Effects of Delaying Receipt of Retired-Worker Benefits

by Bruce D. Schobel, FSA, MAAA, CLU, CEBS

ABSTRACT

Delaying receipt of retired-worker benefits will increase the monthly benefit amount in two ways: (1) age-related increases due to smaller early-retirement reductions and/or larger delayed-retirement increases, up to age 70, and (2) increases attributable to having additional earnings that increase the average lifetime indexed earnings, up to any age, even after having become entitled to benefits. Both types of benefit increase are almost entirely within the worker's control, if continuing to work is an option. Workers and retirees who have not yet claimed Social Security benefits should understand both types of benefit increase for purposes of sound financial planning.

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Most workers who are covered by Social Security through employment or self-employment (roughly 96 percent of the U.S. labor force) and contemplating retirement know that Social Security's retired-worker benefits can begin as early as age 62. (Disabled-worker benefits can begin at younger ages, but those benefits are not the subject of this column.) Workers also usually know that delaying receipt of retired-worker benefits until later than age 62 will result in larger monthly benefits, beyond just the annual cost-of-living adjustments (COLAs) that all beneficiaries receive. Delaying receipt of retired-worker benefits will increase the monthly benefit amount in one or possibly two additional ways: (1) age-related increases due to smaller early-retirement reductions and/or larger delayed-retirement increases, up to age 70, and (2) increases attributable to having additional earnings that raise the average lifetime indexed earnings, up to any age, even after having become entitled to benefits. Both types of benefit increase are almost entirely within the worker's control, if continuing to work is an option. Note that delaying receipt of benefits does not require that the individual actually continue working. Workers and retirees who have not yet claimed Social Security benefits should understand both types of benefit increase for purposes of sound financial planning.

In the simplest terms, most workers can start receiving Social Security retired-worker benefits at any age in the range of 62-70. It's their choice. The retirement earnings test prevents some people who continue to work after eligibility from receiving benefits before their normal retirement age (NRA), but that's another matter entirely. That test ceases to apply starting with the month when the worker attains his or her NRA, and after reaching that age, workers can earn any amount without losing any benefits. Moreover, earnings at and after age 62 can increase monthly Social Security benefits, whether or not those benefits have already been claimed and received.

Table 1 shows Social Security's NRA by year of birth.

Workers becoming eligible for retired-worker benefits during 2021 generally attained or will attain age 62 during this year. Therefore, they were born during 1959 and have an NRA of 66 years and 10 months. Starting in 2022, under present law, all workers becoming eligible for retired-worker benefits will have an NRA of 67.

Retired-worker benefits that are claimed *before* NRA are reduced by 5/9 percent per month for up to 36 months of early retirement and 5/12 percent for each additional month, if any. The maximum number of such additional months is 22 in 2021, but it will rise to 24 next year when workers born in 1960, whose NRA is 67, will first become eligible for retired-worker benefits (and a total of 60 months of early retirement becomes a possibility). Thus, workers claiming benefits at exact age 62 in 2021, whose NRA is 66 years and 10 months, receive monthly benefits equal to 70⅚ percent of their unreduced (NRA) benefit. Under present law, retired-worker benefits claimed at exact age 62 will decline to 70 percent of the unreduced (NRA) benefit for workers with NRA of 67, who will attain age 62 in 2022 and after.

Retired-worker benefits that are claimed *after* NRA are increased by delayed-retirement increments. For workers born in 1943 or later, the increase is ⅔ percent per month of delay, up to age 70. Workers claiming retired-worker benefits at exact age 70 in 2021 were born in 1951 and therefore have an NRA of 66. Thus, their monthly benefits will be equal to 132 percent of what they could have received at NRA, based on 48 months of delayed-retirement increments and ignoring additional earnings-related increases that may or may not apply, as well as COLAs, of course. Under present law, the age-70 benefit will gradually decline to 124 percent of the NRA benefit for workers with an NRA of 67, because they cannot have more than 36 months of delayed-retirement increments. That will first occur for workers born in 1960, who will attain age 70 in 2030, assuming they survive.

Social Security's early-retirement reduction and delayed-retirement increase factors are approximately "actuarial"—that is, they do not significantly subsidize or penalize retirement at any particular age, absent special circumstances such as being terminally ill. In other words, the discounted present value of lifetime benefits is approximately the same, regardless of when benefits are first claimed. The reduction and increase factors are not perfectly actuarial—and cannot be, because the Social Security program is gender-blind and has been for almost 40 years. Social Security law treats men and women exactly the same,

TABLE 1
Social Security's Normal Retirement Age

Year of Birth	Normal Retirement Age
1937 and earlier	65 years
1938	65 years and 2 months
1939	65 years and 4 months
1940	65 years and 6 months
1941	65 years and 8 months
1942	65 years and 10 months
1943-54	66 years
1955	66 years and 2 months
1956	66 years and 4 months
1957	66 years and 6 months
1958	66 years and 8 months
1959	66 years and 10 months
1960 and later	67 years

despite the fact that men and women, on average, have materially different mortality experience. Thus, the reduction and increase factors can't be perfectly actuarial for both genders simultaneously. Moreover, the reduction and increase factors are about right for people with "average" mortality expectations. People who are, for example, terminally ill or confidently expect to live to age 100 obviously would be influenced by those situations (or expectations). In any case, the decision to claim early or delay claiming shouldn't be influenced by the factors themselves, in most cases.

Estimating the effect of additional earnings on retired-worker benefits requires, first, a basic understanding of how Social Security retired-worker benefits are computed. The calculation procedure for a worker has several steps, as outlined below in slightly simplified form:

1. Obtain the worker's Social Security-covered earnings history at every age, year by year. Noncovered earnings, including earnings exceeding the annual contribution and benefit base, are not used to compute benefits and should not be considered. Earnings in noncovered employment obviously should not be included. A worker needs essentially 10 years of covered earnings to be eligible for retired-worker benefits from Social Security.
2. "Index" each year of earnings prior to the worker's year of attaining age 60 by multiplying the year's earnings by the ratio of (a) the national average wage in the year that the worker attains age 60, over (b) the national average wage in the year of the earnings. This generally has the effect of scaling up past earnings, except in unusual circumstances when the national average wage declined relative to a prior year. (That happened in 2009 relative to 2008 and likely happened again in 2020 relative to 2019 and perhaps more years, but the 2020 national average wage won't be known until October 2021.) Earnings at age 60 and later are used at face value, without any adjustment for indexing. The series of annual national average wage amounts is available at the Social Security Administration's website, www.ssa.gov.
3. After every year of earnings prior to age 60 has been indexed, select the highest 35 years of indexed earnings from the worker's entire lifetime earnings history. No minimum or maximum age applies. Some of the 35 highest years of earnings may be after benefit eligibility or entitlement. And for many workers, years with zero earnings may be included in the 35 highest years because they do not have 35 years of nonzero earnings. The number of years used to compute benefits may be less than 35 for workers who had a prior period of disability from which they recovered. Workers going directly from the disability rolls to the retirement rolls do so without any change in their monthly benefit amounts, so their benefits have been computed already.
4. Sum the 35 highest years of indexed earnings, including years with zero earnings if needed to reach 35 years.
5. Divide the sum of the 35 highest years of indexed earnings by 420 (12 times 35). The result, rounded down to a whole dollar, is the average indexed monthly earnings, or AIME.
6. The AIME is used in a benefit formula to produce the primary insurance amount, or PIA. The PIA formula for workers first eligible for retired-worker benefits in 2021 (born in 1959) is:

   90 percent of AIME up to $996, plus
   32 percent of any additional AIME from $996 to $6002, plus
   15 percent of any additional AIME exceeding $6002.

   The percentages—90 percent, 32 percent, and 15 percent—are the same for every year of eligibility. They reflect the fact that the

Social Security benefit formula is weighted in favor of lower-earning workers, whose *replacement rates*—but not their actual monthly benefit amounts—are higher than those of higher-earning workers. The dollar amounts, $996 and $6002, are different for every year of eligibility. They change with changes in the national average wage (see step 2 above). These dollar amounts are known as the bend points of the benefit formula. Historical bend points are available on SSA's website. The PIA is rounded down to the next lower dime.

7. The resulting PIA is the basic building block of all primary and auxiliary Social Security benefits payable on this worker's earnings record. The PIA is the monthly benefit amount payable to a worker first claiming retired-worker benefits at NRA (before reduction for any Medicare premiums). Early-retirement reductions and delayed-retirement increases are percentages of the PIA. Spouses and children who may be eligible to receive benefits based on the worker's earnings record receive percentages of the worker's PIA, both before and after the worker's death.
8. The PIA formula for any worker is always determined as of the year of initial eligibility, generally attainment of age 62 in the case of retired-worker benefits, even though the calculation of the PIA can and often does include earnings in subsequent years. Those earnings after eligibility—and even after entitlement to (i.e., actual receipt of) benefits—can increase the PIA, which is recomputed every year after additional earnings are recorded, regardless of the worker's age at the time.
9. The PIA is also increased by COLAs applied in December of each year, if inflation has exceeded zero, beginning with the year of initial eligibility and continuing until death—and even beyond death if eligible survivors are receiving benefits based on the worker's earnings record.

Social Security's benefit-computation procedure described above is quite complicated, especially compared to the typical private-sector pension calculation. Every element of the procedure is important, but with respect to the decision to delay claiming benefits, workers need to consider two aspects in particular:

1. Whether or not an individual is still working at age 62, delaying receipt of retired-worker benefits will increase the monthly benefit amount by reducing early-retirement reductions and, if delayed beyond NRA, increasing delayed-retirement increments until, at most, age 70. (Delaying benefit receipt beyond age 70 makes no sense from an economic standpoint and should never happen.) Workers who reach age 62 may want to delay claiming benefits because, until they reach NRA, their earnings may prevent benefit receipt due to the retirement earnings test. People who are not working at age 62 may claim benefits then if they need the money, but if they have other resources on which to live for a while, then they may want to delay benefit receipt to maximize what is probably their only source of inflation-adjusted lifetime income.
2. People who are still working at age 62 or who have the option of returning to work after age 62 need to consider whether additional Social Security-covered earnings will increase their monthly benefit amounts. That may or may not happen, depending on the circumstances:
    a. If a worker has fewer than 35 years of Social Security-covered earnings, then any amount of covered earnings in a year would replace a year of zero earnings that had been included in the calculation of that worker's PIA. Thus, the

PIA would be higher.

b. If a worker already has 35 years of Social Security-covered earnings, then the amount of covered earnings in a year would be used to compute—and increase—the worker's PIA only if it exceeds the earnings in one of the 35 previous highest years, after indexing. If the new year of earnings is insufficient to replace one of the 35 highest years, then the PIA and monthly benefit amount would not change.

People contemplating retirement often ask whether the potential increase in Social Security benefits due to additional earnings is worth as much as the taxes paid on those earnings. Because the weighted-benefit formula (step 6 in the calculation procedure described above) provides decreasing returns on increasing earnings, the marginal benefit increase is usually less than the value of the taxes paid, especially for higher-earning workers in the 15 percent PIA bracket and certainly if the additional earnings produce no benefit increase at all because earnings in the year do not replace one of the previous 35 highest years of earnings. Of course, that failure to generate sufficient additional benefits is no reason not to work. Most people work because they want the income or want to stay busy, not merely to increase their Social Security benefits. In any event, the financial effect of reducing early-retirement reductions and increasing delayed-retirement increases usually far exceeds the effect of additional earnings on an individual's monthly Social Security benefit amount. ■

Bruce D. Schobel, FSA, MAAA, CLU, CEBS, is a consulting actuary in Winter Garden, Florida, who worked for SSA during 1979 through 1988 and has stayed involved in Social Security matters since then. He was staff actuary to the National Commission on Social Security Reform (the "Greenspan Commission") that developed the framework for the Social Security Amendments of 1983. He can be reached at bdschobel@aol.com.