Understand Your Social Security Benefits

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*President Franklin D. Roosevelt and cabinet signing off on the Social Security plan.

HISTORY OF SOCIAL SECURITY

The United States Social Security program was created in 1935 as a way to protect Americans from poverty as they entered into retirement. After the economic chaos created by the Great Depression, Americans demanded that a solution be devised. This was the catalyst that prompted President Franklin D. Roosevelt to devise a plan to "give some measure of protection to the average citizen and to his family…against poverty-ridden old age". Social Security was created to be a self-funding plan that would be paid for in part by deductions from employees' paychecks, and the other part would be paid for by employers. It was never intended for the program to be funded out of the United States Treasury.

STARTLING FACT:

It's been estimated that nearly 60% of retired Americans rely almost exclusively on their Social Security benefits. What makes this percentage even more startling is the fact that many of these individuals never consulted a financial advisor—or were never approached by one—on how best to maximize their Social Security benefits. Consequently, they have unwittingly prevented themselves from receiving tens of thousands of dollars over a lifetime.

THE IMPORTANCE OF SOCIAL SECURITY:

Social Security is a foundation upon which millions of Americans will build their retirement foundation. With inevitable obstacles, such as tax increases, cost of living increases, longer life expectancies and economic uncertainties, it is more important than ever before to understand and make good decisions about Social Security. Most individuals understand that they can begin collecting SSI at age 62 (and in fact over 50% of Americans start benefits at this age), but many have never been educated on the negative impact this can have on their retirement long term. For some, this is the appropriate decision, but others could be so much better off by postponing until full retirement age…or longer. When to begin collecting Social Security benefits is one of the most important financial decisions you will ever make. Yet most Americans make this choice without ever consulting a professional who can show you the pros and cons of a certain decision and guide you in the path that will best serve you and your family in retirement.

First Recipient of a Social Security check: Ernest Ackerman

The first recipient of a Social Security check was a retired motorman from Cleveland, OH, named Ernest Ackerman. He had participated in the Social Security program for one full day, and upon retirement he received a lump sum payment of .17 cents.

Ida May Fuller receiving the first monthly Social Security check.

The first monthly Social Security check was received by Ida May Fuller, a retired Secretary from Ludlow, Vermont. Since that time, millions of Americans have collected Social Security benefits. For many, these benefits are the primary source of income in retirement. For others, they are a supplement to their personal retirement savings and company pensions.

Ida May Fuller marks the end of the dark period of time during which senior citizens had been left poverty stricken after reaching an age at which they could no longer work to support themselves. From this point on the future was a bright one for senior citizens everywhere.

HOW IS SOCIAL SECURITY FUNDED?

Social Security is funded by payroll taxes (Employee and Employer) and self-employment taxes. Payroll/ Self Employment taxes are as follows:

- Employee pays 6.2% of gross wages on the first $117,000 in yearly income (2014 figure)
- Employer pays 6.2% of each employee's gross wages on the first $117,000 in yearly income (2014 figure)
- Self-employment taxes are 12.4% of self-employment wages on the first $117,000 in yearly income (2014 figure)

In 2014, the most wages an individual will pay Social Security Taxes on is $117,000. This amount typically increases on a yearly basis. Here is a table showing historical "wage base" limits.

Contribution and Benefit Bases, 1937-1982	
Year	Amount
1937-50	$3,000
1951-54	3,600
1955-58	4,200
1959-65	4,800
1966-67	6,600
1968-71	7,800
1972	9,000
1973	10,800
1974	13,200
1975	14,100
1976	15,300
1977	16,500
1978	17,700
1979	22,900
1980	25,900
1981	29,700
1982	32,400

Contributing and Benefit Bases, 1984-1998	
Year	Amount
1983	$35,700
1984	37,800
1985	39,600
1986	42,000
1987	43,800
1988	45,000
1989	48,000
1990	51,300
1991	53,400
1992	55,500
1993	57,600
1994	60,600
1995	61,200
1996	62,700
1997	65,400
1998	68,400

Contributing and Benefit Bases, 1999-2014	
Year	Amount
1999	$72,600
2000	76,200
2001	80,400
2002	84,900
2003	87,000
2004	87,900
2005	90,000
2006	94,200
2007	97,500
2008	102,000
2009	106,800
2010	106,800
2011	106,800
2012	110,100
2013	113,700
2014	117,000

HOW ARE SOCIAL SECURITY BENEFITS CALCULATED?

There are certain numbers you need to know in order to calculate your Social Security Benefit. Until you actually turn 62, you won't know the exact amount, but you can get a fairly close estimate. As a general rule of thumb, you must take your highest 35 years of earnings (adjusted for Wage Indexing) and average them to find your AIME (Average Indexed Monthly Earnings). This means that the highest 35 years of earnings would be divided by 420 (35 years x 12 months/year) to determine the AIME. If you have less than 35 years of wages, those missing years will be counted as "zero" when adding the years together.

Here is an example:

Jim was born in 1950. Each working year, Jim exceeded the maximum wage base limit and consequently contributed the maximum possible to Social Security. Once his top 35 years are indexed for inflation and divided by 420, his AIME is calculated at $8,238.

Once you have determined your AIME, the next step is to apply a three part formula. This allows you to find your PIA (Primary Insurance Amount) which is equivalent to what you would receive in monthly Social Security benefits at full retirement age.

Here is an example:

Jim's AIME is $8,238.

- The first $767 of AMIE is multiplied by 90%
- The next $3,857 (amount between $767 and $4,624) is multiplied by 32%
- Anything over $4,624 is multiplied by 15% (in Jim's case this was $3,614)

Once these three amounts are calculated, they are added to find Jim's PIA. This figure is $2,466.60 (rounded to nearest dime). This means that Jim's monthly Social

Security check (or PIA) will be $2,466.60 if he waits until full retirement age to begin collecting.

There is an easier way to calculate (or estimate) your Social Security benefit amount. By visiting www.socialsecurity.gov , you can create a log-in for yourself and retrieve actual data on your historical earnings and projected benefit amounts. This is important for everyone to do, as it gives you a chance to verify that your records and the Social Security Administration's records are the same.

As of 2014, the Social Security Administration has also re-implemented the mailing of Social Security paper statements every five years.

HOW ARE SOCIAL SECURITY CREDITS EARNED?

Social Security benefits are earned as "credits" over a lifetime of working. Typically you must earn 40 quarters of credits to qualify for Social Security. This equates to ten years of work either as an employee, or as a self-employed individual paying self-employment taxes.

In 2014, you must earn $1,200 in covered earnings to get one Social Security or credit and $4,800 to get the maximum four credits for the year. If you stop working for a period of time, your credits remain and will continue to accumulate when you start working again.

IMPORTANCE OF SOCIAL SECURITY:

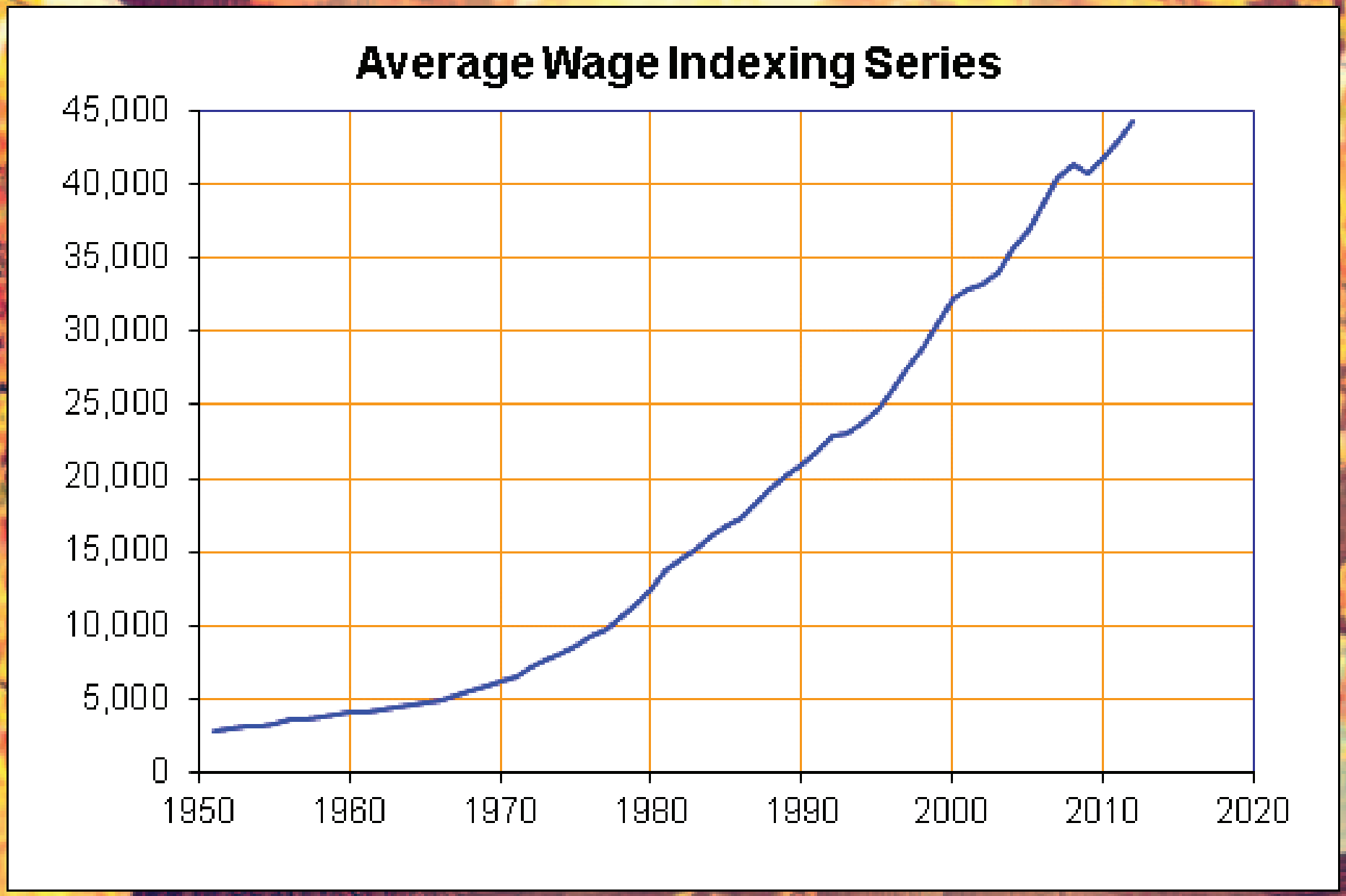
The Social Security Administration uses Wage Indexing when calculating your highest 35 years of earnings. Wage indexing depends on the year in which a person is first eligible to receive benefits. If a person reaches age 62 in 2014, then 2014 is the person's year of eligibility.

An individual's earnings are always indexed to the average wage level two years prior to the year of first eligibility. A person retiring at age 62 in 2014 would have his/her earnings indexed to the average wage index for 2012 (44,321.67). Earnings in a year before 2012 would be multiplied by the ratio of 44,321.67 to the average wage index for that year; earnings in 2012 or later would be taken at face value.

Year	AWI	Annual Change
1951	2,799.16	--
1952	2,973.32	6.22%
1953	3,139.44	5.59%
1954	3,155.64	.52%
1955	3,301.44	4.62%
1956	3,532.36	6.99%
1957	3,641.72	3.10%
1958	3,373.80	.88%
1959	3,855.80	4.95%
1960	4,007.12	3.92%
1961	4,086.76	1.99%
1962	4,291.40	5.01%
1963	4,396.64	2.45%
1964	4,576.32	4.09%
1965	4,658.72	1.80%
1966	4,938.36	6.00%
1967	5,213.44	5.57%
1968	5,571.76	6.87%
1987	18,426.51	6.38%
1969	5,893.76	5.78%
1970	6,186.24	4.96%

Year	AWI	Annual Change
1971	6,497.08	5.02%
1972	7,133.80	9.80%
1973	7,580.16	6.26%
1974	8,030.76	5.94%
1975	8,630.92	7.47%
1976	9,226.48	6.90%
1977	9,779.44	5.99%
1978	10,556.03	7.94%
1979	11,479.46	8.75%
1980	12,513.46	9.01%
1981	13,773.10	10.07%
1982	14,531.34	5.51%
1983	15,239.24	4.87%
1984	16,135.07	5.88%
1985	16,822.51	4.26%
1986	17,321.82	2.97%
1987	18,426.51	6.38%
1988	19,334.04	4.93%
1989	20,099.55	3.96%
1990	21,027.98	4.62%
1991	21,811.60	3.73%

Year	AWI	Annual Change
1992	22,935.42	5.15%
1993	23,132.67	0.86%
1994	23,753.53	2.68%
1995	24,705.66	4.01%
1996	25,913.90	4.89%
1997	27,426.00	5.84%
1998	28,861.44	5.23%
1999	30,469.84	5.57%
2000	32,154.82	5.53%
2001	32,921.92	2.39%
2002	33,252.09	1.00%
2003	34,064.95	2.44%
2004	35,648.55	4.65%
2005	36,952.94	3.66%
2006	38,651.41	4.60%
2007	40,405.48	4.54%
2008	41,334.97	2.30%
2009	40,711.61	-1.51%
2010	41,673.83	2.36%
2011	42,979.61	3.13%
2012	44,321.67	3.12%


Average Wage Indexing Series
45,000
40,000
35,000
30,000
25,000
20,000
15,000
10,000
5,000
0
1950
1960
1970
1980
1990
2000
2010
2020

WHEN IS FULL RETIREMENT AGE?

Full Retirement Age is the age at which a person may first become entitled to their full retirement benefits (or PIA). This age can vary based upon your year of birth. The following is a chart that shows how to determine your Full Retirement Age:

Year of Birth*	Full Retirement Age
1937 or earlier	65
1938	65 and 2 months
1939	64 and 4 months
1940	65 and 4 months
1941	65 and 8 months
1942	65 and 10 months
1943-1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

*If you were born on January 1st of any year you should refer to the previous year. (If you were born on the 1st of the month, we figure your benefit (and your full retirement age) as if your birthday was in the previous month.)

Primary and spousal benefits at age 62 (benefits based on a $1,000 primary insurance amount)						
Year of birth [a]	Normal (or full) retirement age	Number of reduction months [b]	Primary		Spouse	
			Amount	Percent Reduction[c]	Amount	Percent Reduction[d]
1937 or earlier	65	36	$800	20%	$375	25.00%
1938	65 and 2 months	38	$791	20.83%	$370	25.83%
1939	65 and 4 months	40	$783	21.67%	$366	26.67%
1940	65 and 6 months	42	$775	22.50%	$362	27.50%
1941	65 and 8 months	44	$766	23.33%	$358	28.33%
1942	65 and 10 months	46	$758	24.17%	$354	29.17%
1943-1954	66	48	$750	25%	$350	30.00%
1955	66 and 2 months	50	741	25.83%	345	30.83%
1956	66 and 4 months	52	733	26.67%	341	31.67%
1957	66 and 6 months	54	725	27.50%	337	32.50%
1958	66 and 8 months	56	716	28.33%	333	33.33%
1959	66 and 10 months	58	708	29.17%	329	34.17%
1960	67	60	700	30.00%	325	35.00%

DRAWING SOCIAL SECURITY PRIOR TO FULL RETIREMENT AGE:

If you begin collecting your Social Security benefits at age 62, your PIA (SSI benefit at full retirement age) will be reduced by 25%. In our previous example, Jim's PIA was $2,466.60. If he chose to begin receiving his benefit at age 62, the monthly amount would be reduced to $1,849.50. This reduction would be in effect for the duration of his lifetime (increased by Cost of Living Adjustments as deemed by the Social Security Administration). Here is a chart showing the reduction of an individual's PIA if they choose to begin collecting earlier than full retirement age:

WORKING WHILE COLLECTING BENEFITS (PRIOR TO FULL RETIREMENT AGE):

There are pros and cons to continuing to work after beginning Social Security benefits prior to Full Retirement Age.

Pros: Annual earnings during this time period (if higher than one of the 35 highest years used to calculate your AIME) could cause your benefit to be recalculated and possibly increased. Any increase would be retroactive to January in the year after you earned the money.

Cons: Annual earnings during this time period (if higher than the annual limit: $15,480 in 2014) could cause a reduction in your monthly benefit. Every $2 in annual earnings in excess of this limit results in a $1 reduction in your monthly benefit amount. In the year that you reach full retirement age, there is a reduction of $1 in benefits for every $3 you earn above a different limit. In 2014, the limit on your earnings is $41,400 but only earnings before the month you reach your full retirement age are counted.

Please note that Pension income from a previous employer (if you contributed to Social Security under that employer) will not have any impact on your Social Security benefit amount at all. Additionally, income from other retirement sources such as IRA's, 401k's, 403b's, etc., will not have an impact.

WORKING WHILE COLLECTING BENEFITS (ON OR AFTER FULL RETIREMENT AGE):

Beginning with the month you reach full retirement age, your earnings no longer reduce your benefits, no matter how much you earn.

DRAWING SOCIAL SECURITY AT FULL RETIREMENT AGE:

Once you've reached Full Retirement Age, you will be eligible to receive your entire PIA (Primary Insurance Rate). This amount will not be reduced by any percentage, even if you continue to work and earn over the annual limit.

DRAWING SOCIAL SECURITY AFTER FULL RETIREMENT AGE:

Waiting to draw Social Security benefits beyond Full Retirement Age will result in an increased benefit amount. Each year that you delay, your benefit will increase by 8% up to age 70. Any time period between Full Retirement Age and your 70th birthday will be prorated using the 8% annual increase amount. Once you reach age 70, there will be no additional increases to your Social Security benefit amount. This means that there would be no benefit in delaying your benefits past your 70th birthday.

HOW DO COLA'S (COST OF LIVING ADJUSTMENTS) AFFECT SOCIAL SECURITY:

Cost of Living Adjustments are a serious factors that affect purchasing power and dollar value in retirement. Each October, the Social Security Administration announces the COLA amount for the upcoming year. This COLA percentage is applied not only to existing monthly Social Security benefits, but also to future benefits that haven't been collected yet.

COLA's are based on the increase in the CPI (Consumer Price Index) from the third quarter of the previous year through the third quarter of the current year. There is no way to predict precise future COLA's (it has been suggested to use 2.8% as an average), but the following is a chart of historical COLA's applied:

Social Security Cost-Of-Living Adjustments

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

a The COLA for December 1999 was originally determined as 2.4 percent based on CPIs published by the Bureau of Labor Statistics. Pursuant to Public Law 106-554, however, this COLA is effectively now 2.5 percent.

SPOUSAL SOCIAL SECURITY BENEFITS:

If there are two qualifying spouses (both have met the requirement of 40 quarters), there are two possible scenarios for drawing Social Security.

1. Each spouse can take their own benefit based on their individual AIME

2. The spouse with the higher AIME can take their full benefit, and the spouse can receive half of that amount. (Spousal Benefits)

In order for one spouse to receive full Spousal Benefits, the other spouse must be at Full Retirement Age.

If there is only one qualifying spouse (only one spouse has met the 40 quarter requirement), there is only one possible scenario for drawing Social Security.

1. The non-qualifying spouse can collect based on the qualifying spouse as long as the two have been married at least one year or have a child together. Benefits collected by a non-qualifying spouse at or after Full Retirement Age will be equal to 50% of the PIA of the qualifying spouse. Benefits collected by a non-qualifying spouse between age 62 and Full Retirement Age will be reduced.

The problem is that too many Americans nearing retirement wrongly assume that they have no choice as to when they start receiving Social Security benefits. As soon as they turn 62, they believe, the direct deposits begin rolling in automatically. Because the decision is irreversible, it could very well be one of the worst mistakes they'll ever make.

This is where you, the independent agent, can help.

Let clients know that just because they're eligible to start collecting payments doesn't necessarily mean that they should. If they're still healthy, productive at work and not in a financial crisis, they can (and indeed should) strategically withhold their benefits past the age of 62. This allows them to eventually receive a larger monthly benefit. Every year a person delays claiming his Social Security benefits past the age of 62—until he turns 70—he increases his benefit amount between 5 and 8%.

Another strategy clients should be aware of is what's known as "file and suspend." If a married couple is at retirement age, one of the spouses, typically the husband, may apply for benefits but choose to have his payments suspended. The wife can then claim spouse's benefits, even if she has never worked outside the home.

In any case, the goal is to delay receiving payments for as long as you can. As an illustration, imagine that you have recently turned 62 and decided to claim Social Security benefits. You're thrilled to see that a cool $1,500 is deposited into your account every month. As pleased as you are by this amount, you could have been receiving $500 more had you waited another four years to claim Social Security. That's an additional $6,000 a year. And if you had waited until the age of 70, the amount would have ballooned to $2,640—a 32% increase above the initial $1,500. That's an additional $1,140 a month, or $13,680 a year. All for strategically waiting an extra six years.

Granted, 70 might be too long to wait for some. But if a person has other revenue streams—a salary or pension, dividends, annuity payments—there is little reason to claim Social Security as soon as he turns 62.

SOCIAL SECURITY BENEFITS FOR DIVORCED SPOUSES:

Divorced spouses may still be able to claim Social Security benefits from their former spouse's work record. To qualify, you must meet the following criteria:

1. You must be at least age 62. Your benefits may be reduced if you are not yet Full Retirement Age.
2. You and your former spouse must have been married at least 10 year before the divorce.
3. You must be currently unmarried.
4. Your own Social Security benefit cannot be more than the benefit you would receive from the former spouse (50% of their Primary Insurance Amount – reduced if taken prior to Full Retirement Age).
5. As long as you have been divorced for two years, and you and your former spouse are 62 or older, you can receive Social Security benefits even if the former spouse has not started collecting yet.

The benefit that a divorced spouse receives has no impact on you or your current spouses benefits.

STRATEGIES FOR SOCIAL SECURITY MAXIMIZATION:

1. FILE AND SUSPEND

   The file and suspend strategy involves the primary wage earner filing for their Social Security benefits at their Full Retirement Age, and then immediately "suspending" the benefit. This allows the other spouse to begin collecting the spousal benefit which is 50% of the primary wage earner's PIA (subject to reduction if the spouse is not yet at Full Retirement Age). The primary wage earner can then allow their suspended benefit to increase by 8% annually until they decide to "un-suspend" it. There is no reason for them to suspend beyond age 70, as the benefit does not continue to grow past that age.

2. FILE RESTRICTED

   The file restricted strategy involves the primary wage earner filing a "restricted" application at Full Retirement Age. This allows them to claim spousal benefits on the other spouse. The primary wage earner can continue to receive spousal benefits (typically 50% of the other spouse's PIA) until switching to their own benefit at age 70.

SOCIAL SECURITY BENEFITS IN SUMMARY:

Understanding the complexities of Social Security is critical to making wise decisions about when and how to claim benefits. Every year millions of Americans make poor choices that will cost them tens of thousands of dollars in lost Social Security benefits. When it comes to a financial decision of this magnitude, it is extremely important to work with a professional who can help you understand the best way to maximize your benefits.

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We strive to provide a systematic approach to help our clients achieve their definition of financial freedom. Using state of the art investment strategies and tools to provide safe and steady growth to their net worth. Two rules guide everything we do; manage your cash flow and protect your assets. We believe by following these two rules average Americans can change their financial future and legacy. Our goal is to educate our clients so they can make an informed decision on the best way to meet their stated financial goals.

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