

American Association of Individual Investors
presents
Financial Planning Workshop

Social Security and Medicare

Fred Smith

fred@fredsmithfinance.com

Webcast details at www.siliconvalleyaaii.org

Financial Planning Workshops

- Fundamentals of Investing
- Building a Diversified Portfolio
- Introduction to Computerized Investing
- Active versus Passive Investing Strategies
- Retirement Planning
- Managing your Cash Flow in Retirement
- Safe Withdrawal Rates from your Retirement Portfolio
- >>> Social Security and Medicare
- Estate Planning

Overview

- **Background**
- **Social Security Benefits**
 - Full Retirement Age, Early and Late Retirement
 - Retirement, Spousal, Minor and Survivor Benefits
- **The Bipartisan Budget Act of 2015**
- **Claiming Strategies: Singles and Married Couples**
 - File and Suspend
 - Restricted claim for spousal benefits only
- **Medicare**
 - _ Parts A, B, C and D
 - _ Seven Medicare myths and the facts

Background

- **1935 Social Security Act signed by Franklin Roosevelt**
- **Benefits to worker only**
- **Funded by 2% tax on first \$3000 earnings**
- **Approximately 7 workers to support each retiree**
- **Retirement at age 65**
- **Expected retirement duration 5 years**

Other Benefits Added

- 1939 Benefits for spouse and minor children added
- 1950 Cost of living adjustments (COLAs) added
- 1954 Disability program added
- 1965 Medicare health care benefits added
- 1972 Supplemental Security Income (SSI) added
- 1997 Temporary Assistance for Needy Families (TANF) placed under SSA
- 1997 State Children's Health Insurance Program (SCHIP) added to SSA

Current Social Security Programs

Administered by the Social Security Administration, SSA

- **Old-Age (Retirement), Survivors, and Disability Insurance, OASDI**
- **Temporary Assistance for Needy Families, TANF**
- **Health Insurance for Aged and Disabled, Medicare**
- **Grants to States for medical assistance programs for low income families, Medicaid**
- **State Children's Health Insurance Program, SCHIP**
- **Supplemental Security Income, SSI**
 - **Low income people over age 65, or blind, or disabled**

Maximum Taxable Earnings

Year	Max		Year	Max		Year	Max
1937	\$3,000		2000	\$76,200		2009	\$106,800
1940	\$3,000		2001	\$80,400		2010	\$106,800
1950	\$3,600		2002	\$84,900		2011	\$106,800
1960	\$4,800		2003	\$87,000		2012	\$110,100
1970	\$7,800		2004	\$87,900		2013	\$113,700
1980	\$25,900		2005	\$90,000		2014	\$117,000
1990	\$51,300		2006	\$94,000		2015	\$118,500
			2007	\$97,500		2016	\$118,500
			2008	\$102,000		2017	\$127,200

Current Funding for SSA

- 6.2% for OASDI capped at \$127,200 (2017) income + 1.45% for Medicare with no income cap
- Employer makes a matching contribution
- Self employed
 - Total rate = $(6.2\% + 1.45\%) \times 2 = 15.3\%$
- Currently have approximately 3 workers per retiree
- Projected to drop to 2.2 workers/retiree by 2030

Calculation of Retirement Benefits

- **Must have worked for at least 40 quarters**
- **Income from early years is adjusted for inflation**
- **Sum up 35 highest-earning years**
 - **Back-filled with zeros if 35 years not available**
- **Divide by 420, i.e. 35 years x 12 months**
 - **Average Indexed Monthly Earnings, AIME**
- **Calculate the Primary Insurance Amount, PIA**
 - **PIA = First \$885 of AIME x 90%**
+ (\$885 to \$5,336) x 32%
+ AIME over \$5,336 x 15%
 - **Amount of monthly benefit at Full Retirement Age, FRA**

Full Retirement Age, FRA

Year of Birth	FRA		Year of Birth	FRA
</= 1937	65		1955	66 + 2 mths
1938	65 + 2 mths		1956	66 + 4 mths
1939	65 + 4 mths		1957	66 + 6 mths
1940	65 + 6 mths		1958	66 + 8 mths
1941	65 + 8 mths		1959	66 + 10 mths
1942	65 + 10 mths		1960 +	67
1943-1954	66	Potential Change ?	1966 ? 1972 ? 1978 ?	68 ? 69 ? 70 ?

Early Retirement

- Can claim as early as age 62
- Lose $\frac{5}{9}$ of 1% per month early up to 36 months and $\frac{5}{12}$ of 1% per month in excess of 36 months

Full PIA at FRA = 66 if born 1943-1954

Lose 6.667% at age 65

Lose 13.333% at age 64

Lose 20.000% at age 63

Lose 25.000% at age 62

Late Retirement

- Can delay claiming benefits until age 70
- PIA is increases by 8% pa for each year delayed up to age 70
 - Full PIA at FRA = 66 if born 1943-1954
 - Gain 8.0% at age 67
 - Gain 16.0% at age 68
 - Gain 24.0% at age 69
 - Gain 32.0% at age 70
- No increase in delayed retirement credits (DRCs) past age 70

Monthly Benefit Amount

Based on Age You Choose to Start Receiving Benefits

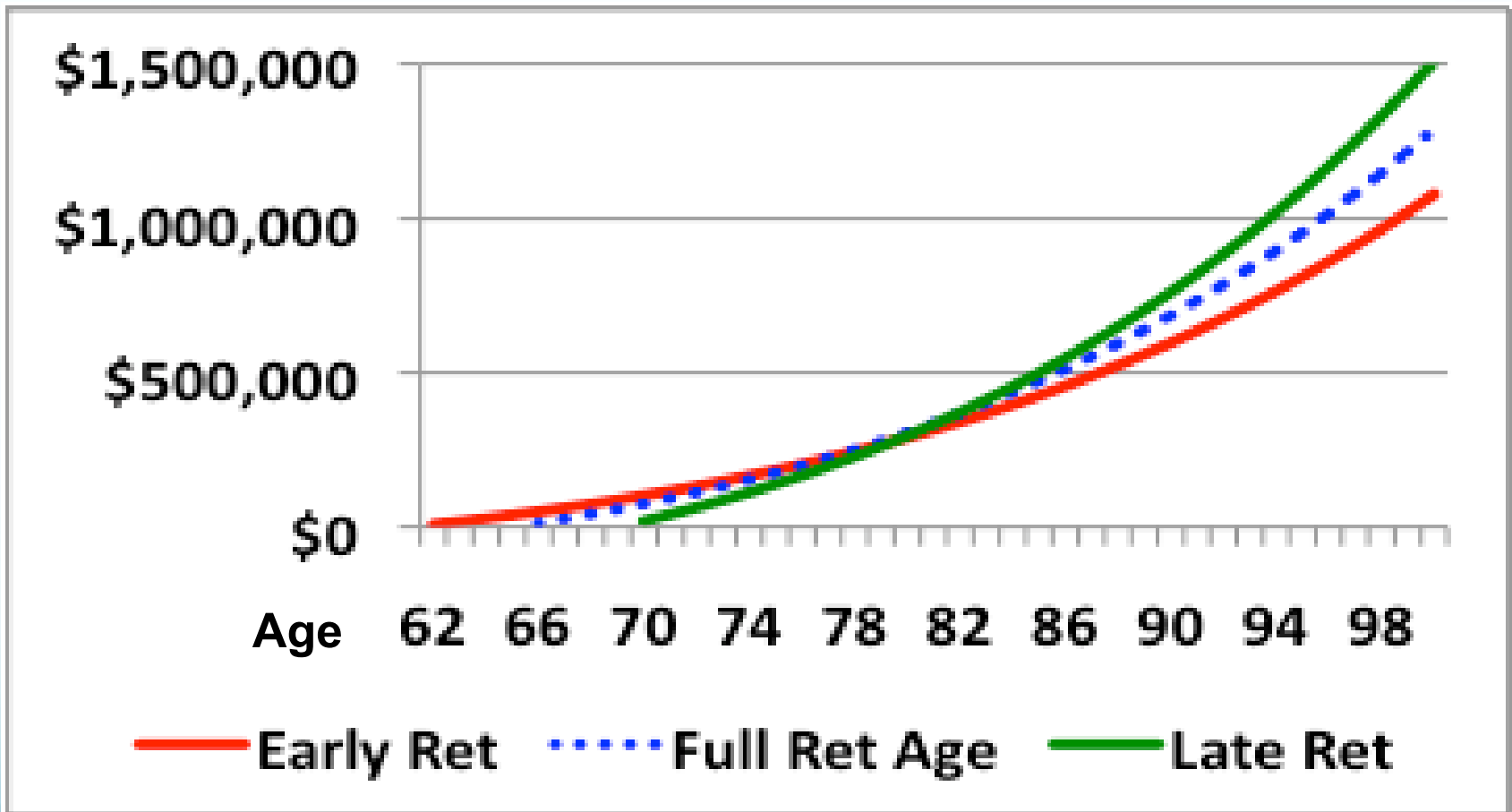
YoB:	1943-54	1955	1956	1957	1958	1959	1960+
FRA:	<u>66</u>	<u>66+2m</u>	<u>66+4m</u>	<u>66+6m</u>	<u>66+8m</u>	<u>66+10m</u>	<u>67</u>
62	75.0%	74.2%	73.3%	72.5%	71.7%	70.8%	70.0%
63	80.0%	79.2%	78.3%	77.5%	76.7%	75.8%	75.0%
64	86.7%	85.6%	84.4%	83.3%	82.2%	81.1%	80.0%
65	93.3%	92.2%	91.1%	90.0%	88.9%	87.8%	86.7%
66	100.0%	98.9%	97.8%	96.7%	95.6%	94.4%	93.3%
67	108.0%	106.7%	105.3%	104.0%	102.7%	101.3%	100.0%
68	116.0%	114.7%	113.3%	112.0%	110.7%	109.3%	108.0%
69	124.0%	122.7%	121.3%	120.0%	118.7%	117.3%	116.0%
70	132.0%	130.7%	129.3%	128.0%	126.7%	125.3%	124.0%

Cost of Living Adjustments (COLA)

<u>Year</u>	<u>COLA</u>		<u>Year</u>	<u>COLA</u>		<u>Year</u>	<u>COLA</u>
1975	8.0		1990	5.4		2005	4.1
1976	6.4		1991	3.7		2006	3.3
1977	5.9		1992	3.0		2007	2.3
1978	6.5		1993	2.6		2008	5.8
1979	9.9		1994	2.8		2009	0.0
1980	14.3		1995	2.6		2010	0.0
1981	11.2		1996	2.9		2011	3.6
1982	7.4		1997	2.1		2012	1.7
1983	3.5		1998	1.3		2013	1.5
1984	3.5		1999	2.5		2014	1.7
1985	3.1		2000	3.5		2015	0.0
1986	1.3		2001	2.6		2016	0.3
1987	4.2		2002	1.4			
1988	4.0		2003	2.1		1977-96	5.13%
1989	4.7		2004	2.7		1997-16	2.13%

Lifetime Accumulation of Benefits

Assumes \$1000/m benefit at FRA with 3% pa appreciation and 3% pa inflation



Spousal Benefits

- **Requirements**
 - Worker must be eligible for, or actually receiving retirement benefits
 - Spouse must be at least 62 years of age
- **At FRA the spouse can receive the greater of ...**
 - ... 100% of his/her own benefit, or
 - ... 50% of the working spouse's retirement benefit
- **Same sex couples are entitled to all the same benefits if ...**
 - ... they are legally married
 - ... and they live in a state which recognizes the marriage

Taking Spousal Benefits Early

- If you claim spousal benefits early you lose
 - 25/36 of 1% per month early up to 36 months
 - and 5/12 of 1% per month in excess of 36 months

<u>Claiming at ...</u>	<u>Spouse Receives</u>
... FRA	50.00% of worker's benefit
... 1 yr prior to FRA	45.84%
... 2 yrs prior to FRA	41.67%
... 3 yrs prior to FRA	37.50%
... 4 yrs prior to FRA	35.00%
... 5 yrs prior to FRA	32.50%

Benefits for Minors

- **If you are collecting retirement benefits ...
... your minor dependent children are entitled to benefits too**
- **Children must be unmarried, under age 18, or under age 19 and still in school**
- **Each child is entitled to 50% of the parent's FRA benefit, subject to a (complicated !) family maximum benefit amount**

Survivor Benefits

- A widow(er) can claim a survivor benefit if ...
 - ... the marriage lasted at least 9 months
 - ... the survivor is at least 60 years old
or at least 50 years old if disabled
 - ...the survivor must not have remarried
unless remarrying after age 60
- Survivor benefits claimed at FRA are equal to the deceased spouse's full benefit (including delayed retirement credits) if greater than survivor's own benefit
- Reduced benefits if collected as early as 60
- Not affected by the new law for any age group

Survivor Benefits Can Be Claimed Early

- Can claim as early as age 60
- If you claim survivor benefits at FRA you will receive 100% of deceased worker's benefit

... 1 yr prior to FRA 95.3%

... 2 yrs prior to FRA 90.5%

... 3 yrs prior to FRA 85.7%

... 4 yrs prior to FRA 81.0%

... 5 yrs prior to FRA 76.3%

Benefits for Divorced Spouses

- **Must have been married at least 10 years**
- **Must not have remarried**
- **Both an ex-spouse and (!) a widow(er) are entitled to survivor benefits**
- **Working ex-spouse's benefits are not affected**
 - **Need not have filed yet**
 - **Need not know you are filing on his/her work record**
- **New law:**
 - **Lucky Old Fogies and Tweeners can still file a Restricted Application on ex-spouse's record, but not the Unlucky Youngsters (Defined later)**

Bipartisan Budget Act of 2015

- **Limits applicability of File/Suspend and Restricted Claim strategies depending on which of three age groups you fall into**
- **Group 1: Lucky Old Fogies**
 - Born before April 30, 1950
 - Age 66 or older on 4/30/16
- **Group 2: Tweeners**
 - Born between May 1, 1950 and January 1, 1954
 - Age 62 on 1/1/16 to age 65 on 4/30/16
- **Group 3: The Unlucky Youngsters**
 - Born after January 1, 1954
 - Age 62 or younger on 1/1/16

File and Suspend Strategy

- **Old rules; still valid for Lucky Old Fogies**
 - File for benefits at full retirement age
 - Immediately suspend receipt of benefits until later
 - Must have filed before 4/30/16
- **Filer's delayed retirement credits, DRCs accumulate to age 70**
- **Allows spouse to file a Restricted Claim**
 - Can also trigger benefits for eligible children
- **Option to undo delay strategy if necessary**
 - Locks in a filing date for a potential lump sum payout if circumstances change
- **Only one member of a couple can file and suspend**

File and Suspend Strategy Under New Law

- **After April 29, 2016 if anyone asks to have their payments suspended ...**
 - ... the SSA will also suspend the benefits for everyone eligible to collect on that record, e.g. spousal or child benefits
 - ... it will no longer be possible to receive a lump sum payment of benefits that have already been withheld.
- **A worker can still voluntarily suspend his own benefit on or after FRA to earn DRCs**
- **Nothing changes for anyone who has already begun a File and Suspend strategy before 4/30/16**

Restricted Claim

- **Old rules; still valid for Lucky Old Fogies and Tweeners**
 - **File a claim restricted to spousal benefits only**
 - **Spousal benefits equal half of worker's benefit at FRA**
 - **Meanwhile your own benefits grow at 8% per annum**
 - **Switch to your own larger benefit at age 70**
- **Can claim early but ...**
 - **... SSA pays your own benefit (if any) first, topped off by spousal benefit if larger, i.e. "deemed" by SSA to have filed for own benefit first**
 - **... cannot switch to spousal benefit only at FRA**
- **Working spouse must be receiving benefits or have filed and suspended**
- **Only one spouse can file a restricted claim**

Coordinate Both Strategies for a Dual-Income Couple

- Old rules; still valid for Lucky Old Fogies and Tweeners
- At FRA high earning spouse can file and suspend, delaying benefits to age 70
- At FRA second spouse can file a restricted claim for spousal benefits only, delaying benefits to age 70
- At age 70 each spouse can switch to his or her own maximum benefit
- Works best if both spouses are roughly the same age

Deemed Filing

- **Old law**
 - **Before FRA:** If you were eligible to receive more than one benefit, e.g. spousal and own, you were “deemed” to be filing for all benefits.
 - **After FRA:** You were able to choose which benefit to receive.
- **New law**
 - **Lucky Old Fogies and Tweeners** are “grand-fathered” to the old deeming rules.
 - **All Unlucky Youngsters** will be deemed to be filing for all benefits and cannot choose which to receive.

What does an Optimum Social Security Claiming Strategy Mean?

- **Two Rational Options**
 - 1. Maximize the present value of my expected lifetime benefits**
 - “I want to get the most out of the system if I die at my actuarially expected age adjusted for health, etc.”
 - 2. Minimize longevity risk; optimize benefits late in life**
 - “If I die early, money will be the least of my problems!”
 - “If I survive into my 90s I want to optimize my benefits then so that I don’t run out of money.”

When should a Single Person Start Taking Benefits?

- **A single person should consider taking benefits early if ...**
 - ... she needs the money
 - ... she is in poor health or has a poor family history
- **Absent any of the above, she should consider delaying benefits at least to FRA, especially if she is still working**
- **A better option if she is eligible (Born before 4/30/50)**
 - **Could have filed and suspended her benefits at FRA**
 - **Allows benefits to grow at 8% per annum to age 70**
 - **Allows her to claim a lump sum refund if circumstances change**

When Should a Married Couple Start Taking Benefits?

- **Key Point: Benefits are equivalent to a joint annuity**
 - Surviving spouse receives the larger of his/her own benefits or the deceased spouse's benefits
- **75% probability that at least one spouse will live longer than average**
- **Best strategy for most couples is usually to maximize the benefits of the higher-earning spouse by delaying taking benefits to age 70, unless there are health issues for both spouses, or you really need the money**
 - Maximizes the benefits for the surviving spouse regardless of who dies first

What If Circumstances Change?

- Suppose you decide to delay taking benefits to age 70 so as to maximize your benefits
- But things change:
 - Maybe you really need the money, perhaps for a medical emergency
 - Or you (and your spouse, if married) are diagnosed in poor health
- Limited do-over
 - You can backdate an application to the month of your FRA, or 6 months, whichever is shorter, and collect the lump sum benefits

Do-Over Strategies for Early Filers

- **Two do-over options for people who filed early:**
 - 1. If you change your mind within 12 months of first claiming benefits you can return all payments received and re-start your benefits later at a higher rate. This is a once-per-lifetime option.**
 - 2. If you wait to FRA you can voluntarily suspend your benefits without returning any payments and earn 8%/year delayed credits (on the reduced benefits) up to age 70.**

Earnings Cap

- **If you continue to work while claiming early benefits ...**
 - ... before FRA (62 – 65) you lose \$1 for every \$2 earned above a cap (\$16,920 for 2017)**
 - ... during FRA (66) you lose \$1 for every \$3 earned above a cap (\$44,880 for 2017)**
 - ... after FRA there is no reduction in benefits**
- **Any reduction during early years is restored as higher benefits after FRA**
- **For most people if you plan to keep working it does not make sense to claim early benefits.**

Your Benefits May Be Taxable

- **Combined income**
= AGI + Nontaxable interest + Half SS benefit
- **For individual filers**
 - **Combined income < \$25,000** **Benefits are not taxed**
 - **\$25,000 to \$34,000** **50% of benefits are taxed**
 - **Greater than \$34,000** **85% of benefits are taxes**
- **For married couples filing jointly**
 - **Combined income < \$32,000** **Benefits are not taxed**
 - **\$32,000 to \$44,000** **50% of benefits are taxed**
 - **Greater than \$44,000** **85% of benefits are taxes**

Medicare

Enacted by Lyndon Johnson in 1965

- **Part A: Major Medical, Hospitalization**
- **Part B: Doctor visits, Outpatient care**
- **Part C: Medicare Advantage Plans**
- **Part D: Prescription drugs**

Medicare Myth #1

“I can sign up anytime, there’s no rush”

- Do not miss the 7-month window to sign up
Month of your 65th birthday (regardless of FRA)
+ 3 months before and after
- Draconian Penalty; never goes away
1% per month for each month late
Example: delay signing up by 5 years
Pay a 60% penalty for the rest of your life
- Penalty does not apply if you can prove coverage by a “creditable plan”

Medicare Myth #2

“I don’t need any prescription drugs now so I can sign up for Part D later”

- Do not neglect to sign up for prescription drug plan
- Draconian Penalty; Never goes away
 - 10% per annum for each year late
 - Example: delay signing up by 5 years
 - Pay a 50% penalty for the rest of your life
- Penalty does not apply if you can prove coverage by a “creditable plan”

Medicare Myth #3

“ I’ve been paying into Medicare all my working life so there’s only a nominal charge now”

- The standard Part B premium in 2017 is \$134.00 per month
- High earners pay an additional premium depending on their most recent modified adjusted gross income, **MAGI**
 - $MAGI = AGI + \text{tax-exempt interest income}$
- If your 2015 MAGI is above certain limits you must pay an additional Income Related Monthly Adjustment Amount, IRMAA, for Medicare for Part B

Medicare Part D

Prescription Drugs

- Part D prescription drugs are covered by a separate private insurance plan which you must purchase separately
- Part D coverage is often included in many Part C Advantage plans
- If your 2015 MAGI is above certain limits you must pay an additional Income Related Monthly Adjustment Amount, IRMAA, to Medicare for Part D

2017 Medicare Premiums for People with a High MAGI in 2015

<u>Single Filers</u>	<u>Married FJ</u>	<u>Part B</u>	<u>Part D</u>
<u>Modified AGI</u>	<u>Modified AGI</u>	<u>IRMAA</u>	<u>IRMAA</u>
Under \$85,000	Under \$170,000	\$0	\$0
\$85,001 up to \$107,000	\$170,001 up to \$214,000	\$53.50	\$13.30
\$107,001 up to \$160,000	\$214,001 up to \$320,000	\$133.90	\$34.20
\$160,001 up to \$214,000	\$320,001 up to \$428,000	\$214.30	\$55.20
Above \$214,000	Above \$428,000	\$294.60	\$76.20

Medicare Myth #4

“Now that I’ve signed up, most of my medical costs will be covered”

- Significant deductions and copayments apply
- May need to buy Medigap supplemental insurance from a private insurer
 - Unless covered by a Part C Advantage plan purchased from a private insurer
 - Covers various gaps in traditional Medicare, including deductibles, copayments, etc.
 - Standard policies: A, B, C, D, F, F*, G, K, L, M, N
 - Coverage is standardized but not the premiums

Medicare Myth #5

“ I’m covered by Medicare wherever I go”

- Medicare does not cover any illness while traveling outside the United States
- Should consider signing up for either ...
 - ... Part C Advantage Plan
 - ... or Supplemental Plan C, D, F, F*, G, M or N
- Supplemental Plans A, B, K and L do not include coverage for foreign travel
 - Consider buying separate travel insurance

Medicare Myth #6

“Medicare will cover my Long Term Care needs”

- Medicare has very limited LTC coverage
 - 90 days only after hospitalization
- Should consider a separate LTC insurance policy
 - One of two potential “train-wrecks” to an otherwise great retirement plan
 - Covered in an earlier Financial Planning Workshop
“Managing Your Cash Flow In Retirement”
Slides/recording available at www.siliconvalleyaaii.org

Medicare Myth #7

“My Health Savings Account, HSA, is not affected by Social Security or Medicare.”

- **Triple tax advantages of HSAs**
 - Contributions are tax deductible
 - Earnings are tax free
 - Withdrawals for medical purposes are not taxed
- **Requirements for HSAs**
 - Must own a high-deductible health insurance plan
 - Must not be on Medicare
 - Contribution limits: \$3,400/\$6,750 pa + \$1,000 >age 55
- **Beware signing up for early SS retirement benefits**
 - SS automatically enrolls recipients in Medicare at age 65
 - Can still make HSA withdrawals, but not contributions

The Future Holds Many Challenges

- **Current 3 workers per retiree projected to drop to 2.2 workers by 2030**
- **Without further changes ...**
 - ... OASDI Trust Fund projected to run out in 2034**
 - ... Benefits would drop to 70% of current levels**
 - ... SSI program already borrowing from OASDI Trust**
 - ... Medicare costs rising faster than CPI**

Potential Solutions Are Not Easy

- **Increase 15.3% FICA tax rate**
- **Raise or eliminate the current \$127,200 income cap for OASDI payments**
- **Raise the FRA above 67**
- **Reduce the cost of living allowance, COLA**
- **Means test and/or reduce the benefits**
- **Increase Medicare Parts B and D premiums further**
- **Raise the Medicare age above the current 65**
- **Reduce Medicare payments/coverage**
- **Eliminate fraud and abuse**

Disclaimer

- **Social Security claiming strategies and Medicare choices are complicated**
- **Almost everything we have discussed here has additional fine print rules attached to it**
- **I am not an expert. Please talk to an expert about your individual case before making any major decisions.**

References

- **Social Security Basics, William Reichenstein and William Meyer, AAll Journal, October 2013**
- **Social Security Strategies for Singles, William Reichenstein and William Meyer, AAll Journal, November 2013**
- **Social Security Strategies for Couples, William Reichenstein and William Meyer, AAll Journal, December 2013**
- **Social Security: Delay Benefits at the Expense of Personal Savings?, Marty Allenbaugh, AAll Journal December 2014**
- **The Changes to Social Security Claiming Strategies, Charles Rotblut, AAll Journal January 2016**
- **Social Security Made Simple, Mike Piper, The Oblivious Investor**
- **How To Make Your Money Last, Jane Bryant Quinn, Simon & Schuster, 2016**

Useful Websites

- www.aaii.com Broad selection of financial planning material
- www.siliconvalleyaaii.org Previous presentations on various topics
- [www.santaclaracountylib.org/Adults/Business & Money](http://www.santaclaracountylib.org/Adults/Business%20&%20Money)
- www.obliviousinvestor.com/ Mike Piper blog
- www.letsmakeaplan.net Find a CFP professional
- www.ssa.gov Social Security website
- www.medicare.gov Medicare website

Social Security Website: www.ssa.gov

Home Numbers & Cards Benefits Information for... Business & Government Our Agency



my Social Security

How much could I get from Social Security?

Create a my Social Security account today and find out



Apply for Retirement



Employers:
File W-2s online



Get Benefit Verification Letter



Change of Address



my Social Security

Check out your *Social Security Statement*, change your address & manage your benefits.



Online Services

Whether you are applying for or receiving benefits, learn what you can do online.



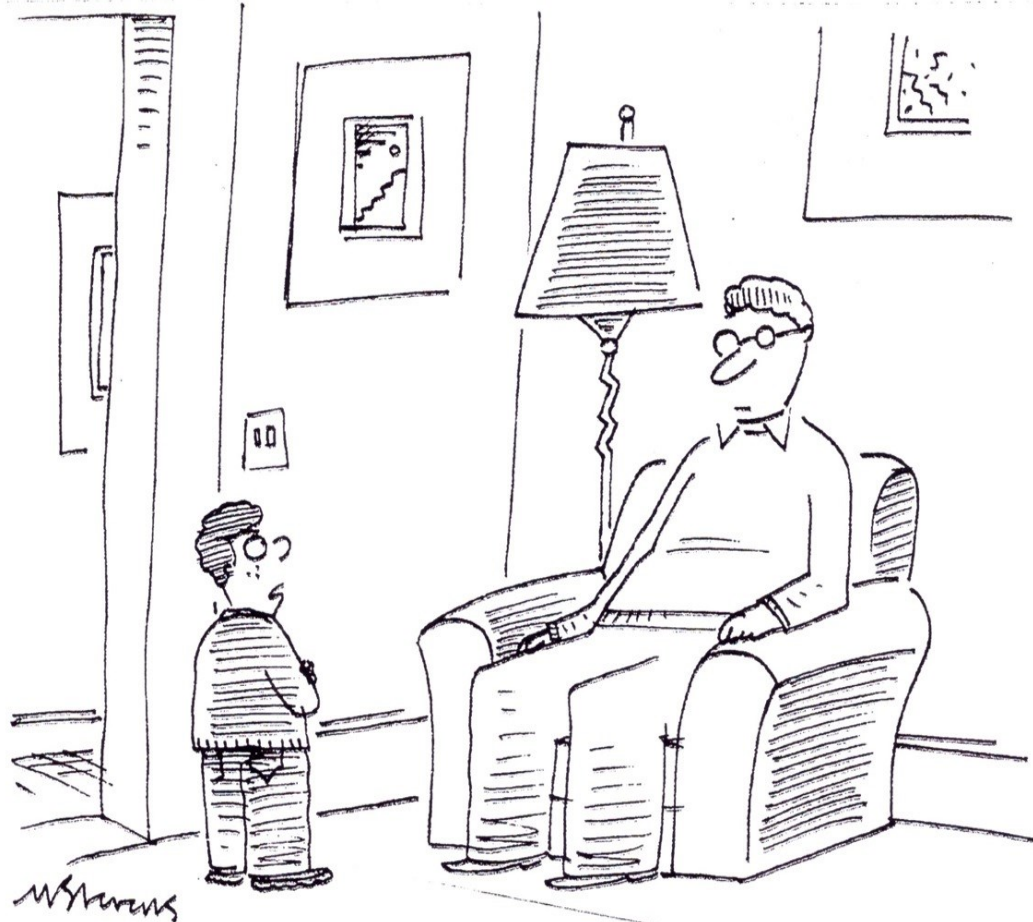
Retirement Estimator

Calculate your benefits based on your actual Social Security earnings record.



FAQs

Get answers to frequently asked questions about Social Security.



“Just what exactly is your generation going to do about my generation’s Social Security?”