When to Take Social Security

Retirement conjures up images of exotic travel destinations, frozen margaritas, and games of pickleball. For us in the world of investing and personal finance, it also means analyzing sources of retirement income. And exhibit 1 in this regard is Social Security. Incidentally, a family member in the beginning stages of retirement recently asked us for help on determining when to apply for Social Security. In this article we want to explore how Social Security works and when is the best time to start taking it.

How Social Security Works

Social Security is a federal government program that provides a source of income. It is funded by Social Security taxes that you pay while you work. According to usa.gov, "This tax money goes into a trust fund that pays benefits to those who are currently retired, to people with disabilities, and to the surviving spouses and children of workers who have died. Each year you work, you'll get credits to help you become eligible for benefits when it's time for you to retire." While there are four types of benefits that the Social Security Administration offers—retirement benefits, disability benefits, benefits for spouses or other survivors of a family member who's passed, and supplemental security income—we will only focus here on retirement benefits.

You are eligible to receive full Social Security retirement benefits when you reach "full retirement age." Full retirement age used to be 65 for everybody, but that is no longer the case. Below is a table that summarizes full retirement ages based on the current law, which depends on date of birth.

If you were born in …	Your full retirement age is …
1950 or earlier	You've already hit full retirement age
1951-1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 or later	67

Source: ssa.gov

To make things more complicated you can choose to start receiving Social Security early (i.e. before full retirement age) or late. As you can imagine there is a "penalty" for taking benefits early and a credit for delaying benefits. If you start receiving Social Security up to 36 months before full retirement age, the retirement benefit is permanently reduced by 5/9 of 1% for each month. If you start more than 36 months before full retirement age, the retirement benefit is *further permanently reduced* by 5/12 of 1%.

Here is a summary of the percentage of insurance amount one would receive at different ages (based on a date of birth of January 2, 1943 to January 1, 1955):

Beginning Age	% of insurance amount to be received
62	75%
63	80%
64	86.6%
65	93.3%
66	100%

On the other hand, if you decide to start taking retirement benefits sometime between your full retirement age and age 70 you would earn a "delayed retirement credit." The credit is 8% per year for each year after full retirement age. Here is a table similar to the one above illustrating the impact of delaying taking benefits (again based on a date of birth of January 2, 1943 to January 1, 1955).

Beginning Age	% of insurance amount to be received
66	100%
67	108%
68	116%
69	124%
70	132%

Take It Later

The decision of when to take Social Security retirement benefits boils down to cash needs, life expectancy, and whether the participant has a spouse. Even though everybody has different circumstances regarding these three factors and even though waiting to get retirement benefits yield a higher amount, the majority of adults claim Social Security by the time they turn 63. This is to their financial detriment.

A recent study analyzed the actual Social Security decision and wealth accumulation of 2,024 households in a Social Security Administration sponsored survey. It is the first study of its kind and it evaluated the financially optimal time to receive Social Security retirement benefits by comparing the actual household's decision on when to claim Social Security to the "optimal decision." According to the report, this "optimal decision" was determined by running simulations on "amount of lifetime wealth, income, and taxes associated with every combination of Social Security claiming age for a household, account sequencing strategy, and over 1,000 different possible market outcomes."

The study found that only 4% of retirees make the financially optimal decision about when to claim Social Security retirement benefits. It found that about 57% of retirees would be better off financially if they waited to claim until they were 70 years old. And while over 70% of retirees currently claim benefits before turning 64, only 6.5% would be better off going that route. A whopping 92% of retirees are expected to be better off waiting to claim their benefits until at least their 65th birthday. In dollar terms, all of this means that, according to the report, "current retirees will collectively lose an estimated $2.1 trillion in wealth because they made the sub-optimal decision about when to claim Social Security, or an average of $68,000 per household."

The main obstacle to retirees waiting more to claim their benefits is that they would be losing some wealth in the near-term (i.e. in their sixties). Nevertheless, they would more than make up for it in the later years. Retirees need to overcome this bias of "money now" and hopefully a study like this will make more people improve their Social Security decisions.

Conclusion

Determining when to take Social Security retirement benefits is an important decision that almost all of us will need to make. Choosing the wrong time may cost tens of thousands of dollars in lost retirement income. For the majority of U.S. adults it is wise to wait until age 70 and take advantage of the higher payouts.

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