

Understanding Social Security Benefit Estimates

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–Elaine Floyd, CFP®

If you track your Social Security benefit estimates via your annual statement, you've probably noticed some variations. How can it be that the amount you are scheduled to receive at full retirement age (FRA) is different – perhaps even lower – than it was a few years ago?

Earnings assumptions

The reason is that the Social Security Administration (SSA) is basing your future benefit on certain assumptions. One key assumption relates to your earnings. Using a complex algorithm that factors in your past earnings as well as projections for your future earnings, SSA refigures your benefit estimate every year, sometimes changing the amount based on variations in the average wage index. In other words, if they've been assuming your wages would rise by X% but the average wage index rises by less than X%, they will adjust your benefit estimate to account for the lower increase. If you see your benefit estimate go down, it doesn't mean they are reducing your benefit; it means their prior estimate was too high.

Actual earnings

Another thing that can cause your benefit estimate to be off is that your actual earnings may turn out to be different from SSA's assumptions. In this case you may not find out until you apply for benefits that the amount you've been seeing on your statement is not the amount

you will actually receive. SSA assumes you will keep working at the same salary (plus annual raises) until claiming age. The amount you are projected to receive if you apply at your FRA, called your primary insurance amount or PIA, assumes you will keep working until FRA. The amount you are projected to receive if you apply at age 70 assumes you will keep working until age 70. If you stop working prior to claiming age, your benefit could turn out to be lower than the amount you see on the statement.

What if you retire early?

How much will your benefit be if you retire at, say, age 55? If you are a maximum earner – that is, you earned the maximum amount on which Social Security taxes are paid each year for 35 years – you will still receive close to the maximum benefit. But because recent earnings count for more than earlier earnings, even after those earlier earnings are indexed for inflation, the fact that you had zero earnings for the 12 years leading up to your FRA will cause your benefit to be lower than the amount shown on your statement.

Using the SSA Quick Calculator, we see that the benefit for a maximum earner age 55 who keeps working to age 67 and who claims his benefit at FRA is \$3,281. But if he stops working at 55, his age-67 benefit is \$3,200, a difference of \$81 per month. Needless to say, a lot goes into the decision to retire at 55. You must have enough income from other sources to get you by before Social Security starts, whether you take a permanently reduced benefit at 62 or hold out for the maximum benefit by claiming at 70. Before making any decisions, you will need to have accurate data. To see how your Social Security benefit may be affected by stopping work early, use the Retirement Estimator at www.ssa.gov/estimator.

What if you work longer?

The flip side of retiring early is working longer. More baby boomers are working well into their 60s and 70s today, even after they've started receiving Social Security benefits. How will continued work affect their Social Security benefit?

Here's an example for a maximum earner born in 1960. Upon turning 62 in 2022, his PIA is officially calculated based on his highest 35 years of indexed earnings. Having earned the maximum each year, his PIA is calculated to be \$3,357. (Note: this is the amount he will receive in four years when he applies at his FRA, not the reduced amount he would receive at age 62.)

Now, what if he works another four years? Because recent earnings count for more than earlier earnings even after indexing, his PIA will go up. But not by very much. His new PIA, calculated with four years of additional earnings (and four years of earlier earnings dropped off his record to count exactly 35 years of earnings), would be \$3,386, just \$29 higher. These numbers do not account for annual cost-of-living adjustments.

As this illustration shows, once you already have 35 years of maximum earnings, additional earnings will not increase your Social Security benefit by very much. At this point, the main reason to keep working is for the earnings themselves and the extra retirement security those earnings can bring (plus the psychic rewards, of course).

People with less than 35 years of earnings – such as parents who took time out of the work force to stay home with children – have more of an opportunity to raise their Social Security benefit. If you are interested in seeing how continued earnings may raise your Social Security benefit, use the Retirement Estimator at www.ssa.gov/estimator.

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