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Evolution of Social Security Claiming Strategies and the Bipartisan Budget Act of 2015

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On April 7, 2000, President Clinton signed into law P.L. 106-182, the Senior Citizens' Freedom to Work Act. This significant legislation liberalized how benefits are paid to Social Security beneficiaries. The major change made by this legislation to the Social Security law was the elimination of the earnings test for people who worked between their full retirement age and their age of 70. Before the Senior Citizens' Freedom to Work Act became law, prior to age 70, Social Security benefits were reduced if a worker had earned income over an established threshold in the year that benefits were paid. Although this earnings test threshold limit increased each year, the earnings test reduction in benefits was not popular with the increasing number of working seniors. The earnings test was a holdover of the Depression era rule that tried to force older workers out of the work force to make room for younger workers. The rule had seen its time and needed to be changed to keep up with the evolving role of older workers in the United States economy.

In addition to the elimination of the earnings test, the Senior Citizens' Freedom to Work Act quietly introduced new filing options that added flexibility to the system and allowed workers to leverage their spousal benefits. The most significant new filing option was called the File and Suspend strategy. The second filing option was called the Restricted Filing strategy.

The details and advantages of the File and Suspend strategy and the Restricted Filing strategy are clear when used in a short case study. In this example, let's assume that married couple Bob and Mary were both born in the same year (1950) and are both now 66 years old. Let's also assume that Bob has earned benefits that would pay him $2,400 a month at his full retirement age of 66 (this year). Let's also assume that Mary has earned benefits that would pay her $1,000 a month at her full retirement age of 66 (this year). Using these filing options, both Bob and Mary could increase their retirement income cash flows from Social Security. In this case, Bob would file for benefits and suspend the payments. Bob would do this for two reasons:

1. To allow Mary to file for her spousal benefits from his record and also earn delayed retirement credits of 8 percent per year (simple interest) on her record. Using this strategy, her benefits would increase by 32 percent for the rest of her life, starting at her age 70.

2. To allow Bob to earn delayed retirement credits of 8 percent per year (simple interest) on his own record. At his age 70, his benefits would also increase by 32 percent for the rest of his life. Before age 70, he could lift the restriction and either begin receiving Social Security benefits with the delayed retirement credits earned to that time or receive a lump sum payment of the suspended benefits and start receiving benefit payments without delayed retirement credits.

Mary would apply for Social Security benefits but using a Restricted Filing, restricts it to only her spousal benefits. This would allow her to receive half of Bob's benefits while her own benefits earn delayed retirement credits. When she is 70, she lifts the restriction and receives her own benefits. Her benefits have increased by 32 percent, to an amount that exceeds her spousal benefits on Bob's record.

The extraordinary thing about the combination of these two filing strategies is that Mary could have monthly income benefits starting at age 66 from her spousal benefits. This spousal benefit income could help provide an income bridge to their age 70 when delayed retirement credits would add 32 percent to both of their earned benefits.

It is important to remember that delayed retirement credits were introduced in 1983 as a way to entice people to take benefits later in life. The delayed retirement crediting rate of increase for people born after 1943 is two-thirds of 1 percent per month or 8 percent per year. Keep in mind that the prime interest rate, as reported by the Federal Reserve on their website in 1983, hovered in the 10.5 percent to 11 percent range. In 1983, this made the 8 percent rate for delayed retirement credits reasonably conservative. However, by 2008, when people born in 1944 started to approach their full retirement age of 66, the prime interest rate, as reported by the Federal Reserve, hovered in the 3.5 percent range. These interest rate differences reflected the relative decline in rates between 1983 and 2008. Although the rates available to the average person were different from the prime rate, they dramatically reflected the change in rates over time.

Because of this implosion of interest rates, in the shadow of the looming Great Recession, the value of the 8 percent per year delayed retirement credit with no market risk, became a very big deal. By combining the two filing strategies of File and Suspend with File and Restrict, workers turning 66 in 2009 had a real advantage over the existing interest rate market and could dramatically increase their benefits with little or no interest market rate risk.

It took some time for workers, the financial service industry and the press to catch up to the new world of Social Security retirement benefits.

By 2015, however, the File and Suspend and File Restricted methodologies were perceived by some in government as the evolution of aggressive claiming strategies, which would only be used by higher income people to game the system in ways that were never intended by those who drafted the Senior Citizens Freedom to Work Act in 2000. As a result, changes to the Social Security law were included in the Bipartisan Budget Act of 2015. It was signed by President Obama on Nov. 2, 2015.

There is some good news contained in this new law. People who have already claimed benefits using these filing strategies and those who qualify for survivor benefits are not affected by these changes. There is also some bad news contained in this law.

Workers now fall into one of three tiers, with different levels of impact for each tier.

Tier 1 – The ability to file and suspend at age 66 so that a spouse (or other dependents) can claim benefits using the worker's personal earnings record is only available until April 29, 2016. To take advantage of this limited "grandfather" provision, the worker must be 66 and apply to the Social Security Administration to file and suspend "their benefits by April 29, 2016. After April 29, 2016, suspending worker's benefits will also suspend benefits of anyone who has also claimed on that record."

It is important to note that these dates are tentative and subject to change at any time by the Social Security Administration. In fact, a revision to one of the File and Suspend dates was just announced on Feb. 18. Suspending benefits after April 29, 2016 will suspend the worker's benefits and any other benefits being paid on the worker's record.

Tier 2 – If workers were born on or before Jan. 1, 1954, they can still make a Restricted Filing to restrict their Social Security application to spousal benefits once they turn age 66. This will allow their own benefits to grow with delayed retirement credits while they collect spousal benefits. If married workers want to take advantage of this limited grandfather provision of the law, one spouse must either be receiving benefits or have filed and suspended.

Divorced workers who were married more than 10 years, and born on or before Jan. 1, 1954, can file for spousal benefits from their ex-spouse. If the workers have been divorced for at least two years, the ex-spouse does not have to file for benefits. If the workers have not been divorced for at least two-years, the ex-spouse must have filed for his or her benefits before spousal benefits can be paid.

Tier 3 – For younger workers, the option to File and Suspend and the Restricted Filing strategies have been eliminated. For younger workers, suspending benefits will now impact all benefits. After April 29, 2016, no one else can receive benefits based on the worker's record during the suspension. File and Suspend will only be beneficial to the worker who filed for benefits before his full retirement age and wants to now stop and earn delayed retirement credits. For example, the worker could file for benefits at age 62, perhaps to allow a spouse or dependent child to receive benefits. The worker could then suspend his own benefits at full retirement age to earn delayed retirement credits. This would increase his Social Security benefits when the suspension is lifted at a later age.

If a worker files and suspends his benefits after April 29, 2016, he will not be able to request a lump sum payment of the benefits that he was entitled to receive during the suspension period.

In addition, if a worker is under age 62 on Jan. 1, 2016, he will not be able to file and restrict his benefits to claim spousal benefits while he earns delayed retirement credits on his own record.

CONCLUSION

For those who cannot File and Suspend or cannot file a Restricted Application, Social Security planning is still important. If a worker's full retirement age is 66, waiting until age 70 will result in a 76 percent larger benefit than claiming benefits at age 62. Waiting even one or two years past full retirement age can produce a larger monthly benefit in retirement.

Coordinating the starting ages for a married couple, or for singles, is still a powerful and the only remaining way to maximize these benefits during retirement. The removal of the File and Suspend and the Restricted Filing strategies has shifted greater responsibility for funding retirement to individual workers. Only by careful planning and increased savings can younger workers build bridging strategies that will help offset the loss of Social Security benefits they could have received using these strategies. ■

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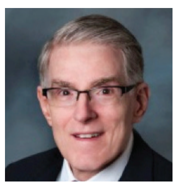

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