
Claim Check

By Editor Test *Mon, Aug 5, 2013*

How should you respond if your clients are convinced that they should claim Social Security benefits at age 62? Research presented at the 15th annual meeting of the Retirement Research Consortium in Washington, D.C., last week offers some clues.

A man in a khaki suit—I've always associated khaki suits with summer in Washington, D.C.—leaned toward me at the National Press Club last week and said that a third of the people who claim Social Security at age 62 don't think they'll live very long, a third don't have jobs and the rest, well, their motives aren't clear.

Sometimes they just don't trust the government. He knew an executive at a Fortune 500 company who claimed Social Security at age 62 because he didn't think the Old Age Survivors and Disability Insurance system will be solvent for much longer.

The man in the cotton suit and I were at the 15th annual meeting of the Retirement Research Consortium, which includes the Center for Retirement Research at the Boston College, the Center for Retirement Research at the University of Michigan and the National Bureau of Economic Research.

These centers conduct and sponsor research that the Social Security Administration provides funding for. The researchers generally address problems that face Social Security. They analyze data on the use of benefits, look for patterns and cause-and-effect relationships, and try to draw conclusions that might help the program run more efficiently and effectively.

One pattern that the Social Security Administration would like to alter is the tendency of Americans to claim their old age benefits at age 62. Until 1956, everybody (except for widows) had to wait until age 65 to claim retirement benefits. But Congress amended the law that year to allow women to retire at age 62. The same privilege was extended to men in 1961. Today, thanks in part to the law of unintended consequences, about half of all 62-year-olds claim Social Security benefits as soon as they can.

An urge to claim early

As we all know, lengthening lifespans (which mean more claiming years per person) threaten to strain the system's finances, so policymakers would like to nudge able-bodied people toward working longer and claiming later. That would mean more taxes going into Social Security and fewer benefits coming out, at least in the near term. It would also mean higher annual payments for workers when they do claim benefits, and, when they pass, potentially higher benefits for their surviving spouses.

Because Social Security plays such an important role in almost everyone's retirement income strategy, and because the claiming age can have such a big impact on the amount of the annual benefit, financial advisors need to prepare themselves for conversations with their near-retirement clients about when they intend to claim Social Security and why.

Those could be challenging conversations. They will require the advisor to know a lot about Social Security.

They may also require advisors to channel their inner psychologists. According to a paper presented at the RRC conference last week by Suzanne Shu of the Anderson School of Business at UCLA (co-authored with John Payne of Duke's Fuqua School of Business), some people claim Social Security early for reasons that aren't purely rational.

For instance, some people have a pessimistic idea of how long they will live. Obviously, someone in poor health may have good reason to believe he or she might die 10 years sooner than average. should claim Social Security early. But, according to Shu's research, people's estimates about their own life expectancies aren't necessarily accurate. In fact, the estimates can swing by as many as 10 years, depending on whether you ask them what age they think they will to or what age they think they will die by. And the answer can have an impact on claiming behavior. "An extra 10 years of subjective life expectation [translates] to a six-month delay in claiming," said the Shu-Payne paper.

Fairness factor

Other behavioral factors may drive the claiming decision. Some people, the researchers found, might be biased to collect Social Security early because of "loss aversion." They may feel an acute sense of loss if they don't claim money that they feel belongs to them. Others may believe that it's "unfair" for them to delay a reward that they worked hard for and deserve.

To be sure, some old-school Social Security economists don't consider these behavioral factors to be nearly as strong as concrete drivers of early claiming like illness or employment. But the behavioral view is gaining traction—in many parts of the financial world—because it promises to open up new avenues for behavior modification.

The takeaway? As an advisor, you might need to help clients determine if their reasons for claiming early are reasonable, and whether or not they outweigh the potentially ample benefits of waiting. The benefit payout grows 8% every year they postpone claiming, until age 70. Even if your clients can afford to stop working at 62, they might still benefit from using other sources of income—such as 401(k) assets or a period-certain annuity—while postponing Social Security.

Jobs and debts

Employment status and debt levels also have a big impact both on the timing of retirement and the commencement of Social Security benefits, research at the conference showed. For instance, the availability of Social Security at age 62 apparently can tempt older people who have lost their jobs to abandon their search for a new job (it takes longer for older people to find new jobs than for younger people), according to a paper presented by Alex Gelber of the Wharton School. As an advisor, you may be called upon to help someone decide whether they should yield to that temptation.

The need to service their debts apparently often compels many people to keep working well into their 60s and, consequently, to postpone claiming Social Security. According to a paper presented by Barbara Butrica of the Urban Institute, simply having a mortgage raises the likelihood of working by about seven percentage points above average and reduces the probability of claiming Social Security by three

percentage points. (At the conference, one economist quipped that Boomer debt could end up helping to solve Social Security's solvency problems.)

The debt levels of older people have been steadily rising. On average, debt consumed 10% of older adults' assets in 1998, 14% in 2006 and 18 in 2010, according to Butrica. The median value of outstanding debt among those between ages 62 and 69 grew to \$32,000 per person in 2010 from \$19,000 in 1998. Note to advisors: Clients who say they want to retire earlier might benefit from guidance on eliminating mortgage debt, either through refinancing to a shorter-term loan, accelerating their payments, or downsizing to a smaller home.

Systemic security

What about a client who wants to claim early because he or she thinks the Social Security system is headed for the same fate as Detroit's insolvent municipal pensions? There are evidently many such people, and their numbers will probably grow. One University of Delaware professor at the conference said that he surveys his students each semester and a majority consistently say they don't expect ever to collect Social Security.

None of the experts at the conference—outspoken admirers of Social Security, for the most part—seemed to doubt the program's durability. A featured speaker, economist Alice Rivlin, a former vice chairman of the Federal Reserve, said Social Security merely needs "restorative reform," as opposed to radical reform, in order to regain solvency. She and others at the conference also asserted that as long as older Americans are a potent voting block, legislators of both parties are unlikely to try to do away with it. Social Security wasn't dubbed the "third rail of American politics" for nothing.

Pessimism about Social Security may stem from a mistaken belief that the program is as susceptible to insolvency as a municipality's public employee pension or a private company's defined benefit plan. But the federal government's ability to fund itself is of an entirely different nature than a city's or a corporation's. People who want to claim at 62 purely out of fear that Social Security is on the verge of collapse should probably be advised to take a chill pill.