SOCIAL SECURITY

A QUICK & EASY PLANNING GUIDE

MITCHELL
CAPITAL MANAGEMENT

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The Social Security Act was signed by Franklin Delano Roosevelt in August, 1935 to provide economic security for America's working citizens. Lump sum payments were the policy at first, but monthly payments began in 1940. However, changes were being made to the program almost immediately. In 1939 the program was expanded to include worker's dependents and survivors. In 1956 Social Security Disability Insurance was added and the Civil Rights Act of 1964 ensured coverage for all eligible Americans, without discrimination.

In 1965, Medicare was introduced, including Part A (hospital care) and Part B (physician care). Cost of Living Adjustments (COLA) arrived in 1972, and the retirement age was raised from 65 to 67 (phased in through 2027) in 1983. Many other smaller changes have come (and gone) to leave us with what we have today.

Social Security is a political creation. Considering the changing political climate and its long life span, the number of adjustments is not surprising. It is a pay-as-you-go program, and with fewer workers supporting a larger number of beneficiaries, we can expect more changes if the program is to reach 100 years and beyond. Social Security was not intended to fully fund one's retirement, but it can represent a substantial portion of retirement income.

As with any effort to create something for everyone, Social Security can be mind-numbingly opaque and difficult to understand. Complexity is part of the game. This guide is not intended to provide the "one" best answer, because when to start is a unique decision for everyone based on your personal situation. This guide will provide a road map of questions and considerations to weigh in forming your own decision.

1. A FEW FACTS.

Social Security is a pay-as-you-go program, where the payroll taxes collected from today's workers are used to pay benefits for today's recipients. Proceeds are placed into Social Security trust funds in the U.S. Treasury for the sole purpose of paying scheduled benefits.

1.0 TRILLION

Amounts collected for Social Security in 2018: 88% from payroll taxes, 8% on interest from government bonds held by the Trusts and 4% from taxes on Social Security benefits.

67.9 MILLION

people received benefits from programs administered by the Social Security Administration in 2019.

176 MILLION

workers with earnings in Social Security-covered employment in 2018.

6%

of those workers had earnings that exceeded the maximum amount subject to taxes. This peaked at 36% in 1965, which means more income is being taxed.

55%

of adult Social Security beneficiaries in 2018 were women.

2. AM I ELIGIBLE FOR SOCIAL SECURITY?

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5.6 MILLION

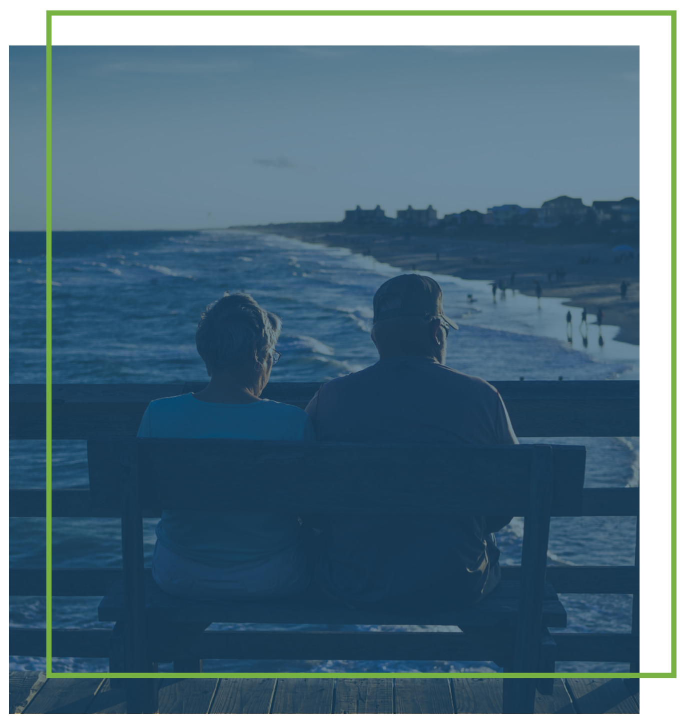
people were newly awarded Social Security benefits in 2018.

Social Security started off with a narrow list of beneficiaries, but has expanded over the years and through political evolution. In order to be eligible for Social Security retirement benefits you must have at least 40 “credits”. You can receive one credit for every $1,300 you earn in a job that deducts Social Security tax (FICA from your paychecks), but you are limited to earning four credits in a year. If you earn $5,200 in a single day at work, you have maxed out your full allotment of credits for the year. Most workers will be eligible after working for ten years. Spouses who did not work may also be qualify based on the elibility of their working spouses.

3. HOW IS SOCIAL SECURITY CALCULATED?

$1,461

average monthly retired worker benefit in 2018.



Social Security is often portrayed as a hopelessly complex series of calculations that require machine learning to decipher and decode. Not quite. If you understand the general guidelines of Social Security you can better understand the foundational nature of the calculations. We’ll keep the technical terms to a minimum, but these are the relevant factors and some important terms.

Full Retirement Age (FRA). For individuals born between 1943 and 1954, your full retirement age is 66, and gradually rises to 67 for those born in 1960 or later.

Highest 35 years of earnings. Social Security keeps track of how much you earn each year. Your benefit calculation will take the highest 35 years of earnings, leaving aside any extra years. What if you have fewer than 35? They will use what is available, and will then use a zero for any "missing" years.

> **"We'll keep the technical terms to a minimum, but these are the relevant factors and some important terms."**

Indexing. Social Security then indexes these annual amounts to put them on an equal footing. For example, without indexing, earnings at the beginning of your working life would be given much less weight than deserved due to inflation. By indexing, money earned during 1985, for example, carries the same weight in calculating your benefits as money earned in 1995, or 2005, or 2015. Indexing stops when you turn 60, and any subsequent money you earn is unadjusted.

Averaged Indexed Monthly Earnings (AIME). Your AIME is calculated by taking your annual earnings, indexing them to today's dollars and converting them to a monthly equivalent over those 35 years, or 420 months. The higher your AIME, the greater your benefits. We can't exert influence over the indexes used, but we can influence the highest 35 years of earnings. For example, we could continue working and replace earlier, lower earnings, although this impact may be minimal. Or, if we don't have 35 years of earnings history, we could keep working to accrue more, which would replace any zeros currently in use.

Primary Insurance Amount (PIA). This is what we all want to know, how much will we will receive once we reach full retirement age. The PIA is a specific formula that starts with your AIME and follows a series of calculations to derive your expected monthly payment. PIA is a redistributive formula. It is designed to reward workers who earn more with higher benefits, but also to ensure that benefits do not rise nearly as fast as earnings. It does this through something called bend points in the formula.

Bend Points. It is important to understand that Social Security benefits are designed to replace a larger portion of earnings for lower income workers. Bend points are income levels that will be adjusted each year to account for wage changes. To this end, your PIA is broken up into three amounts based upon your bend points . The largest replacement percentage - 90% - is applied to your AIME below the first bend point. 32% of the amount between the first and second bend points is added, and only 15% of the amount above the second bend point is added.

Let's look at an example on the next page of someone who will reach their first eligibility (turn 62) in 2019 and is thinking of retiring. They have been taxed for the last 35 years at the maximum level. We will calculate their PIA and talk about more questions to consider.

Year	Nominal Earnings	Indexing Factor	Indexed Earnings
1985	39,600	3.0998	122,752
1986	42,000	3.0104	126,437
1987	43,800	2.8299	123,950
1988	45,000	2.6971	121,370
1989	48,000	2.5944	124,531
1990	51,300	2.4798	127,214
1991	53,400	2.3907	127,663
1992	55,500	2.2736	126,185
1993	57,600	2.2542w	129,842
1994	60,600	2.1953	133,035
1995	61,200	2.1107	129,175
1996	62,700	2.0123	126,171
1997	65,400	1.9013	124,345
1998	68,400	1.8068	123,585
1999	72,600	1.7114	124,248
2000	76,200	1.6217	123,574
2001	80,400	1.5839	127,346
2002	84,900	1.5682	133,140

Year	Nominal Earnings	Indexing Factor	Indexed Earnings
2003	87,000	1.5308	133,180
2004	87,900	1.4628	128,580
2005	90,000	1.4111	126,999
2006	94,200	1.3491	127,085
2007	97,500	1.2906	125,834
2008	102,000	1.2615	128,673
2009	106,800	1.2809	136,800
2010	106,800	1.2513	133,639
2011	106,800	1.2133	129,580
2012	110,100	1.1765	129,533
2013	113,700	1.1617	132,085
2014	117,000	1.1219	131,262
2015	118,500	1.0841	128,466
2016	118,500	1.072	127,032
2017	127,200	1.0362	131,805
2018	128,400	1.0000	128,400
2019	132,900	1.0000	132,900

			Highest -35 Total	4,486,414
AIME			**4,486,414 / 420 months**	$10,682
Bend Points	**First**	$960	**90% * $960**	$864
	Second	$5,785	**32% * ($5,785 - $960)**	$1,544
			15% * ($10,682 - $5,785)	$735
			Monthly Primary Insurance Amount (PIA)	$3,143

1. Fast Facts and Figures about Social Security, 2019
2. www.ssa.gov

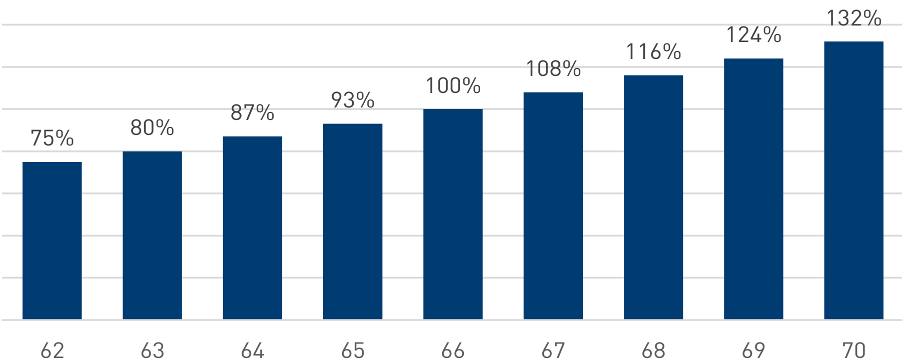
The PIA Pivot Point

The PIA is the calculated benefit you will earn at your full retirement age. It is also the starting point for numerous types of Social Security benefits. In the case of early retirement your benefit is reduced 0.56% for each month before normal retirement age, up to 36 months. If the number of months exceeds 36, the benefit is further reduced by 0.42% per month.

For example, if your full retirement age is 66, but you decide to file and begin benefits at age 62 instead, your PIA will be permanently reduced by 25%. On the other hand, for each year past your full retirement age that you delay claiming Social Security, it will be increased by 8%, thanks to something called the Delayed Retirement Credit. If you delay until the maximum age of 70, your check will increase by 32%. The exhibit below shows the progression of benefits at each age as a percent of your PIA.

Social Security Benefits by Retirement Age

Percent of Primary Insurance Amount



Data Source: Social Security Adminstration

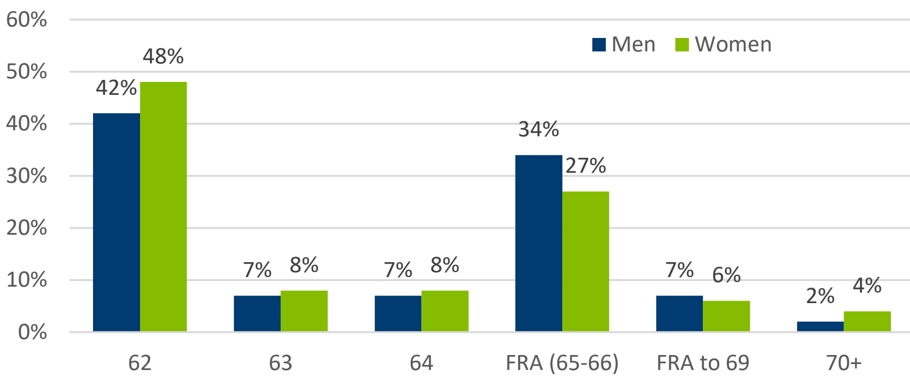
Like the bend points, there is some logic going on here. Social Security holds no opinion about when you file to start your benefits. The Social Security benefit formula adjusts monthly payments so that someone living to average life expectancy should receive about the same amount of benefits over their lifetime regardless of which age they claim. Many pre-retirees embark on a breakeven analysis to determine the best time to claim, but this is only a variation on the same theme: how likely am I to outlive the average life expectancy. We can never know in advance.

Your decision about when to file should not depend solely on the size of the benefit, but rather on other factors relevant to your own situation.

What are the trends?

What are others doing? According to a report by the Center for Retirement Research at Boston College, 90% of Americans begin collecting Social Security retirement benefits at or before their full retirement age or FRA. The most popular age is 62, the earliest age possible, for both men and women.

Age Distribution of Individuals Claiming Retired-Worker Benefits, 2013



Source Data: Center for Retirement Research

The report noted two other findings. One, the United States is in a period of lowering Social Security replacement rates, vanishing traditional pensions and longer lifespans, and many workers realize they may need to work longer in response. And they are. Data shows that retirement increased by about two years over the previous 25 year span. Second, using published and unpublished data from Social Security, the Center found that early claiming actually declined over the same period.

4. AVAILABILITY OF OTHER ASSETS

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62% of aged beneficiares report that in 2015, Social Security represented more than half of their total income for the year.

34% of aged beneficiares received at least 90% of their income from Social Security in 2015.

For many families, Social Security will represent the majority of their retirement income, which will factor heavily into the decision to claim early. But many more are able to consider other income streams to help cover the costs of retirement. This will offer greater flexibility in determining when to file for benefits.

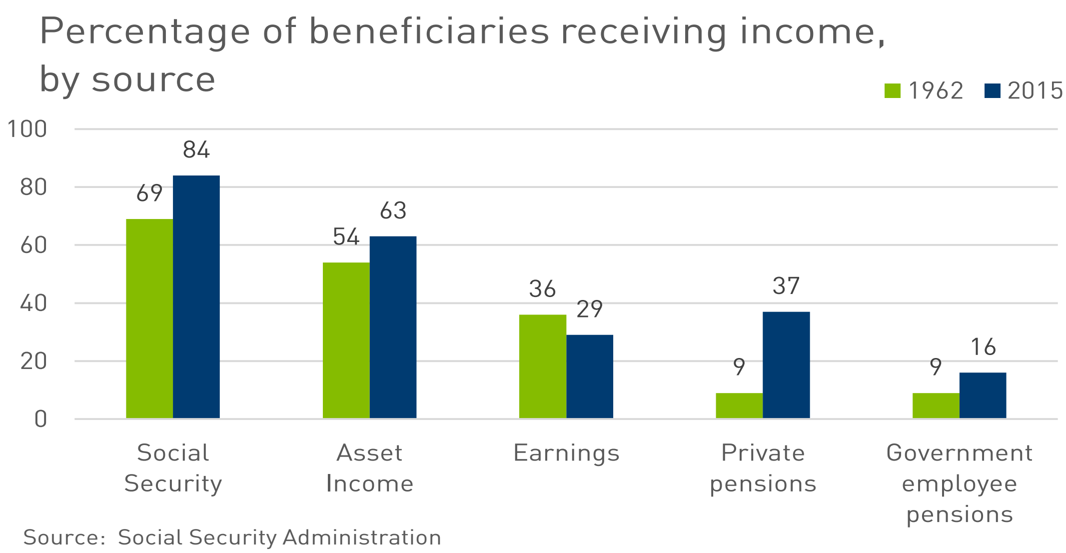
Salary: Do you plan to work in retirement? If so, you will need to estimate how much salary you can expect. For purposes of estimating your income, just consider direct financial compensation from your employer to you.

Business and Real Estate: Do you maintain an interest in a business or an investment property that will produce income? Expect that these sources of income will be more susceptible to market or operating conditions. Plan for less reliability than other sources.

401k and/or IRAs: If you have been contributing to these accounts, they may make up a substantial part of your retirement income. Withdrawals from these accounts can be variable, due to market changes and income needs. They offer the greatest flexbility in terms of timing and amounts of income, but in most cases, withdrawals must start by age 70. And remember that withdrawals from these accounts will be taxed. If you plan to withdraw $50,000 each year, income taxes due will leave you with something less to cover your expenses.

Pension: Defined benefits plans are becoming less common. From 1980 through 2008 coverage by a defined benefit pension plan dropped from 30% of the workforce to 13%. If your employer offers a pension, you should determine how much you can expect to receive on a regular basis. Will it increase or decrease over time?

Social Security benefits are the most common source of income for married couples and non married persons aged 65 or older. The next most common source is asset income followed by private pension income, then earnings. The chart below shows how the impact of these income sources have changed since such records began in 1962.

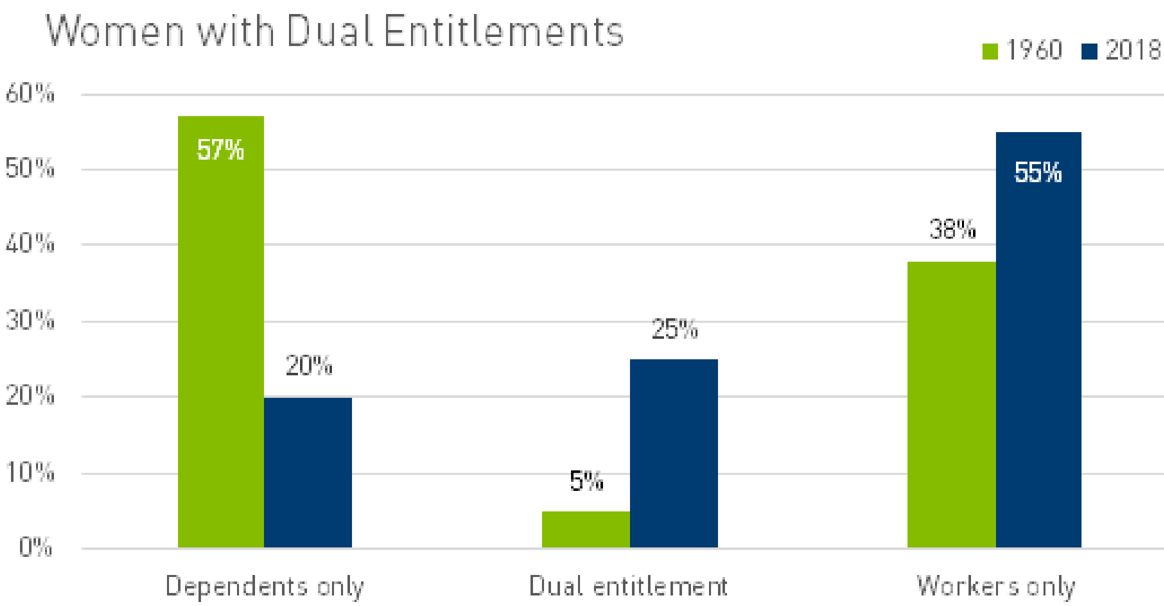


Hand in hand with the changing political times, Social Security has become almost universal as more and more have come to count on it as a source of income. Reliance on asset income has grown as well along with a growing recognition that more and more retirement saving responsibilities would be bourne by the retiree. Reliance on earnings has declined while pension income has increased. The huge rise in pensions occurred only after the second world war in the form of defined-benefits plans where retirement income is linked to a proportion of the workers final salary, depending on years of service. This explains the marked rise in pension income as those workers move their way into and through their own retirement years.

But plan sponsors have been retreating from pension plans because of the expense. Workers are living longer. And generous promises made when markets were stronger have been harder to honor. Thus there has been a big shift towards defined contribution plans where both the employer and employee contribute to an account, which the workers gets in retirement. These trends are likely to continue leading to a reversal in pension income and a greater increase in asset income.

5. TAKING CARE OF YOUR SPOUSE

Spouse and survivor benefits were introduced into the Social Security program in 1939. Initially filing as dependents, many more spouses today are earning their own level of benefits. Since 1960, the frequency of dependent-only filers has dropped dramatically as more spouses have entered the workforce and earned their own entitlements, or have had a combination of benefits to enjoy.



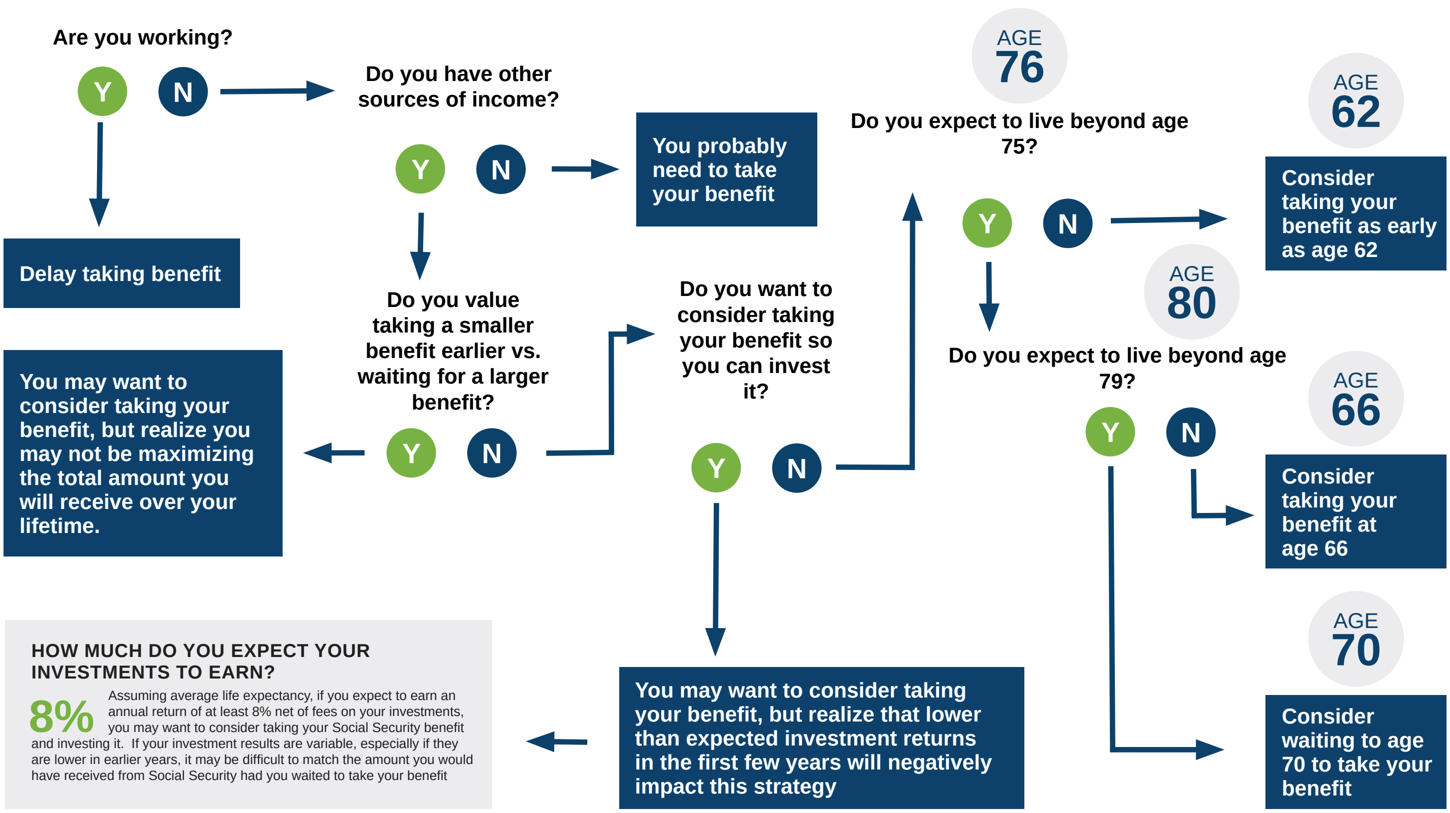
Generally if you have been married to someone who qualified for retirement benefits, you can also qualify for spousal benefits, typically 35-50% of principal beneficiary benefits, depending on when you file. Even if you are divorced, you may still be able to get benefits on your ex-spouse's record. If you have your own benefits, you may still qualify for spousal benefits, but you will only earn the higher of the two. Despite many moving parts, there are some important factors to keep in mind.

- You cannot receive spousal benefits before the principal beneficiary starts receiving benefits.
- If you qualify and apply for your own retirement benefits and for benefits as a spouse, you will receive your own benefits first.
- If your benefits as a spouse are higher than your own retirement benefits, you will get a combination of benefits that equal the higher spouse benefit.

Deeming provision: For spouses who are entitled to both their own benefits and greater spousal benefits, the order in which they and the principal beneficiaries file early can have an impact on total benefits. To maintain flexibility and maximize benefits, it usually makes sense for the spouse to file for their own benefits first. Then once the principal beneficiary files, the spouse can elect to move to spousal benefits once the principal reaches full retirement age.

6. SOCIAL SECURITY CHECKLIST

Now that we understand Social Security better, it is time to think about how to proceed. Consider your expected financial situation in retirement, whether Social Security will play a supporting or a primary role in your planned income.



Mitchell Capital works with investors to address the challenge of when to file for Social Security. We can help you work towards your financial goals in retirement by helping you stay disciplined and provide resources and services along the way. There are many options, but only one that is right for you and your situation.

Still have questions?
Not sure what's best for you?
Need help getting started?

Mitchell Capital has been helping guide investors through financial decisions for over 30 years.
Call us at **913-428-3222** to find out how we can help you navigate yours.