How to Help Participants Maximize Their Social Security Benefits

For Americans in their 60s, choosing when and how to claim Social Security is, quite literally, a life-altering decision. By one estimate, the median household stands to gain $182,000 in lifetime discretionary spending by claiming at the right time.[1] This is meaningful given that the average 401(k) balance is about $200,000 for participants age 55–60 and the median balance is just $55,000.[2]

Most plan sponsors, advisors, and consultants are aware that delaying taking Social Security results in higher income for life—each year delayed represents about a 7–8% increase in annual benefits for the rest of one's life.[3] In addition, Social Security benefits are indexed to inflation, which helps retirees preserve purchasing power.[4]

But there is a clear disconnect between what we know and how participants behave. In Allspring's latest Retirement Study, we found that half of near-retirees rely solely on self-education to understand Social Security.[5] Perhaps as a result, 62 remains the most popular age to claim, even though doing so results in permanently reduced annual benefits.[6]

Since Social Security claiming is so important, how can plan sponsors, advisors, and consultants help participants understand that claiming **later** usually means claiming **more**?

Almost 1 in 2 near-retirees rely solely on self-education to understand Social Security.

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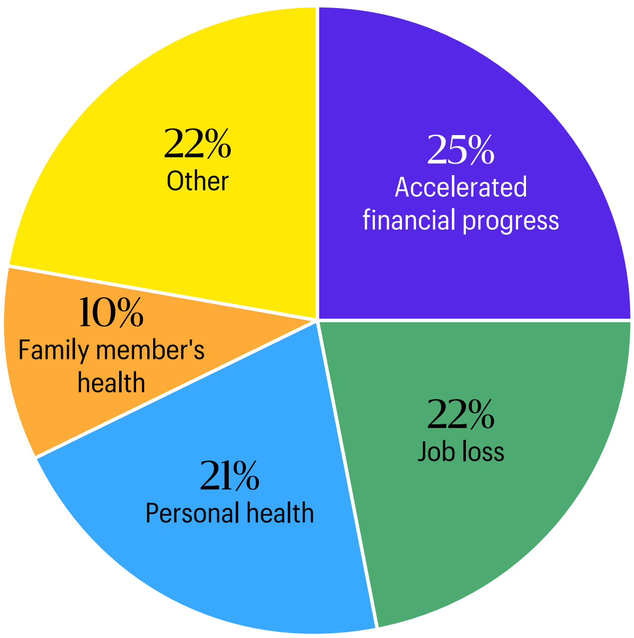
1. For participants age 45–62. How Much Lifetime Social Security Benefits Are Americans Leaving on the Table? David Altig, Laurence J. Kotlikoff, Victor Yifan Ye 2022
2. Note that some retirees may have multiple accounts. Does not include Americans who do not have a DC account. https://www.empower.com/the-currency/life/average-401k-balance-age
3. https://www.ssa.gov/oact/quickcalc/early_late.html#:~:text=A%20worker%20can%20choose%20to,by%20retiring%20at%20age%2070.
4. https://www.ssa.gov/oact/cola/colaseries.html
5. Participants needed to be 50 years or older in age, live within the United States, be a primary decision-maker of household financials and investments, and have at least $50K in household investable assets. Near-retirees needed to also be employed and less than 10 years out from retirement. Hiding Behind the Averages: What does conventional wisdom tell us about successful retirement outcomes? Allspring, 2022
6. https://money.usnews.com/money/retirement/social-security/articles/the-most-popular-ages-to-collect-social-security

Retiring and claiming Social Security should be separate decisions

Retiring from one's job should not be automatically linked with the decision of when to claim Social Security benefits.

Early retirement occurs for a variety of reasons. Allspring found that 25% of people that retire early do so because of "accelerated financial progress," 22% do so because of a job loss, 21% due to personal health, and 10% due to a family member's health issues.

WHY PEOPLE RETIRE EARLY



Source: Allspring Retirement Study

Those who are retiring for "good reasons," such as better-than-expected financial progress, likely have additional savings or sources of income that can ease the decision to delay claiming. For those who retire because of a job loss or due to a family member's illness, the decision to claim immediately should not be automatic. In fact, most of these people could benefit from delaying claiming for as long as possible. Serious health issues that threaten personal life expectancy may warrant claiming at 62, but even in this scenario the impact on spousal benefits should be carefully considered.

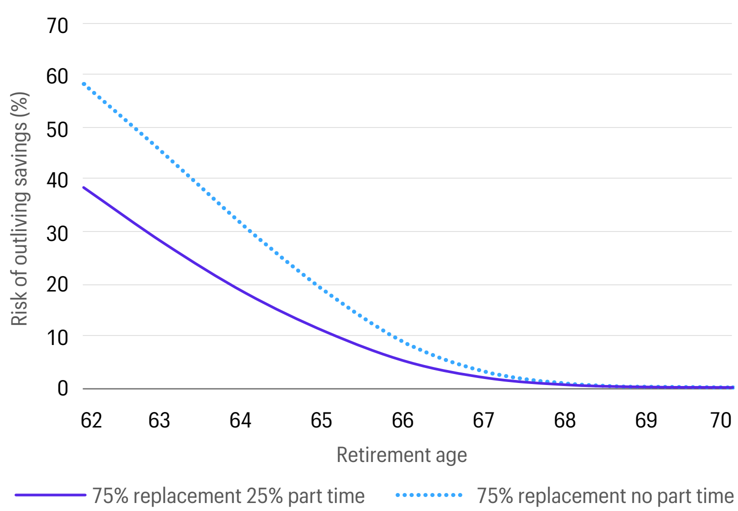
DID YOU KNOW?

Every year, thousands of Social Security recipients receive checks from the Social Security Administration (SSA) that are below or above the benefit they actually qualify for; in aggregate, this adds up to billions of dollars per year.[8] Major causes of these errors include incorrect self-reporting of wage and employment information and a failure within the agency to access relevant data.[9] If the SSA becomes aware of overpayment errors, it has the authority to claw back payments in as short a period as 30 days. It is possible to appeal, but the process can be exceedingly stressful.[10] Participants who have received Supplemental Security Income at some point during their lifetime are especially at risk.[11]

One way to address this is to stop communicating that age 62 is the "early retirement age." This way of framing may be misinterpreted by participants who see retiring early as an unambiguously good thing. Instead, plan sponsors, advisors, and consultants can refer to age 62 as the "minimum benefit age," which better reflects the reality of claiming early.

Another is to encourage participants to delay claiming and instead work part time in retirement. Currently, 13% of all retirees still work in some capacity, as do 18% of retirees with a bachelor's degree.[7] Allspring has found that working, even minimally, can significantly reduce the risk of a retirement shortfall.

PART-TIME WORK IN EARLY RETIREMENT IMPROVES OUTCOMES



Source: Allspring

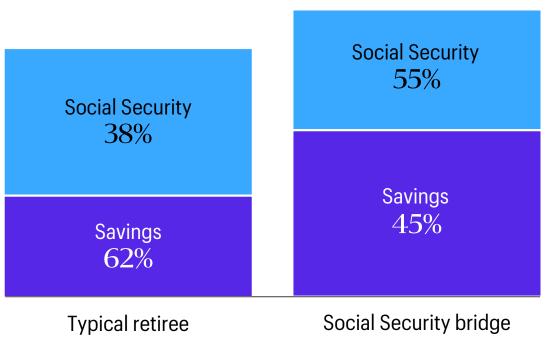
7. https://www.federalreserve.gov/publications/files/2022-report-economic-well-being-us-households-202305.pdf
8. https://www.gao.gov/assets/gao-23-106285.pdf
9. https://www.cfo.gov/wp-content/uploads/2022/Q3/Old-Age,%20Survivors,%20and%20Disability%20Insurance%20Payments%20Integrity%20Scorecard%20FY%202022%20Q3.pdf
10. https://www.nextavenue.org/social-security-horror-stories/
11. https://www.gao.gov/assets/gao-23-106285.pdf

Build a bridge

Defined contribution (DC) participants need to know that a Social Security "bridge strategy" can help them receive higher lifetime benefits. In a bridge strategy, retirees delay taking Social Security until age 70 while taking larger withdrawals from other sources or continuing to work (on a full- or part-time basis) to fund their retirement expenses in the interim. Sources of this income can include DC assets, brokerage accounts, IRAs, bank deposits, and more.

To visualize this, we can look at an average U.S. man who retired at 65 and compare the impact of him claiming Social Security immediately or using a bridge strategy until age 70.[12] If he lives to his average life expectancy of 84 years, the bridge strategy would generate an extra $24,000 of real income from Social Security (while also preserving $24,000 from his other savings sources). He could spend more every year because a greater portion of his ongoing income is coming from a guaranteed source. Moreover, since Social Security is inflation-indexed, 55% of his income is sheltered from inflation risk.

RETIREMENT INCOME SCENARIOS FOR 84-YEAR-OLD



	Typical retiree	Social Security bridge
TOTAL SS PAYOUT:	**$355K**	**$359K**
SAVINGS PAYOUT:	**$535K**	**$511K**

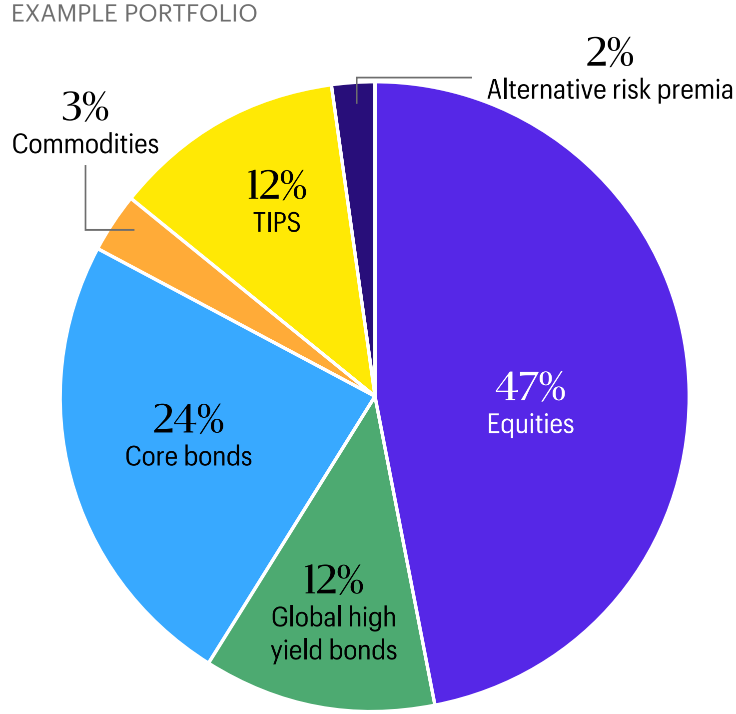
Source: Allspring

A bridge strategy can be behaviorally challenging, as participants are often reluctant to draw down their retirement savings. However, research suggests that one-third of retirees would be open to implementing a bridge strategy, even if they had no prior knowledge or experience with the approach.[13] It is possible that future changes to Social Security could make this strategy less attractive. The good news is that researchers have found that the bridge strategy will likely retain its status as a top lifetime income strategy even under various possible Social Security benefits reforms.[14]

For DC plans looking to promote the use of a bridge strategy, it's important to determine if the plan/recordkeeper offers ad hoc partial withdrawals and scheduled withdrawals, ideally at low or no cost. This option makes it easier for participants to rely on the plan before drawing Social Security. Second, plans may consider making post-retirement distributions the default, with the goal of using participant inertia to encourage retirees to live off their retirement savings for longer before claiming.

Once these operational considerations have been addressed, the plan can look at participants' asset allocations. A balanced fund could work for some. Others who have outside assets may wish to purchase tax-inefficient strategies that would be shielded by the tax-advantaged status of a DC plan. The average DC plan offers just one fixed income fund for every three equity funds,[15] so there may be room for higher income and higher turnover strategies. Finally, it's important to consider inflation risk, because inflation is a significant risk to the purchasing power of retirees. Plans can address this by including inflation-sensitive asset classes.

EXAMPLE PORTFOLIO



Source: Allspring Retirement Study

12. The benefit of a bridge strategy is even higher for the average woman, because of greater longevity.

13. WOULD 401(K) PARTICIPANTS USE A SOCIAL SECURITY "BRIDGE" OPTION? Alicia H. Munnell and Gal Wettstein, Boston College Center for Retirement Research, December 2021

14. The Quest for Lifetime Income: Will the Bridge Strategy Weather the Approaching Storm of Social Security Reform? Morningstar, 2022

15. The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, September 2022

Action steps

01 Offer education

- Communicate to participants the critical importance of claiming Social Security at the right time. Cite research that claiming correctly can provide **$182,000 higher disposable income** for a household.
- Help participants **separate the decision** to retire from the decision to claim Social Security benefits.
- Instead of referring to age 62 as **“early retirement age,”** call it the “**minimum benefit age.”**
- Highlight the idea of **working part time in retiremen**t.
- Consider offering access to robust **Social Security optimization software**, which can guide participants through a claiming strategy that is specific to their situation. This may be more affordable than you expect.

02 Review operations

- Reach out to your recordkeeper to determine if **scheduled and ad hoc partial distributions** are possible. Ensure that the cost of these distributions is low or zero so they are affordable.
- Consider **defaulting participants** into receiving regular distributions from the plan once they retire.

03 Use your resources

- Plan sponsors should **partner with their advisor/consultant**, particularly regarding the selection of investment strategies to include in plans. They can also help guide conversations with recordkeepers and thoughts on best practices.

Please be sure to check out our retirement study, “A Clear Vision of Retirement: How Perception Shapes Our Reality,” on allspringglobal.com.

For further information

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