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WEALTHYMINDS

INSIGHTS FOR YOUR FINANCIAL WELL-BEING

SOCIAL SECURITY: RUNNING DRY? NOT SO FAST

FOUR BASIC QUESTIONS TO HELP YOU UNDERSTAND THE INS AND OUTS OF SOCIAL SECURITY AS A PART OF YOUR RETIREMENT PLANS

People's United Advisors®

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SOCIAL SECURITY R.I.P. 1935-2034?

While Social Security is facing financial challenges with the graying of America–**more retired workers living longer with fewer young people behind them paying into the system–**it's not heading for bankruptcy.

CONCEIVED IN THE DEPTHS OF THE GREAT DEPRESSION, Social Security has been a safety net for retirees for decades[1], guaranteeing them a lifelong stream of monthly income. But getting the most out of Social Security is infamously complicated, and the system is facing financial challenges severe enough to threaten a cut in benefits by 2034.

Many younger workers even fear Social Security bankruptcy before they have the chance to reap any benefit from the hard-earned money they've contributed to the program. (See "Grateful or Skeptical: The Generations Look at Social Security" on page 7).

So, what are some of the things that you should know about Social Security payments? And does any of it matter if Social Security is going broke?

But first, the dimensions of the program…

Social Security Is Popular!

Social Security is a very big deal. An estimated 178 million workers were covered by the system in 2019, and as of June, more than 53 million retired workers and their dependents and survivors were receiving monthly checks. That's nearly nine out of every 10 Americans age 65 or older[2].

How dependent are Americans on the program? According to the Social Security Administration (SSA), among elderly beneficiaries, about one out of five married couples and close to half of singles rely on their monthly payments for 90% of their income, or more[3]. In our view, that's excessively dependent—more about that later—but it throws into bold relief how important this program is.

It's *Not* Going Broke

Let's get rid of the elephant in the room at the outset: While Social Security is facing financial challenges with the graying of America—more retired workers living longer with fewer young people behind them paying into the system—it's not heading for bankruptcy. The mechanics of Social Security funding are fairly simple: Payroll taxes on both employees and employers (including the self-employed) funnel into the system and are deposited into a huge interest-bearing reserve account invested in Treasury securities.

1. Social Security also provides benefits to the disabled, but this paper is focused on its "Old-Age" program, essentially assurance of an income floor in retirement.

2. https://www.ssa.gov/news/press/factsheets/basicfact-alt.pdf

3. Ibid.

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NOTHING IS ONE SIZE FITS ALL

When you should start collecting checks is anytime between the ages of 62 and 70 that's best for you–**which depends on your unique circumstances and your long-term financial plan.**

As long as contributions into the system are larger than payments to beneficiaries, Social Security is in surplus. That has been the case for almost its entire history. Now, actuaries project that starting in 2020, Social Security outflows will be larger than inflows, forcing the system to start using its reserve funds to pay beneficiaries. Presumably the system would never again be in surplus, and the reserve funds would run out in 2034.

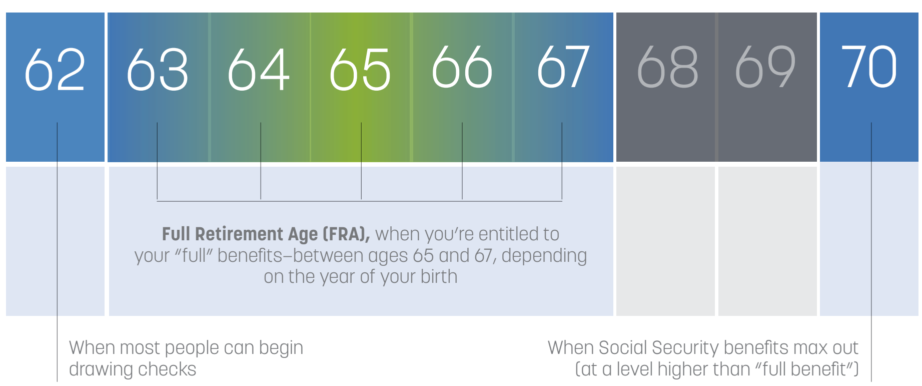
Now, projections like these are estimates and may or may not come to pass. But let's assume the worst: The Social Security reserve fund is empty in 2034 and forever after. The tax revenues supporting the program would continue to flow in, which all analysts agree, would be sufficient to pay out 75-80% of the benefits. A $2,000 monthly check might be reduced to about $1,550.

Although any outcome is possible, we feel strongly that in the next 15 years, Congress or the Executive branch will take action to preserve Social Security.

If Social Security is here to stay (even if in attenuated form), what do current and future beneficiaries need to know about it? We'll look at several questions they often ask; some are easier to answer than others.

Question:
When Should I Start Taking Benefits?

This is definitely not one of the easier questions. There are three critical dates in the mix:



In reality though, when you *should* start collecting checks is anytime between the ages of 62 and 70 that's best for you—which depends on your unique circumstances and your long-term financial plan.

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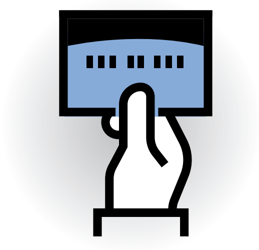

THERE'S ONLY ONE YOU

But averages don't really help you much: **You'd like to know the optimal time for you to start collecting.**

The most popular age to start drawing benefits is the earliest; as reported in 2018, 42% of men and 48% of women began collecting Social Security at age 62[4]—presumably, in many cases, because they need the money to live. That's a shame, because the longer you wait to start taking checks, the bigger the checks get (until age 70, when the benefit levels off).

For recipients born between 1943 and 1954 inclusive, whose FRA is age 66, monthly benefits if started at 62 are 25% lower than if started at 66, and fully 76% lower than if begun at 70 (Exhibit 1). That the cumulative effect of benefit reductions if you start to collect earlier than your FRA, and the "credits" you earn for delaying—in this case, of 8% per year over the FRA. Mind you, Social Security isn't just giving away free money: Their actuaries have determined, based on longevity data, that all beneficiaries, on average, whether they start collecting early or late, will likely receive roughly the same amount over their lifetimes.

But averages don't help you much: You'd like to know the optimal time for you to start collecting. If you're healthy, willing to wait, and don't need the benefit to live on, you may be best off delaying until 70—especially if you have a lower-earning spouse who stands to collect your benefit after your death. But that's not a particularly large cohort. Most recipients do need the Social Security early in retirement, and some are unwilling to (or can't) count on a long life ahead.

EXHIBIT 1: WAIT LONGER TO START COLLECTING SOCIAL SECURITY, AND YOU'LL GET MORE EVERY MONTH:

Monthly Benefit, Assuming $1,000 at a Full Retirement Age of 66

Source: Social Security Administration

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4. https://www.fool.com/retirement/general/2016/04/19/when-does-the-average-american-start-collecting-so.aspx

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FOUR ASPECTS TO CONSIDER:

There are a number of considerations to keep in mind when looking at **your Social Security benefits as part of your overall retirement plan:**

When to Begin

The reality is, you should start collecting checks anytime between the ages of 62 and 70 **that best suits your unique circumstances and your long-term financial plan**.

Working While Collecting

If you're at or above your FRA, **you can work and earn as much as you like** without any penalty attached to your Social Security check. Of course, those wages will be fully taxable.

How Benefits Will Be Taxed

Social Security figures twice in your taxes: once in the taxation of the benefit, as described above, and again in how your taxable income is determined in the first place.

Spousal Benefits

A surviving spouse of a Social Security recipient **is entitled to 100% of the benefit** that his or her late spouse was receiving at the time of death, even if the survivor never received Social Security.

One of the critical factors in deciding when to start collecting is the "break-even" age: the age when the cumulative benefit from the higher but delayed checks equals (and then surpasses) the cumulative benefit from the smaller checks that have started earlier. The longer you delay the checks, the longer until "break-even." Exhibit 2 illustrates how to calculate the break-even age between starting a $1,500 monthly benefit at an FRA of 66 versus waiting one additional year (ignoring any taxes on the benefits and potential earnings on payouts that you invest).

Is 12½ years too long to wait before receiving bigger checks in return for delaying slightly? That depends on the immediate income needs, the health situation, and the patience of the Social Security recipient. Regardless, an age of 78½ is well within the cone of possibility these days for a 66-year old. According to the SSA, one out of three Americans aged 65 today will live past 90[5]. However, unless you have a crystal ball, you don't know how long you'll live.

So we're not advocating for taking benefits early, late, or in-between. That's something you need to decide based on your specific situation, very possibly in coordination with a financial planner.

EXHIBIT 2[6]: AN EXAMPLE OF BENEFITS LATER BUT HIGHER: WHEN WILL YOU COME OUT AHEAD VERSUS STARTING EARLY?

$1,500 Monthly Benefit at FRA of 66

INCREASE IN MONTHLY BENEFIT PER YEAR FOR DELAYING	ANNUAL BENEFIT FORFEITED BY DELAYING	DIVIDE SUM IN BOX #2 BY BOX #1	DIVIDE MONTHS IN BOX #3 BY 12
$1,500	$1,500	$18,000	150
X 8%	X 12	÷ 12	÷ 12
$120	$18,000	150 MO	12.5 YRS TO BREAK-EVEN[7]

5. https://www.ssa.gov/planners/lifeexpectancy.html

6. An adaptation of an example in https://www.kiplinger.com/article/retirement/T051-C032-S014-how-to-calculate-social-security-break-even-age.html

7. The relationship isn't linear: Delaying benefits for two years rather than one won't double the break-even date.

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THE MORE YOU KNOW:

Social Security figures twice in your taxes... **We strongly encourage you to consult with your tax advisor before filing any forms.**

Question: Can I Work and Still Receive Social Security Checks?

The short answer is yes, but as with virtually all questions about Social Security, the rules are nuanced. If you're at or above your FRA, you can work and earn as much as you like without any penalty attached to your Social Security check. Of course, those wages will be fully taxable—and see the "Question" below on the taxability of your Social Security benefit.

If you're under your FRA, however, the SSA will levy a penalty on your checks if you earn more than $17,640 annually (the 2019 figure; it has been going up slowly). The penalty is $1 for every $2 you earn above the threshold amount. However, in your FRA year (before your birthday month, at which point any penalty is lifted) the rules are more liberal.

But the work penalty is temporary: Once you reach FRA, any penalty will start coming back to you in installments. The moral here: If you want to labor like Hercules while receiving Social Security benefits, you probably will be able to do so.

Question: Will My Social Security Benefits Be Taxed?

Above certain—low—income thresholds, a portion of your benefits will be subject to taxation, at your ordinary-income rate. Up to 50% of your benefit is taxable in the 2019 tax year if you make between $25,000 and $34,000 as an individual, or between $32,000 and $44,000 for married couples. If your income exceeds these limits, you'll be liable for tax on up to 85% of your benefits. (These figures apply only to federal income tax; some states also levy their own taxes on the benefits.)

And Social Security figures twice in your taxes: once in the taxation of the benefit, as described above, and again in how your taxable income is determined in the first place. In assessing tax on Social Security, your "income" is defined as your adjusted gross income plus any non-taxable interest income you earned plus half the value of your Social Security benefits. Once upon a time (prior to 1984), there was no tax on Social Security benefits; those days will undoubtedly never return.

As in all tax matters, we strongly encourage you to consult with your tax advisor before filing any forms.

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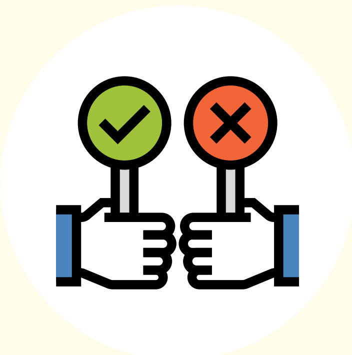

While no one is untroubled by the current state of Social Security, **the different generations see the program differently**.

Grateful or Skeptical: The Generations Look at Social Security

To some Baby Boomers, Social Security is still a dream come true[8]: guaranteed inflation-adjusted income for their rest of their lives. And though others are more wary, they surmise (correctly, in our view) that even if the program does go down, it won't be in their time.

Many Boomers Expect Too Much from Social Security…

In fact, many Boomers are overly reliant on Social Security, which was never intended to fully fund retirement—only give its recipients a good head start. According to the SSA, the program has been replacing about 40% of an average retiree's pre-retirement annual earnings, and that figure may decline in the future if benefits wind up curtailed. Meanwhile, studies have shown that most retirees will need about 70% of what they used to earn, and possibly more[9].

Not that all Boomers even know how much they'll need: 58% in a recent survey admitted to not having a clue[10]. And though that's marginally lower than the figure for Americans as a whole, it's more concerning, since Boomers have precious little time—if any—to work out a retirement plan. The moral: *Don't look to Social Security for retirement salvation. Even in its best days, it would have failed you.*

…Even as Younger Americans Are Cynical

If Boomers have come to expect too much from Social Security, most of their younger counterparts have become Unbelievers. About 80% of Millennials according to a Transamerica study[11], and, it appears, a similar majority of the Gen X cohort, now believe that Social Security will come up empty for them: a Ponzi scheme in which they were the unfortunate newcomers. As for Gen X, some commentators see them as even worse off than Millennials, since they've had less time to prepare for the Social Security "apocalypse" to come.

Our view, unsurprisingly, is that too many in both the older and the younger age cohorts have staked out unrealistically extreme positions. But there's a difference in the consequences of the two extremes. Boomers who look to Social Security as their sole security blanket in retirement will be hit hard when the program fails them, even if benefits are not actually reduced in the decade to come. For Millennials and Gen Xers who expect Social Security to dissolve, the excessive pessimism may have a silver lining: If it induces them to save more, to assemble a robust retirement package, so much the better. Indeed, every generation should be striving to *save the most they can*.

8. Some commentators are pessimistic about the prospects for Social Security, even for Boomers. See, for example, https://www.forbes.com/sites/chriscarosa/2019/04/25/will-social-security-still-be-around-when-i-retire-and-if-not-what-can-i-do-about-it-right-now/#1b76be997f8d.

9. https://www.ssa.gov/planners/retire/r&m6.html

10. https://www.bankrate.com/retirement/survey-how-much-needed-to-retire/

11. https://fee.org/articles/80-of-millennials-are-worried-social-security-won-t-be-there-for-them/

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YOUR FUTURE STARTS TODAY

Every day that goes by without you having a plan in place **is another day that you are missing out on investing and planning for the future you are counting on.**

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Question: What Should I Know About Spousal Benefits?

Spousal benefits are one of the more complicated areas within the Social Security landscape, and there are many exceptions to and detailed clarifications of the broad guidelines below. But in general:

- A surviving spouse of a Social Security recipient is entitled to 100% of the benefit that his or her late spouse was receiving at the time of death, even if the survivor never received Social Security, if the survivor is at his or her FRA. If younger, the survivor can collect a reduced benefit starting at age 60 (50 if disabled). A divorced spouse of a deceased beneficiary can also collect benefits if the marriage lasted at least 10 years. Both widowed and divorced beneficiaries may lose their eligibility if they remarry before certain ages. If a survivor is collecting Social Security in his or her own right, the survivor chooses the higher amount; no double-dipping is allowed[12].

- If both spouses (married at least one year) are living and the lower-earning (or non-earning) spouse is at least 62, he or she can apply for a spousal benefit. The higher-earner must already be receiving Social Security, and the spousal benefit caps at 50% of the higher-earner's check, when the spousal claimant reaches his or her FRA. If both spouses are working, a spousal-benefit claimant is entitled to either his or her own benefit or the spousal benefit, whichever is higher—not both. And again, divorced spouses can claim under certain conditions.

- In most cases, only claimants born before January 2, 1954, can file "restricted applications," which allow them to take spousal benefits at their FRAs while delaying their own benefits—often until age 70, for maximum growth. This strategy used to be available generally, but was disallowed in recent legislation, except for certain narrowly defined groups.

If all this sounds complicated, it is! (And there's more in the fine print that we're not bothering you with.) If you wish to take maximum advantage of Social Security spousal benefits, you should seek the counsel of a Social Security expert.

12. There is a limit to the amount of Social Security benefits that can be paid on a worker's earning record, including survivor, spousal, and children's benefits (and a maximum benefit paid to an individual as well).

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The Big Take-Away: *Plan* for Retirement Income

We've taken a micro view of Social Security in much of this paper. In our conclusion, we're moving the camera all the way out: Social Security, despite all its ins and outs, has been a pretty good deal, at least so far, but it's only one piece of a much larger tapestry: Virtually everyone should have, long before retirement, tried to assure income in his or her leisure years that will meet personal needs.

But for too many Americans, their finances are inadequate and siloed. When they're working, they rely too much—sometimes exclusively—on salary checks to get them through. In retirement, it's Social Security: another month-to-month paycheck. But the program was always intended to be a helpmate, not a panacea. Instead of financial siloes in each phase of financial life, from initiating bank and investment accounts to accumulating wealth to drawing down assets, there should be many cooks in the kitchen (and they won't spoil the broth). Whatever your mixture of gainful employment, judicious savings, diversified taxable and tax-deferred portfolios—and yes, Social Security—at any one time, let us help you plan for a sturdy and goals-oriented retirement.

Where We Come In

Do you have questions about Social Security and how you can use it to your best advantage? Make an appointment with our experts at People's United Bank, and we'd be happy to include your attorney, accountant, or other professional in our discussion.