Social Security Planning for Couples: Maximizing Survivor Benefits

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A key benefit of Social Security that most people never think about are the payments to survivors following the death of the primary wage earner. These payments can be life-saving for young families, of course, but they can also be very important in determining your retirement income.

One of the first things to understand when you are thinking about when to claim Social Security is that after the death of the higher-earning spouse, the higher benefit will transfer over to the surviving spouse (her own benefit will stop) and continue to be paid for as long as she is alive.

Because the higher-earning spouse's benefit is determined by the age at which he initially claimed his benefit, the higher-earning spouse has direct control over the amount of his spouse's eventual survivor benefit. He can maximize that benefit by delaying the start of his benefit to age 70.

Total lifetime benefits under different life expectancies

Steve and Sarah are a hypothetical boomer couple, age 60. Steve was a high earner all his life and will receive a Social Security benefit of $2,500 if he applies for it at his full retirement age of 66. This is his primary insurance amount, or PIA.

If he files for Social Security at 62, he will receive 75% of $2,500, or $1,875. If he delays the start of his benefit to age 70, he'll receive 132% of $2,500, or $3,300, not counting cost-of-living adjustments between now and then.

Like many boomer women, Sarah had some years where she worked part-time or not at all. Her PIA is $1,400, or a little more than half of Steve's.

Let's imagine two outcomes for Steve and Sarah. One is that they ride off into the sunset together and both live to age 95. The other is that Steve dies at age 70 while Sarah lives to age 95. To be honest, Sarah's early death would have less of a financial impact on Steve—at least from a

Social Security planning standpoint—so we're mainly looking at how to take care of Sarah after Steve dies. It is *his* life expectancy that's the key function here because he has the higher Social Security benefit.

Under the first outcome—they both live to age 95—they will receive a total of $2,062,195 if they both apply for benefits at 62, assuming 2.8% annual cost-of-living adjustments and no change in the current Social Security benefit formula.

If they wait and apply at 70, with Sarah receiving a spousal benefit from 66 to 70, they'll receive a total of $3,128,153, a difference of $1,065,958. This can be considered the value of Social Security's <u>longevity</u> insurance—that is, protection for both spouses in case they both live to age 95. (In present-value terms, with a 0% COLA, cumulative benefits are $1,193,400 under the early-claiming scenario vs. $1,666,176 under the later-claiming scenario—a difference of $472,776.)

Now let's look at the second outcome: Steve dies at age 70. After Sarah reports his death, her Social Security benefit will stop and she will begin receiving her survivor benefit, which will equal Steve's benefit at the time of his death. The amount of this survivor benefit will depend on when Steve originally applied for his benefit. So the value of Social Security's life insurance to Sarah will depend on that decision.

Under the early-claiming scenario, total benefits with COLAs will be $1,456,558 at Sarah's age 95, versus $2,060,963 under the later-claiming scenario, a difference of $604,405. (Or, with a 0% COLA, $878,400 vs. $1,111,776, a difference of $233,376.)

So the insurance is clearly worth more if they delay. But unlike a traditional insurance policy, they didn't have to pay anything for this extra insurance. All Steve had to do was delay his benefit. By waiting until age 70 to start his Social Security benefit, he is gaining over a million dollars worth of longevity insurance in case he lives to age 95, plus an extra $600,000 worth of life insurance in case he dies at 70.

The only time the delayed filing strategy would not pay off is if Sarah also dies early. If Sarah were to die at age 70, the delayed filing strategy would cause them to forego $218,510 in benefits they could have received from age 62 to 70. This may be seen as the "cost" of both the longevity insurance (if Steve lives to 95) and the life insurance (if Steve dies at 70). But this cost goes away if Sarah lives past the classic breakeven age of 78. After that, there is no cost to delaying benefits.

Under the traditional breakeven analysis, an individual must decide between two claiming scenarios: start benefits early at a lower amount, or start benefits later at a higher amount. The breakeven age is the age at which total cumulative benefits from the later-claiming scenario begin to exceed total cumulative benefits from the earlier-claiming scenario. If you are comparing 62 to 70, the breakeven age is about 78. So if you think there is a good possibility that you will live longer than 78, consider delaying your benefit to age 70.

But when you are married, the analysis changes. Then you have to consider the potential life expectancy of the longer-lived spouse. Because Steve's benefit will prevail regardless of who dies first (because his is the higher benefit), they will want to maximize that benefit. So when determining Steve's claiming age, it is not necessary to make a guess on Steve's life expectancy. What matters is Sarah's life expectancy. The odds are very good that she will live past age 78. In any case, it is just good risk management to implement the strategy that will ensure financial security in case she does make it into old age.

So Steve should delay his benefit, even if he has a short life expectancy. In fact, a short life expectancy is all the more reason for him to delay his benefit, because Sarah will be transferring over to her survivor benefit all the sooner. If Steve dies before he claims his benefit at 70, Sarah's survivor benefit will include the delayed credits Steve's benefit had been accumulating up until the time of his death. But if he claims at 62 thinking he might as well get as many checks as he can before he dies, he will leave Sarah with a reduced survivor benefit.

Now, if they really thought Steve might die at 70, Sarah could file for her benefit at 62. This would give her $117,569 in benefits from age 62 to 70, before she switches over to her survivor benefit.

But there is a tradeoff: if Steve ends up living to age 95 (meaning it will be many years before Sarah transfers over to her survivor benefit), they'll end up with lower total benefits: $2,698,426 if she files at 62 vs. $3,128,153 if they both delay. In this case, where you are considering whether Sarah should file for early benefits while Steve delays, Steve's life expectancy *does* matter.

If he has a short life expectancy, he should still delay his benefit in order to maximize the survivor benefit for Sarah. But Sarah can go ahead and file at 62 because her reduced benefit will not be permanent.

On the other hand, if Steve has a long life expectancy, Sarah will be sticking with her benefit for many years before switching to the survivor benefit, so they'll want to maximize her benefit by having her delay and collect spousal benefits from 66 to 70.

The bottom line: Steve should be thinking about Sarah's life expectancy when he claims his benefit, and Sarah should be thinking about Steve's life expectancy when she claims her benefit.

Fast-forward 30 years

We've been talking about the value of Social Security in terms of cumulative benefits. But to surviving spouses the income is often more important.

The year is 2043. Sarah is 90-years old and sitting on the front stoop of her assisted living facility with her other widowed friends. They are comparing their monthly Social Security checks. Sarah recalls back when she and her late husband Steve were talking with their financial advisor about when to claim Social Security benefits. It was tempting to start Social Security at 62, but their advisor showed them how much more they would receive if they delayed the start of their benefits to age 70.

Sarah shares with her friends that her monthly Social Security benefit, with all the cost-of-living adjustments, is now up to $7,556. That's because when Steve died right after claiming his benefit at 70, his higher benefit transferred over to Sarah. Because he had delayed his benefit, her survivor benefit included all the delayed credits that had accrued to him between full retirement age and age 70. And then the benefit was raised each year by annual cost-of-living adjustments.

"I wish my husband had done that," Sarah's friend Janice remarks. "My monthly check is only $4,293. It's hard to get by on that amount now that everything is so expensive." Sarah empathizes with her friend, but can't help feeling satisfied that her Social Security check is more than half again as much as Janice's. (It's actually 76% higher.)

The lower amount that Janice is now receiving would have been Sarah's monthly benefit if she and Steve had taken early benefits. Sarah's eyes might have glazed over 30 years ago when they were talking about total potential benefits in the millions of dollars, but what matters to her right now is the amount of income she is receiving in her old age and her ability to make ends meet without worrying about running out of money. She knows the income will continue for as long as she lives, and she's grateful that her late husband and their advisor had the forethought to maximize her Social Security income by delaying the start of benefits—even when it seemed counterintuitive to do so.

As director of retirement and life planning for Horsesmouth, Elaine Floyd helps advisors better serve their clients by understanding the practical and technical aspects of retirement income planning. A former wirehouse broker, she earned her CFP designation in 1986.