7 Social Security Mistakes to Avoid

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Most clients get lost trying to navigate Social Security on their own. There are about 8,000 strategies available for couples and more than 2,700 separate rules on benefits, according to the Social Security Administration. Yet most couples don't explore all the possibilities; as a result, they end up leaving an estimated $100,000 in benefits on the table, reports Financial Engines, an online money management firm.

For many advisors, talking to clients about Social Security often means having a brief conversation that ends with the traditional advice of "wait as long as you can until you file." But Social Security, with its myriad filing-maximization strategies, should play a much larger role in a comprehensive planning discussion.

Consider these basic questions: How do you ensure a nonworking spouse reaps the highest possible payment? Should the higher earner wait until age 70 to receive payments? What's the advantage of taking benefits at age 62? Should clients take benefits earlier if they are in poor health? How can divorcees claim a benefit based on an ex-spouse's earnings?

Clearly, there are several right and wrong routes to maximizing Social Security benefits. Here are some of the most common mistakes and how advisors can address them.

1. Not planning for opportunity cost

What's the cost of waiting to take Social Security? How will withdrawals from retirement funds impact clients' portfolios?

Advisors need to understand how a Social Security claiming strategy will affect a client's net worth, notes Ben Hockema, a CFP with Deerfield Financial Advisors in Park Ridge, Ill. "If you wait to take Social Security, that will mean withdrawing more money from a portfolio," he says. "The Social Security decision involves trade-offs."

Hockema runs Excel spreadsheets in conjunction with specialized Social Security software to show clients what opportunity costs look like in terms of lower portfolio values, displaying return assumptions with graphs.

Many financial advisors point out that the answer is not always to wait until 70 to take Social Security. You have to take a broader view.

2. Failure to consider family history

What are the client's family circumstances? What do they expect in terms of life expectancy? Have other relatives been long-lived?

Even if answers are imprecise, the discussions can provide valuable insights into how to plan Social Security claiming, say advisors who are trained in these strategies. But it's the advisor's role to tease out that information, notes CFP Barry Kaplan, chief investment officer with Cambridge Wealth Counsel in Atlanta.

"People often have no clue" about the best Social Security claiming strategies, Kaplan says. "It's complicated."

3. Not integrating tax planning

One key question to consider: What are the tax implications of a particular strategy, given that working clients will be taxed on Social Security payments?

Here's how Social Security benefits taxation works: If your clients are married and filing jointly, and their income is between $32,000 and $44,000, then they may have to pay tax on half of their benefits. Above $44,000, up to 85% of the benefits can be taxed.

For those filing single returns, the range is from $25,000 to $34,000 for the 50% tax and 85% above $34,000. Be sure you can advise your clients on how to manage their income alongside their Social Security benefits.

4. Failing to ask about ex-spouses

Be sure to ask your clients about their marital history, understand what they qualify for and analyze how it will impact their cash flow. Was the client married long enough to qualify for spousal benefits? How much was the client's ex making? Be sure to walk through different options with clients.

Kaplan offers the example of a 68-year-old woman who was twice divorced: "She was still working, and it had been 20 years since her last marriage," Kaplan says. "I then discovered ... a former spouse's income that netted my client an immediate $6,216 — six months in arrears — and would result in an additional $1,036 per month until age 70, for a total [of] $30,000 in additional benefits."

Kaplan's divorced client was able to claim benefits based on her first spouse's earnings, which boosted her monthly payment considerably.

5. Overlooking spousal options

A key question to ask: Does the "file and suspend" strategy make sense in your clients' situation? In this case, the higher-earning spouse can file for benefits, then immediately suspend them, allowing the monthly benefit to continue to grow even if the other partner receives the spousal benefit.

The result: The lower-earning spouse can collect benefits while the higher-earning spouse waits until 70 to collect the highest possible payment.

6. Not taking advantage of new tools

Although specialized software packages can generate a range of benefit scenarios, only 13% of planners use subscription-based tools designed for Social Security maximization. (Most planners do have some comprehensive planning tools available, but they may not integrate Social Security scenarios.)

Most planners rely upon the free and often confusing calculators from the Social Security Administration, along with online calculators and general planning software, according to a survey by Practical Perspectives and GDC Research.

That's despite the fact that only a quarter of planners "are comfortable enough to plan and recommend Social Security strategies to clients," the survey noted.

A detailed conversation about Social Security may be even less likely to occur with high-net-worth clients, according to the survey.

When you approach Social Security with your clients, consider that there are multiple nuances within the system's rules that few practitioners have studied, and these could result in higher payments. You may need some of the sophisticated tools now available.

7. Dismissing it altogether

There's another reason clients — and often planners — don't drill down into Social Security strategies: They don't think it will be available in coming decades.

But don't write it off altogether. The truth is that Social Security's trust fund, the money held in reserve to pay for future retirees, is adequate to pay full benefits until 2033. If Congress does nothing to address the funding shortfall, the government will pay three-quarters of benefits until 2088.

And Social Security is one of the most successful and popular government programs in history, so it's difficult to bet against its long-term survival.

David Blain, president of BlueSky Wealth Advisors in New Bern, N.C., suggests that, in addition to carefully reviewing benefit statements and earnings records, advisors should explore other aspects of Social Security, including spousal, death and survivor benefits.

"You need to take it seriously," Blain says about integrating Social Security into a plan. "Clients may not understand it and think it's not going to be there for them."FP

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