Future retirees often overestimate Social Security benefits

Advisory clients are better informed about claiming strategies

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Chalk it up to wishful thinking, or merely misinformation, but many future retirees overestimate how much they are likely to receive from Social Security, according to an annual survey released May 8th by the Nationwide Retirement Institute.

Clients who work with retirement advisers are less likely to claim benefits early and tend to receive larger benefits as a result, the sixth annual survey found.

"Social Security is a complex source of retirement income, often causing a disconnect between what consumers think their benefit will be compared to reality," said Tina Ambrozy, president of sales and distribution at Nationwide. "Preparing for retirement holistically by working with advisers can help older adults maximize benefits and achieve personal goals."

The online survey of more than 1,300 older adults who are retired or who plan to retire in the next 10 years, found that nearly half — 44% — say Social Security will be their main source of retirement income, followed by just 23% of older adults who say they will rely on a pension. Yet fewer than one in 10 older adults could identify all four of the factors that determine how much a person can receive, including work history, birth year, age at time of claim and marital status.

In fact, 70% of those surveyed believe they are eligible for full benefits much earlier than they actually are. On average, future retirees incorrectly believe they will be eligible for full benefits at age 63, rather than their full retirement age of 66 or later, and 26% incorrectly believe that if they claim Social Security early, their benefit will automatically go up once they reach full retirement age.

Future retirees expect to receive $1,805 a month in Social Security benefits, but retirees currently collecting Social Security receive $1,408 per month on average — a 28% difference.

About one in three survey respondents work with a retirement adviser. Current retirees who work with a retirement professional report receiving almost 15% more in benefits that those who do not. They were also less likely to draw benefits before full retirement age, and 90% of them say they are able to do the things they want to do in retirement, compared to just 56% of those retirees who didn't work with an adviser.

Among the one-third of future retirees who worked with a retirement adviser, about half said they received advice on how to handle Social Security. And more than three-quarters of future retirees — 76% — who work with an adviser or who plan to work with an adviser said they would want information about when and how to claim Social Security.

Future retirees with investible assets of $250,000 or more, are far more confident in their knowledge of Social Security than the general population, including details particular to their income level.

For example, they are more likely to know that income determines how much a person pays for Medicare premiums and that someone who makes $150,000 per year pays the same amount in Social Security taxes as millionaires.

Social Security payroll taxes are applied to the first $132,900 of wages or net self-employment earnings in 2019. Only a small portion of FICA taxes that funds Medicare applies to wages above that level; in addition, high-income workers whose earnings exceed $200,000 ($250,000 for married couples) pay an additional 0.9% Medicare tax.

Social Security recipients pay income taxes on up to 50% of their benefits once their combined income, defined as adjusted gross income plus one-half of Social Security benefits plus any tax-exempt interest income from municipal bonds, exceeds $25,000 for individuals or $32,000 for married couples filing jointly.

When combined income exceeds $34,000 for individuals or $44,000 for married couples, up to 85% of their benefits may be taxed at the ordinary income tax rate.

Those thresholds were set in 1983 and were never indexed for inflation, which means each year, more retirees are subject to taxation on some of their Social Security benefits.

Despite their expected dependence on Social Security, two-thirds of future retirees worry that the program will run out of money during their lifetime and 40% believe there will be cuts, the survey found. The most recent Social Security and Medicare Trustees' report shows that the trust funds will run dry in 2034 unless Congress acts before then.

More than 80% of future retirees believe the Social Security system needs changing. About half of them say the changes should including increased taxes on higher earners to boost the program's funding and less taxation of retirees' Social Security benefits of retirees.