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Breaking Bad: How Behavioral Biases Affect Social Security Claiming Strategies

With Social Security planning, perception is not reality, and the wrong strategy based on incorrect and outlandish beliefs will severely impact the retirement portfolio

By **William Meyer**, co-author of *Social Security Strategies: How to Optimize Retirement Benefits.*

Far from Oprah-style, afternoon, drive-time psychobabble, the tenets of behavioral economics are now widely accepted by advisors and clients alike. In its simplest form, the theory, first developed by Amos Tversky and Daniel Kahneman (for which the latter won a Nobel Prize), states that contrary to traditional economic theory, investors and markets are not fully rational. Translation—we're very adept at screwing ourselves.

A simple market illustration reinforces the point: An oft-repeated statistic from a 2003 Dalbar Survey of Investor Returns finds the average mutual fund investor earned only 2.6% annually from January 1984 through December 2002, compared to annualized inflation of 3% and an S&P 500 return of 12%.

In other words, during one of the greatest bull markets in American history, the average investor's return failed to keep pace with inflation and was a fraction of what they would have received had they simply tracked the S&P 500.

The underpinnings of behavioral economics of course go far beyond financial services and market investing. It most famously made its mainstream debut in Moneyball, Michael Lewis' bestselling book and movie of the same name starring Brad Pitt. In that case, professional baseball players were valued according to perception, rather than performance; that is until behavioral economics expert Peter Brand came along.

Where are we going with this? Simple—the decision about when and how to claim Social Security is no different. The strategy that's ultimately chosen is too often influenced by external (and incorrect) stimuli rather that sound analysis,

and ends up hurting recipients in the long run. Take the following refrains we continually hear:

1). "I WANT THE MONEY NOW BEFORE SOCIAL SECURITY GOES BROKE."

Big mistake. Social Security is one of the few government programs that enjoys overwhelming popularity, and claiming early due to the perceived threat of insolvency will only leave money on the table. We join others who predict that any changes to ensure the ongoing viability of the program are not likely to materially impact anyone over the age of about 55. If you're age 25, it's something to watch, but there'll be plenty of time to adjust.

Grandfather clauses and other cushions will also most certainly soften the blow for older recipients.

But don't take it from us. No less of an authority than The Center for Retirement Research at Boston College makes clear, "Don't start [benefits] early because [you think] Social Security has money problems. ... You won't get more if you do."

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2). "I DON'T WANT TO SPEND MY FINANCIAL PORTFOLIO UNTIL I HAVE TO."

It's true; if you delay Social Security benefits, then your financial portfolio will decrease more quickly before Social Security begins. But overcoming the inherent bias that retirement assets subject to market volatility are somehow more secure than guaranteed payments from the government is critical to the long-term viability of the portfolio. For this reason, advisors should help clients focus on the bigger picture. For instance, for a retiree with a full retirement age of 66, real Social Security benefits are 76% higher if they delay payment until age 70.

3). "I'VE PLANNED AND SAVED WITH AGE 62 IN MIND, AND NOW I'M READY TO BEGIN RECEIVING BENEFITS."

This one needs a long runway, meaning it's easier to convince clients to delay Social Security benefits well before they were planning to begin receiving payments. Fully explain Social Security and the benefits of delaying as early in the relationship as possible. Get them comfortable with the strategy, run simulations and ensure when and how to take Social Security is part of the plan from the start.

About William Meyer

Bill Meyer is founder and managing principal of Social Security Solutions, a leading Social Security software firm with patented technology that is dedicated to educating and assisting financial advisors and their clients in optimizing their Social Security claiming strategies. More information is available at www.SSAnalyzer.com.

About Social Security Solutions

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