

AAll Financial Planning

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Social Security and Medicare

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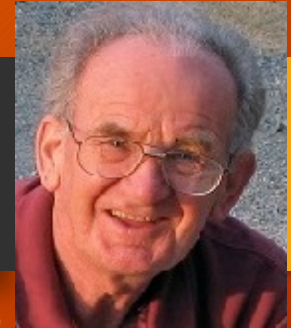


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Our Annual Financial Planning Meeting Cycle



We cover a full range of topics annually in this Financial Planning Discussion Group

Sep. Financial Planning: The Five Pillars of Financial Planning

Oct. Investing I: Modern Portfolio Theory, Building a diversified portfolio

Nov. Investing II: Efficient Market Hypothesis; Can you beat the market?

Dec. Retirement Planning I: Accumulation/Distribution phases, RMDs

Jan. Retirement Planning II: Safe withdrawal rates, Bengen's 4% rule, Bucket strategies

Feb. Taxes: TRJA, Tax diversification, Asset location, QCDs

Mar. Risk Management/Insurance: Annuities, Long-term care, Litigation

Apr. Social Security and Medicare: Full retirement age, Early/late retirement, Medicare traps

May Estate Planning: The documents, Probate, Duties of an executor/trustee, Philanthropy

June Wrap-up Case Study reviewing previous material

Overview

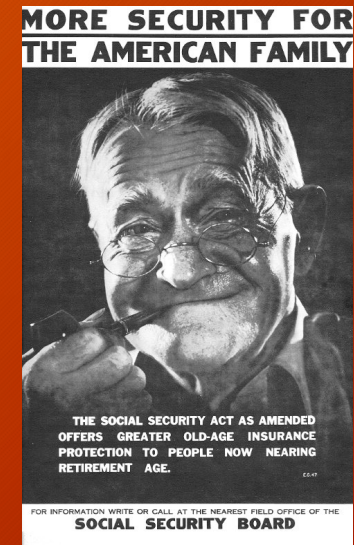


- Social Security Benefits
 - Full retirement age, Early and late retirement
 - Benefits for worker, spouse, survivor, divorced spouse
- Claiming strategies
 - Singles, married couples
- Medicare
 - Parts A, B, C, D
 - Comparison of Traditional Medicare and Medicare Advantage
 - Seven Medicare myths, and the facts

Social Security Past and Present



- 1935 Social Security Act (Franklin Roosevelt)
 - Funded by 2% of first \$3,000 earnings
 - Benefits to worker only, ~7 workers per retiree
 - Retirement at age 65, expected duration 5 years.
- Other benefits added later
 - Spouse, minor children, COLAs, Medicare
 - Supplemental Security Income, SSI
 - Temporary Assistance for Needy Families, TANF etc.
- Current funding
 - 6.2% for OASDI capped at \$137,200 for 2020
 - + 1.45% for Medicare + Employer match.



Calculation of Retirement Benefits



- Must have worked for at least 40 quarters
- Maximum Social Security wages = \$137,700 (for 2020)
- Income to age 60 adjusted for inflation
- Average Indexed Monthly Earnings, AIME
 - $AIME = \text{Sum of 35 highest years} / 420$ (backfilled with zeros)
- Primary Insurance Amount, PIA
 - $PIA = \text{First } \$960 \text{ of AIME} \times 90\% + \text{next } \$5,785 \times 32\% + \text{balance of AIME} \times 15\%$
 - This is the amount of monthly benefit at Full Retirement Age, FRA

Full Retirement Age, FRA



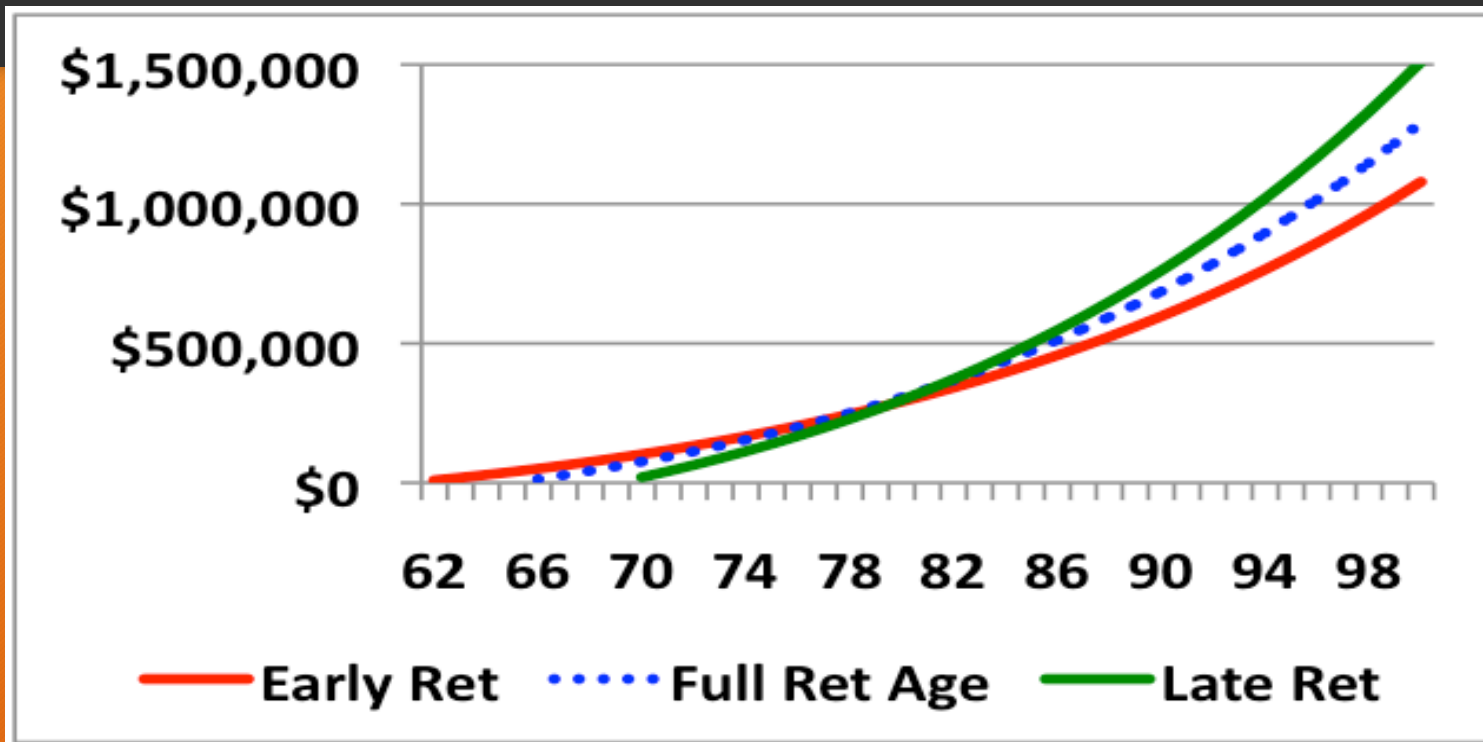
Year of Birth	FRA		Year of Birth	FRA
<= 1937	65		1955	66 + 2 months
1938	65 + 2 months		1956	66 + 4 months
1939	65 + 4 months		1957	66 + 6 months
1940	65 + 6 months		1958	66 + 8 months
1941	65 + 8 months		1959	66 + 10 months
1942	65 + 10 months		>= 1960	67
1943 - 1954	66			

Early and Late Retirement



- Early Retirement: Can claim as early as age 62, but...
 - ... lose 5/9 of 1% per month early up to 36 months
 - ... and 5/12 of 1% per month early in excess of 36 months.
 - e.g. If FRA = 66, then lose 25% of monthly benefit if retire at age 62.
- Late Retirement:
 - PIA increases by 8% per annum for each year delayed up to age 70
 - e.g. If FRA = 66, then monthly benefit is increased by 32% if delayed to age 70.
 - Can collect up to 6 months retroactive benefits

Lifetime Accumulation of Benefits



Spousal Benefits



- Worker must be receiving retirement benefits
- At FRA spouse can receive the greater of 100% of own benefit or 50% of worker's benefit
- Can take spousal benefits early, but...
 - ... lose 25/36 of 1% per month early up to 36 months
 - ... and 5/12 of 1% per month early in excess of 36 months
 - e.g. If FRA = 66, lose 30% of 50% monthly benefit if retire at age 62
- The Bipartisan Budget Act of 2015 eliminated the strategy of filing a restricted claim for spousal benefits only, while delaying own benefits to age 70.

Survivor Benefits



- Requirements
 - The marriage lasted at least 9 months
 - The survivor is at least 60 years old (50 if disabled)
 - Survivor must not have remarried, unless after age 60
- Survivor benefits claimed at FRA are equal to deceased spouse's full benefit (including delayed retirement credits) if greater than survivor's own benefit
- Reduced benefits if collected as early as age 60

Benefits for Divorced Spouses



- Requirements
 - Must have been married at least 10 years
 - Must not have remarried
- Working ex-spouses benefits are not affected
 - Need not have filed yet
 - Need not know
- Both an ex-spouse and a widow(er) are entitled to survivor benefits!

What is An Optimal Claiming Strategy?



- Two Rational Options

1. Maximize the present value of 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 Claiming 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, possibly to age 70, especially if she is still working

When Should a Married Person Start Claiming 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

Earnings Cap



- If you continue to work while claiming early benefits ...
 - ... before FRA you lose \$1 for every \$2 earned above \$18,240 for 2020
 - ... during FRA you lose \$1 for every \$3 earned above \$48,600 for 2020
 - ... after FRA there is no reduction in benefits
- Any reduction during early years is restored as higher benefits after FRA
- If you plan to keep working, for most people it does not make sense to claim early benefits.

Social Security Benefits may be Taxable



First define your Combined Income

= AGI + Tax-exempt interest + Half Social Security benefits

	<u>Single</u>	<u>Married</u>
Benefits not taxed	<\$25,000	<\$32,000
50% of benefits taxed as OI	\$25,001 - \$34,000	\$32,001 - \$44,000
85% of benefits taxed as OI	>\$34,000	>\$44,000

What If Circumstances Change?



- Suppose you file 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 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% per annum delayed credits (on the reduced benefits) up to age 70.

Medicare: Basics



- Enacted by Lyndon Johnson in 1965
- Part A
 - Major medical, Hospitalization (high deductible)
- Part B
 - Doctor visits, Outpatient care, Lab tests, Medical equipment, etc.
- Part C: Medicare Advantage plans (PPOs)
 - May include drug, vision and dental benefits
- Part D
 - Prescription drugs

Comparison of Traditional Medicare and Medicare Advantage



	Traditional Medicare	Medicare Advantage
Insurer	Federal Government	Private insurer
Philosophy	Fee-for-service	Managed care
Care provider	Any doctor who accepts Medicare	Stay within network
Deductibles	Yes	Yes
Co-insurance	20%	No
Annual out-of-pocket limit	No	Yes
Referral needed for specialist	No	Yes
Drug coverage	Only with a separate policy	Usually
Vision/dental coverage	Only with a separate policy	Usually
Coverage outside US	Only with a supplemental policy	Usually
Medical insurance cards	Usually 3 cards	Single card
Switch plans	→ Easy →	← May be difficult ←

Medicare Myth #1



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

- Do not miss the 7-month sign-up window
 - Month of your 65th birthday, regardless of FRA plus 3-months before and after
- Draconian Part B penalty, never goes away
 - 10% penalty for each year late
 - e.g. 40% penalty for 4-year delay in signing up
 - 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”

- Draconian Part D penalty, never goes away
 - 1% per month for each month late
 - e.g. 48% penalty for 4-year delay in signing up
 - 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 no charge now”

- Part A is indeed “free”
- The standard premium for Part B is \$144.60/month in 2020
 - High earners pay an additional Income Related Monthly Adjustment Amount, IRMAA, for Parts B and D depending on their Modified Adjusted Gross Income , MAGI
 - MAGI = AGI from 2-year prior Form 1040 + tax-exempt interest

IRMAA Premiums for 2020



<u>MAGI for Single Filers</u>	<u>MAGI for Married (MFJ)</u>	<u>Part B IRMAA</u>	<u>Part D IRMAA</u>
\$87,000 - \$109,000	\$174,000 - \$218,000	\$57.80	\$12.20
\$109,001 - \$136,000	\$218,001 - \$272,000	\$144.60	\$31.50
\$136,001 - \$163,000	\$272,001 - \$326,000	\$231.40	\$50.70
\$163,000 - \$500,000	\$326,000 - \$750,000	\$318.10	\$70.00
More than \$500,000	More than \$750,000	\$347.00	\$76.40

Medicare Myth #4



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

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

Medicare Myth #5



“I’m covered by Medicare wherever I go”

- Medicare does not cover any illness while travelling outside the United States
- Consider an Advantage plan ...
 - ... or Medigap Plans C, D, F, F*, G, M or N
 - ... or travel insurance

Medicare Myth #6



“Medicare will cover my Long Term Care (LTC) needs”

- Medicare has very limited LTC coverage
 - 90 days maximum after hospitalization
 - Must demonstrate improvement
- Consider purchasing a separate LTC policy to avoid a potential “train wreck”.

Medicare Myth #7



“My Health Savings Account, HSA, is independent of Medicare”

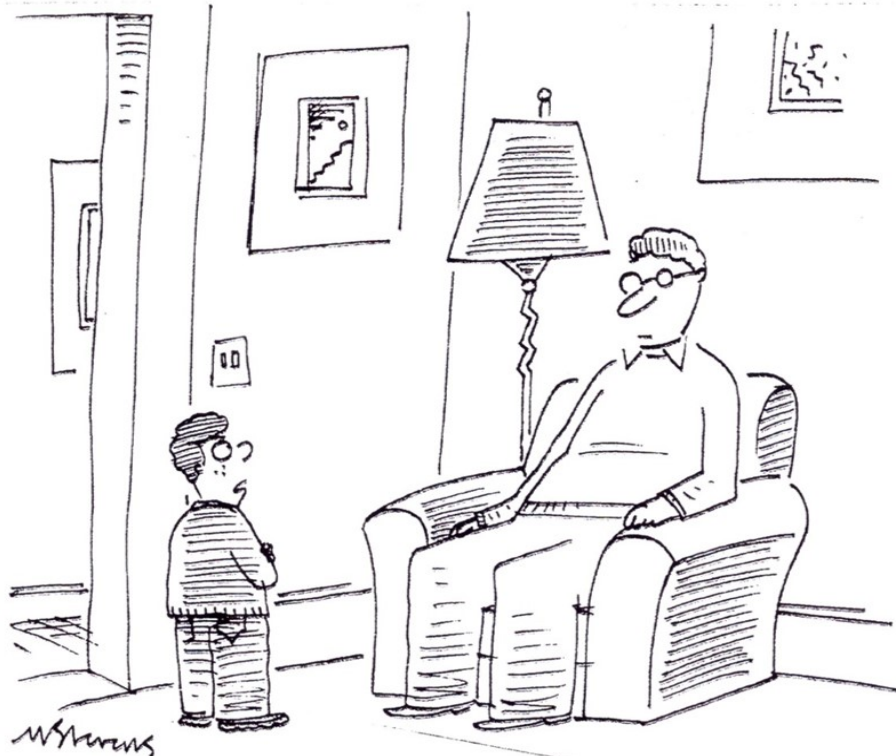
- HSAs can serve as great retirement vehicles
 - HSA contributions are tax deductible
 - Earnings are tax free
 - Medical withdrawals are not taxed

... But you must own a high-deductible health insurance plan and not be on Medicare.

To dig deeper:



- *Which Social Security Strategy is Right for You?* Marty Allenbaugh, AAll Journal, February 2020
- *Using Portfolio Returns to Determine When to Claim Social Security Benefits*, Brian Betker, AAll Journal, August 2019
- *The Changes to Social Security Claiming Strategies*, Charles Rotblut, AAll Journal, January 2016
- *Social Security Made Simple*, Mike Piper, The Oblivious Investor
- *Social Security Strategy Calculator*, Mike Piper: www.opensocialsecurity.com
- *T. Rowe Price Social Security Benefits Evaluator*: www.troweprice.com/socialsecurity
- *How to be a Medicare Master*, AARP Bulletin, October 2019
- *Original Medicare or Medicare Advantage?* Mark Miller, Wealth Management, November 2019



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

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