

# Social Security Early Commencement Benefits

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## The Proposal

In one respect, Social Security offers great flexibility to its future recipients: they can choose any age from 62 to age 70 to begin receiving benefits, with benefits reduced or increased appropriately from the standard formula's result. But other than choosing the start date, Social Security is an all-or-nothing benefit.

What if there were an easy way to increase the benefit's flexibility to provide increased options around benefit commencement – at no cost to the system?

I propose implementing two new “phased retirement” elements/flexible benefit commencement options to remove the all-or-nothing nature of Social Security benefit commencement:

First, I propose to **enable participants to only partially begin benefits**, and defer full benefit commencement to a later time. In an actuarially equivalent manner, their full benefit, when ultimately received, would be reduced to a lesser degree than if they had begun full commencement.

Second, I propose that **early commencees be permitted to stop benefits at any point without penalty or repayment required**, and that, when they restart their benefits, they be **increased in an actuarially-equivalent manner**. Note that there exist strategies to start, stop, and restart Social Security benefits, these are not accessible to the average worker. This proposal seeks to provide maximal flexibility to benefit recipients.

Both of these proposals would be paired with an elimination of earnings penalties currently applied to recipients between early retirement and full retirement age whose earnings exceed a given threshold.

This is not a big proposal. It's intentionally unambitious, more akin to the “life hacks” that promote simple changes that make a tangible difference. But it's feasible, and doable, and bipartisan.

## Some examples

### *Initial partial benefit*

Using the Social Security's existing reduction factors, a full retirement age monthly benefit of \$1,000 will be reduced to **\$700** for an individual commencing benefits at age 62, in 2022 or later.

If that individual were to begin benefits at age 62 at a 50% rate to supplement lower wages, that would provide \$350 per month at age 62.

If that individual were then to begin full benefit commencement at age 67, instead of the \$700 lifetime benefit, the benefit would be **\$850** (\$350 for the continuing age-62-commenced portion and \$500 for the half begun at age 67). Taking this a step further, benefits are increased by 8% for each year of delay from age 67 to 70. If that worker delays collecting full benefits until age 70, the ultimate benefit would be  $\$350 + \$500 * 124\%$  or **\$970**, that is, pretty much the same as if waiting until full retirement age.

#### *Stop/restart options*

Again, an individual beginning benefits at age 62 will receive \$700 where waiting until age 67 would have meant a \$1,000 benefit.

If that individual were to stop benefit collection at age 64, then resume at age 67, the reset benefit reflective of two years of foregone benefit collection, would be \$913.

If the individual delayed ultimate retirement to age 70, the ultimate benefit would be \$1,151 (compared to \$1,240 if the retiree had never commenced until age 70).

(Note that these calculations are based on annuity factors which are a close match for actual Social Security factors: 4% real interest, RP2014 mortality with generational improvements at the year 2019, blended 50/50 male/female.)

## **Who benefits?**

We know that many Social Security participants commence benefits earlier than they expected not because of a personal desire to relax but because of a job loss or other lack of ability or desire to continue working at their usual job, for example, due to personal ill health (not severe enough to qualify as “totally disabled” with respect to Social Security) or the need to care for an ailing spouse.

These two proposals for phased retirement seek to meet the needs of individuals in these circumstances.

In some cases, workers are be unable to continue at their longtime job and prefer employment that is less arduous or demands fewer working hours. This reduced income may not be enough to meet their financial needs, and they may not have sufficient savings to top up their wages until beginning Social Security.

It is hoped that in some such instances, **the ability to use a partial Social Security benefit as a “top up”** could help such individuals both remain in the workforce and defer collecting their full benefit until a later date, enabling them to increase their benefits beyond the lower age-62 amount.

In other cases, individuals who are unemployed when they reach age 62 begin their Social Security benefits and leave the workforce, that is, cease their search for new employment. If such recipients were told they could stop and restart their benefits at any time, and gain more

money in the future by doing so, **they would be less likely to see their working life as ended**, and continue the job hunt instead.

It is also the case that some older workers would use these increased options in the opposite way – workers who would otherwise push themselves to work until age 67 or even later in order to preserve/maximize their Social Security benefits, may use these new options to partially-begin benefits earlier. While this was not be the intention of proposing flexible benefit commencement options, it would nonetheless benefit workers in any case, simply by increasing available options, even if they act in a way that is counter to policy experts’ preferences.

## How Beneficial Would This Change Be?

The concept of providing flexible benefit commencement options through Social Security is new and without precedent in other countries to demonstrate its potential popularity or the benefits it might provide. However, we know the following:

- Workers are delaying Social Security benefit commencement relative to even recent claiming patterns, but significant numbers still do claim early.
- Individuals in surveys express a preference for working longer and for partial retirement.
- Longer working lifetimes result in better health.
- While workers, in principle, can collect their full benefit and save the surplus for a rainy day, automating this via defaults (a “nudge” in behavioral economics terms) makes this more likely to occur.
- The “nudge” also offers reason to believe that benefits could extend beyond the limited group directly benefitting from partial Social Security benefits to the wider population.

To address each of these in turn:

### *Data on early commencement*

In the most recent year of data available, the Social Security Administration reports that, among men,

- 35% of new recipients began receiving benefits at age 62;
- 49%, before the historic normal retirement age of 65; and
- 62%, before their actual full retirement age.

For women, the applicable figures are

- 39% at 62,
- 55% before age 65, and
- 67% before their actual full retirement age.

For both men and women, rates of early commencement are declining; even as recently as 2005, the corresponding rates were 57%/76%/82% for men and 60%/78%/85% for women. (All these rates exclude disability insurance recipients whose benefits automatically convert to old-age benefits at full retirement age.)<sup>1</sup>

The SSA also provides data on the average benefits, among new commencees, split among those with and without early retirement reduction. Among all retirees whose benefits were reduced for early commencement, the average benefit per recipient was \$1,239.77; for that same group, the Primary Insurance Amount (that is, the benefit before reduction) was \$1,490.33. In other words, the average benefit reduction was 17%. (For comparison, the PIA for the non-early-retirement group was \$1,618.13, which was adjusted upwards to an average of \$1,729.20 when taking into account those who retired late.)

Looked at another way:

- 29% of new recipients retiring early had benefits of less than \$1,000 per month,
- 26% had benefits between \$1,000 and \$1,500,
- 22% had benefits between \$1,500 and \$2,000, and
- 23% had benefits of over \$2,000 per month.

Analysis by Boston College's Center for Retirement Research suggests that the benefit differential between early and full retirement recipients extends beyond simply early retirement reductions or higher AIME due to additional years of work, but that lower-education (and hence lower-income) workers retire on average at younger ages. This was not always the case. In 1976 – 1979, high school-only workers and college graduates retired at nearly the same age, 64.1 vs. 64.6, but in the 1980s, and every decade but one since then, the average retirement age for college grads ticked higher, to a current 65.7 years. At the same time, the retirement age for high-school-onlies dropped to 62.6 in the in 1980s, then remained more-or-less stable before increasing somewhat in the last decade, to 62.8.

#### *What drives early-retirement decisions?*

The CRR's analysis finds that poor health is a driver for early retirement, and that poorer-educated older workers are more likely to experience these health setbacks. In addition, working-class jobs, even though less physically demanding than in the past, continue to have less-desirable working conditions, and they are also more influenced by Social Security's signaling of age 62 as a retirement age.<sup>2</sup>

In a separate analysis, CRR researchers evaluated the degree to which workers who, prior to retirement, planned to retire at various ages, actually retired earlier than planned. Not surprisingly, the later the planned retirement age, the more likely study participants were to have actually retired earlier than planned: 38% of those with a planned retirement age of 63 or

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<sup>1</sup> <https://www.ssa.gov/policy/docs/statcomps/supplement/2018/6b.html>

<sup>2</sup> "What Explains the Widening Gap in Retirement Ages by Education?" <https://crr.bc.edu/briefs/what-explains-the-widening-gap-in-retirement-ages-by-education/>

64, 42% of those with a planned retirement age of 65, and 55% of those with a planned retirement age equal to or greater than 66.

The study then evaluates the impact of various “shocks” on earlier-than-planned retirement. Of the statistically-significant shocks, each individual health condition a participant reported pre-retirement was associated with a 3.3 percentage point increase in early retirement, and each new health condition was associated with a 2.2 percentage point increase. (Because the study focuses on earlier-than-planned retirements, it does not evaluate the degree to which those planning relatively-earlier retirements were already motivated by ill-health, only the extent to which those pre-existing health conditions caused them to re-evaluate how long they could continue working.) In addition, a job loss during the period immediately prior to retirement increased earlier-than-planned retirement likelihood by 27.6 percentage points, unless the individual found a new job, in which case the earlier-than-expected retirement likelihood *decreased* by 6.6 percentage points. A wholly voluntary job switch reduced earlier-than-planned retirement by essentially the same amount, 6.8 percentage points.<sup>3</sup>

Taken as a whole, this data suggests that programs that help workers stay in the workforce longer by means of a wage supplement would provide value to those who already express a preference for later retirement but whose plans do not succeed.

#### *Workers express preferences for phased retirement*

There is growing interest in phased retirement, both with respect to individuals and formal company programs. A recent Transamerica Center for Retirement Studies study found that 30% of surveyed workers wished to reduce work hours, and 17% wished to work in a less demanding and/or more personally satisfying role, prior to fully retiring. Similarly, 20% of employers reported offering a formal phased retirement program, and 19% planned to implement one in the future.<sup>4</sup>

At the same time, a 2017 GAO report<sup>5</sup> found that, among 61 – 66-year-olds in 2014, 28% reported they planned to reduce work hours in order to transition to retirement. However, only 11% of men and 6% of women actually succeeded in doing so; in contrast, nearly 70% of survey respondents reported that they ended up (fully) retiring earlier than planned.

#### *Continued employment may improve health*

However much the prospect of “seniors being unable to afford to retire” causes considerable angst, at least some studies show that continued employment may improve health. A recent

<sup>3</sup> “Retiring Earlier than Planned: What Matters Most?” <https://crr.bc.edu/briefs/retiring-earlier-than-planned-what-matters-most/>

<sup>4</sup> Striking Similarities and Disconcerting Disconnects: Employers, Workers, and Retirement Security,” Transamerica Center for Retirement Studies, August 2018. [https://www.transamericacenter.org/docs/default-source/retirement-survey-of-employers/tcrs2018\\_sr\\_employer-retirement-research.pdf](https://www.transamericacenter.org/docs/default-source/retirement-survey-of-employers/tcrs2018_sr_employer-retirement-research.pdf)

<sup>5</sup> “Phased Retirement Programs, Although Uncommon, Provide Flexibility for Workers and Employers,” United States Government Accountability Office, Report to the Special Committee on Aging, U.S. Senate, June 2017, <https://www.gao.gov/assets/690/685324.pdf>

British study found that retirement itself was associated with cognitive decline, even after taking into account normal age-related decline.<sup>6</sup> A French study found likewise.<sup>7</sup> At the same time, other studies have found that retirement may boost blue collar workers' cognitive functioning, and that retirement may improve health, perhaps because retirees might exercise more, reduce smoking, and engage in more cognitively-stimulating activities.<sup>8</sup> However, most recently, a study of Chinese rural workers (presumably more comparable to blue- than white-collar workers) found that an earlier retirement age was associated with cognitive decline.<sup>9</sup>

To what degree phased retirement/reduced work hours/changes to less strenuous work might achieve a “Goldilocks” intermediate ideal, we can't know from these studies, but they do suggest another potential benefit.

### *The nudge*

This proposal relies on the concept of “nudging” and the use of behavioral economics which understand that defaulting people into a choice that's financially advantageous to them can be highly effective, while still preserving their full range of choices, with the intention to provide greater benefit for recipients in the long term due to the choices they make.

It is true that an individual with reduced income can collect their full Social Security benefits at age 62, carefully save the amount in excess of what's needed to top-up their income, and use that savings to supplement their Social Security benefits when they retire. Likewise, an individual who is unemployed, commences Social Security, and then finds new employment can, in principle, save their earnings for the future. (In any case, they may be subject to earnings penalties depending on their earnings, which, in theory, are repaid later and could be perceived of as a form of mandated savings.)

However, an individual in such a situation is much less likely to have the financial savvy to make these plans. This is where the “nudge” concept comes in. It is the idea that underlies such changes in the retirement landscape as autoenrollment and auto-escalation, that is, the practices in which employers seeking to boost their employees' savings automatically initiate payroll deduction with the option for employees to opt-out and automatically increase the contribution every year until a target level has been reached.

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<sup>6</sup> “Effect of retirement on cognitive function: the Whitehall II cohort study”, <https://link.springer.com/article/10.1007/s10654-017-0347-7>

<sup>7</sup> “Health and Working Past Traditional Retirement Ages,” [https://www.prb.org/wp-content/uploads/2018/04/TRA\\_37\\_Health\\_and\\_Working\\_Past\\_Traditional\\_Retirement\\_Ages.pdf](https://www.prb.org/wp-content/uploads/2018/04/TRA_37_Health_and_Working_Past_Traditional_Retirement_Ages.pdf)

<sup>8</sup> Ibid.

<sup>9</sup> Plamen Nikolov and Alan Adelman, “Do Pension Benefits Accelerate Cognitive Decline? Evidence from Rural China,” Institute of Labor Economics discussion paper, August 2019, <https://www.iza.org/en/publications/dp/12524/do-pension-benefits-accelerate-cognitive-decline-evidence-from-rural-china>, summarized at John Anderer, “If You Rest, You Rust? Study Finds Early Retirement May Speed Up Cognitive Decline,” Study Finds, October 30, 2019, <https://www.studyfinds.org/if-you-rest-you-rust-study-finds-early-retirement-may-speed-up-cognitive-decline/>

What’s more, in order to most effectively “nudge” workers into partial retirement, intentional communication of the new options would be important. Rather than buried in the fine print, new commencement options should be placed front-and-center in communicating with workers and retirement-applicants, so that making the decision, “what percent of your benefit do you want to start with?” is a standard element of the process.

### *Extension beyond Social Security itself*

Although middle-class workers were not the direct target of the Policy Innovations Challenge and would likely not find a partial early commencement of Social Security to be a meaningful top-up to reduced wages and might choose to begin taking in-service 401(k) distributions in such a case instead, ***I believe that a partial Social Security benefit could have a much wider impact than merely the direct participants in such a program, if it is able to move retirement norms further along this path and establish expectations on the part of workers and employers more generally that this is “what retirement looks like.”***

In particular, the various studies on phased retirement report greater interest in the option than tends to pan out in the end. In part, according to the above GAO study, it is rare for employers, even where large enough to have formal HR policies generally speaking, to have put into place such a policy regarding phased retirement. According to a 2016 Society for Human Resource Management study referenced in that report, only 4% of employers offer a formal program, and 11% offer informal programs, for instance, by permitting workers to drop down to a part-time status at retirement.

## **What’s the cost?**

In principle, the proposal is intended to be revenue-neutral, with the exception of the expenses associated with revision of communications materials, training of Social Security Administration staff and programming of benefit calculation systems. However, one presumes that the applicable communications materials and computer programs are revised from time to time in any event, and the changes should be conceptually simple enough for staff to learn and begin to explain to clients.

In practice, the program is only revenue-neutral insofar as the Social Security early- and late-retirement adjustment factors are based on genuinely actuarially-equivalent actuarial assumptions. In reality, these factors were set at the time of the passage of the original legislation and there is no ongoing mechanism for evaluating their appropriateness now, but are simply viewed, to the extent that they subsidize retirement at one age vs. another, as a part of the benefit formula. This means that any proposal which encourages participants to defer their benefit commencement, at least partially, to a later age, will have an associated cost or savings, contingent on whether the reduction factors (or increase factors, after age 67) are larger or smaller than the true actuarially-equivalent factors.

As it turns out, this is not easy to assess.



As described by Robert J. Myers, former Social Security Chief Actuary<sup>10</sup>, the initial reduction factors from age 65 to age 62 were set based on a 3% real interest rate (that is, after taking inflation into account), and an evaluation of various life insurance tables available at midcentury. Some allowance was made for conservatism by reviewing annuity tables rather than general life tables as the former assume greater longevity than is the case for the population as a whole. An 80% adjustment factor was chosen as a rounded rate, and for intermediate ages, a simplified proportionate calculation was used – hence, 5/9 of 1% for each month. When the full retirement age was extended to 67 as a result of the 1983 legislation, this factor was continued for the first three years of early retirement, even though the applicable ages were shifted, and the additional reduction factor for the two additional years was reduced somewhat, to 5/12 of 1% per month.

For the delayed retirement factors, the same methods produced an average increase factor of 10% per year; however, for technical reasons relating to wage indexing, it was felt that late retirees were already receiving a 2% benefits boost, so that a credit of 8% per year of delayed retirement was selected.

In one respect, it is easy to assess whether these adjustment factors remain “fair.”

The adjustment factor called for by the 1971 Group Annuity Mortality table, weighted 50/50 for men and women, produces exactly the same 20% reduction for age 62 early retirement, based on the existing-law 65 full retirement age, as the existing formula specifies (albeit now for an age 64 retirement).<sup>11</sup>

However, allowing for updated mortality tables would actually produce smaller reduction factors: that 80% factor changes to 83% for a RP2014 generational mortality table with a valuation year of 2019<sup>12</sup>, and an adjustment factor reflective of a full-retirement-age 67 individual retiring at age 62 would be 73% instead of 70%. In other words, whenever a worker retires early, the federal government “wins” and the worker “loses” in terms of adjustment factors.

At the same time, though, the original calculations used a real interest rate of 3%. Is this the “right” rate? According to the latest Willis Towers Watson survey, the average expected return

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<sup>10</sup> Myers, Robert J., “Appraisal of Early-Retirement and Deferred-Retirement Adjustment Factors under Social Security,” *Proceedings of the Conference of Actuaries in Public Practice, 1980 – 1981*, pp. 422 – 461.

<sup>11</sup> These and all subsequent calculations, are based on the online annuity calculator provided by the Society of Actuaries, <https://afc.soa.org/#Calculator>

<sup>12</sup> RP2014 is the standard mortality table, with variations for projection, “collar,” disability status, and the like, in use for private sector and state-and-local public pension valuations. For these calculations, I used a “total population” table. This is not the same as a table for annuity recipients, who have greater longevity. Also, a “generational” mortality table assumes that mortality increases over time in addition, which would, for example, boost the factors from 83% to 84% and from 73% to 74% for persons retiring in 2039.

on assets for U.S. private-sector pension plan disclosures was 6.57%<sup>13</sup>, which is closer to a real rate of 4% (assuming 2.5% inflation), and even updating the mortality table, adjustment factors at that rate closely match the 70% and 80% adjustment factors in current law (at 70.5% and 80.6%, respectively). On this basis, those factors, however long ago they were derived, remain actuarially-fair.

However, the interest credit used for the Social Security Trust Fund is currently only 3% on a nominal basis.<sup>14</sup> At this rate, the actuarially-equivalent adjustment factor is 79.2% instead of 70% and 86.5% instead of 80%, early retirees are currently being penalized excessively, and it would cost Social Security more, if workers began to delay full retirement to full retirement age. (Note that the Social Security Trustees' Report does not use a discount rate to assess present value or actuarial equivalence but simply looks at fund balance projected into the future.)

To be sure, in both of these cases – more modern life expectancy tables and lower interest rates – the annuities participants receive increase in value relative to older life expectancy tables and higher interest rates. However, because the proportion of the overall value of the benefit coming from years further into the future increases, the relative cost of earlier benefit commencement decreases.

Finally, given the growing understanding that life expectancy is heavily correlated with income, it might be expected that this would impact the cost-effectiveness of encouraging/discouraging full or partial retirement at a given age. One presumes that this program would be most attractive to working-class participants, as better-off workers would be more likely to be able to use savings to supplement their income or to make it through a pre-retirement job loss patch, though even people with some savings might hesitate to liquidate it to defer Social Security benefits. Surprisingly, again, even though, at retirement, the present value of benefits for the top quartile of the population is about 10% higher than for the bottom quartile, in terms of life expectancy, the relative difference in adjustment factors is much smaller, only two percentage points or fewer. (Note, however, that this only holds true for the adjustment factors to age 70. In a hypothetical in which benefits were increased for years of deferral beyond age 70, the relative difference between high- and low-life expectancy groups widens.)

All of this relates only to the early retirement reductions. Separately, there will be other financing impacts with respect to Social Security:

- Individuals who are enabled to continue to work longer will continue to pay FICA taxes.
- Individuals' benefits at time of ultimate retirement may increase, if their extended work years boost their AIME by replacing zero- or very-low-earning years.

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<sup>13</sup> "2018 Global Survey of Accounting Assumptions for Defined Benefit Plans: Executive Summary," <https://www.willistowerswatson.com/en/insights/2018/07/2018-accounting-assumptions-survey-for-defined-benefit-plans>

<sup>14</sup> <https://www.ssa.gov/OACT/ProgData/annualinterestrates.html>

- The calculation of Social Security reductions due to employment would be affected in the short-term, though, in principle, these reductions are meant to be recovered in future years.

Modeling of the effects of these would be required at the time of consideration of actual legislation.

## **Let's Make (Some) Little Plans**

Chicagoans love to cite Daniel Burnham's famous quote:

Make no little plans; they have no magic to stir men's blood and probably themselves will not be realized.

And, indeed, the Social Security 2100 Act, sponsored by Rep. John Larson (D-CT), is a "big plan" – but this and similar Social Security-expansion proposals lack bipartisan support.

On the other hand, the SECURE Act, which makes a variety of small changes with the aim of boosting retirement saving and lifetime income options, passed the House with strong bipartisan support. While it's stalled in the Senate for the time being, it is expected to pass eventually.

In principle, the expansion of Social Security benefit commencement options can be integrated with nearly any such retirement-related legislation (absent a removal of early retirement options entirely) because it is narrowly tailored. In fact, one objective of this proposal is to provide an opportunity for a small bipartisan success that can serve as a trust-building measure for future legislation, by setting the tone for future interparty cooperation.