In future episodes, we will talk about more on the philosophy of claiming at different ages and we will talk more about Social Security reform and the future of the Social Security Trust Fund, which is always something that a lot of people are worried about. We'll try to give you a good low down on that situation and we'll get Jason. Yeah, we'll hopefully have Jason, too, now that I said. He did not reply to our message yet as of recording, but he will now.

59:12

Alex Murguia

All right, stay tuned. Thank you.

59:18

Wade Pfau

See you next week on Retire With Style.

59:23

Bob French

Wade and Alex are both principals of McLean Asset Management and Retirement Researcher. Both are SEC registered investment advisors located in Tysons, Virginia. The opinions expressed in this program are for general informational and educational purposes only and are not intended to provide specific advice or recommendations for any individual or on any specific securities. To determine which investments may be appropriate for you, consult your financial advisor. All investing comes with a risk, including risk of loss. Past performance does not guarantee future results.