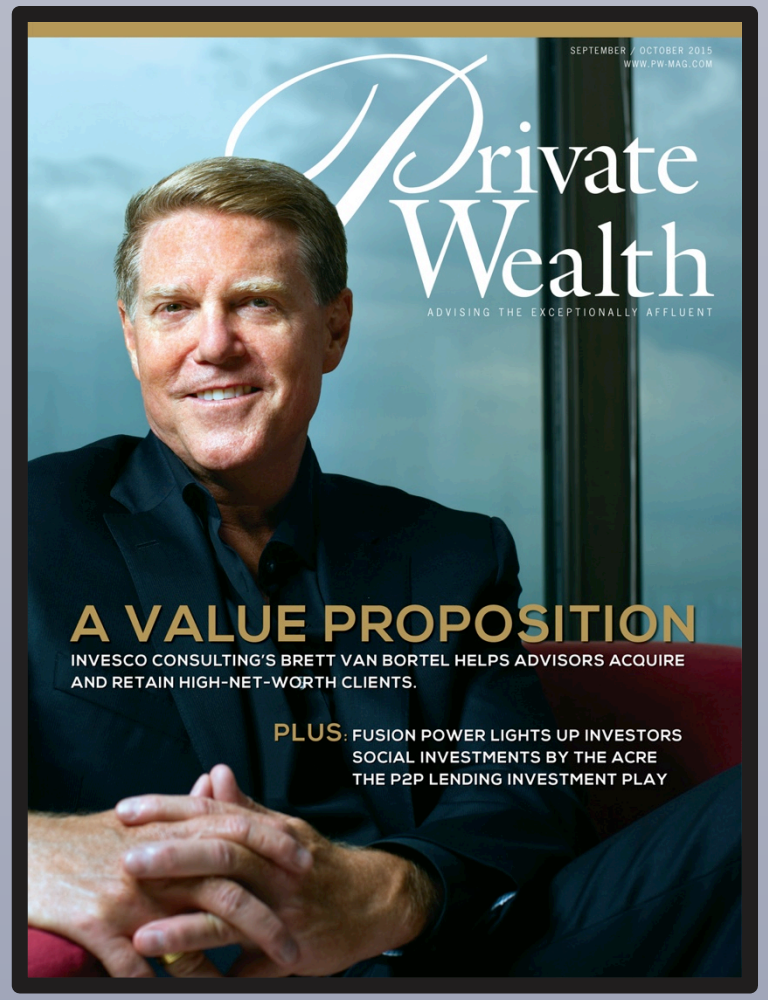

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Fitting Social Security into a Retirement Income Plan

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RetirementResearcher.com/social-security

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Social Security Claiming Decision

Single people:

when to claim benefit

Couples:

when each spouse should claim their own and/or their spousal benefit (while also considering eventual survivor benefits)

restricted application

file and suspend

Especially for lower- and middle-income Americans, Social Security may end up providing the vast majority of retirement income. And so it is very important to get Social Security claiming decisions correct.

Benefits Adjust by Start Date

Adjustments By Age		
	Full Retirement Age = 66	Full Retirement Age = 67
62	75%	70%
63	80%	75%
64	87%	80%
65	93%	87%
66	100%	93%
67	108%	100%
68	116%	108%
69	124%	116%
70	132%	124%

Arguments to Justify Delayed Social Security Claiming

1. Pascal's wager for Social Security

2. Social Security is insurance (not investment):
   - inflation-adjusted, government-backed lifetime cash flows
   - Includes spousal and survivor benefits
   - Don't forget disability insurance for pre-retirees

3. Social Security *also* works as an "investment"

4. Tax opportunities when delaying

Pascal's Wager for Social Security

	Claim Early	Claim Late
Short Retirement	Worked out	Minimal Harm Done
Long Retirement	Permanently **Reduced** Lifestyle	Permanently **Increased** Lifestyle

Social Security *is* Insurance

- Don't think in terms of breakeven investment analysis

- Insurance value of Social Security
  - Inflation-adjusted lifetime annuity backed by government
  - Longevity risk protection
  - Risk averse individuals: even more benefit from Social Security's insurance value
  - Spousal, family, and survivor benefits
  - Government backing

Social Security as an "Investment"

Claiming age choice is meant to be "actuarially fair"

But...

- Longevity has improved since 1983 actuarial calculations
- Interest rates have decreased too
- Financial planning clients live longer than average
- Couples can take advantage of joint longevity

Social Security as an "Investment"

2.9% Real

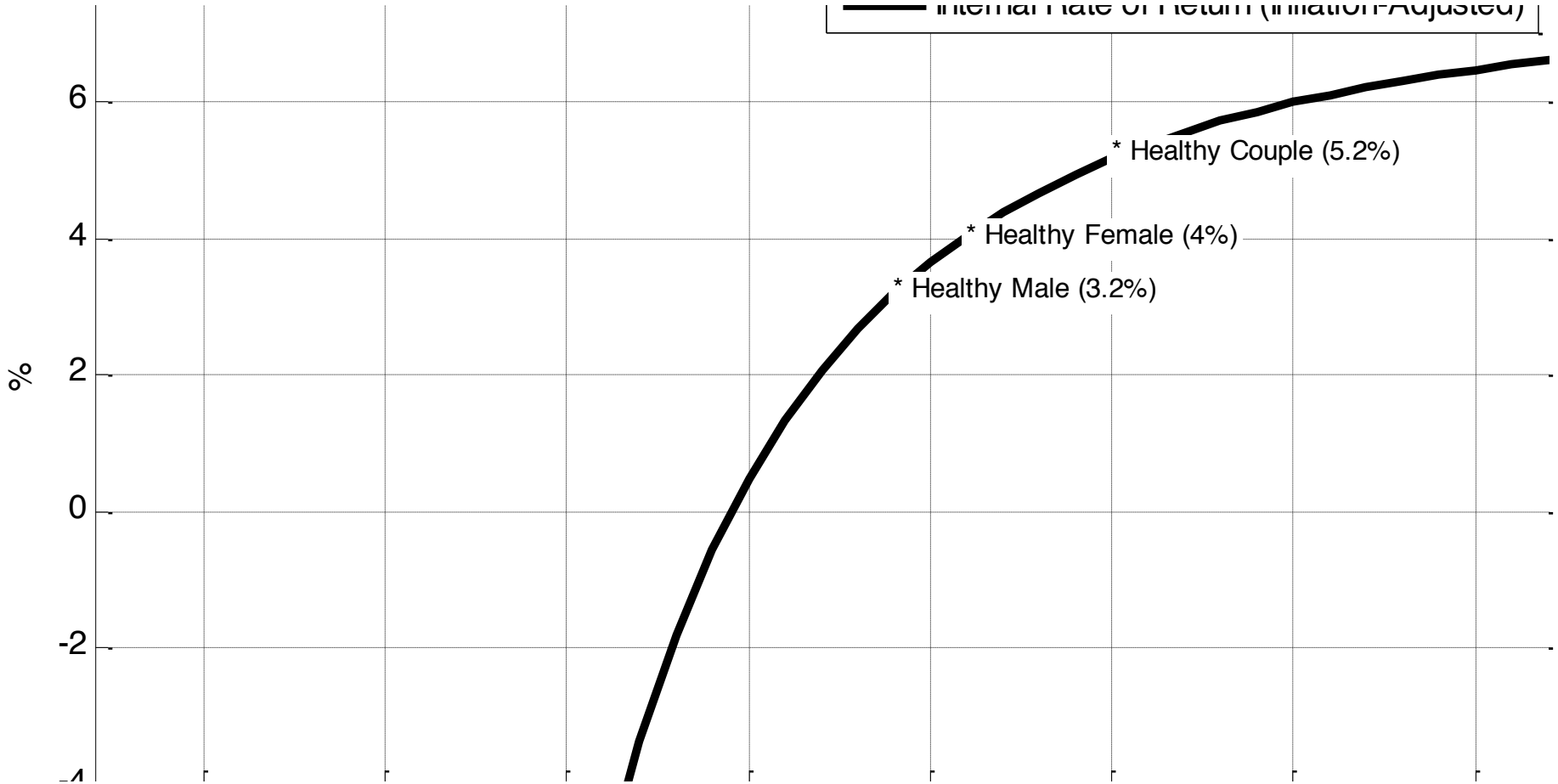
Social Security Administration

1.2% Real

30-Year TIPS Yield

October 2015

Real Compounded Return from Delay to 70



Social Security Claiming Example

- 62 year old, already retired
- Annual spending goal: $60,000 per year (inflation-adjusted)
- Social Security Benefit (inflation-adjusted)
  - Age 62: $1,875 / month ($22,500 / year)
  - Age 66: $2,500 / month ($30,000 / year)
  - Age 70: $3,300 / month ($39,600 / year)
- Remainder of spending goal covered by withdrawals from financial portfolio

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Real Spending in Retirement

Claim Early at 62

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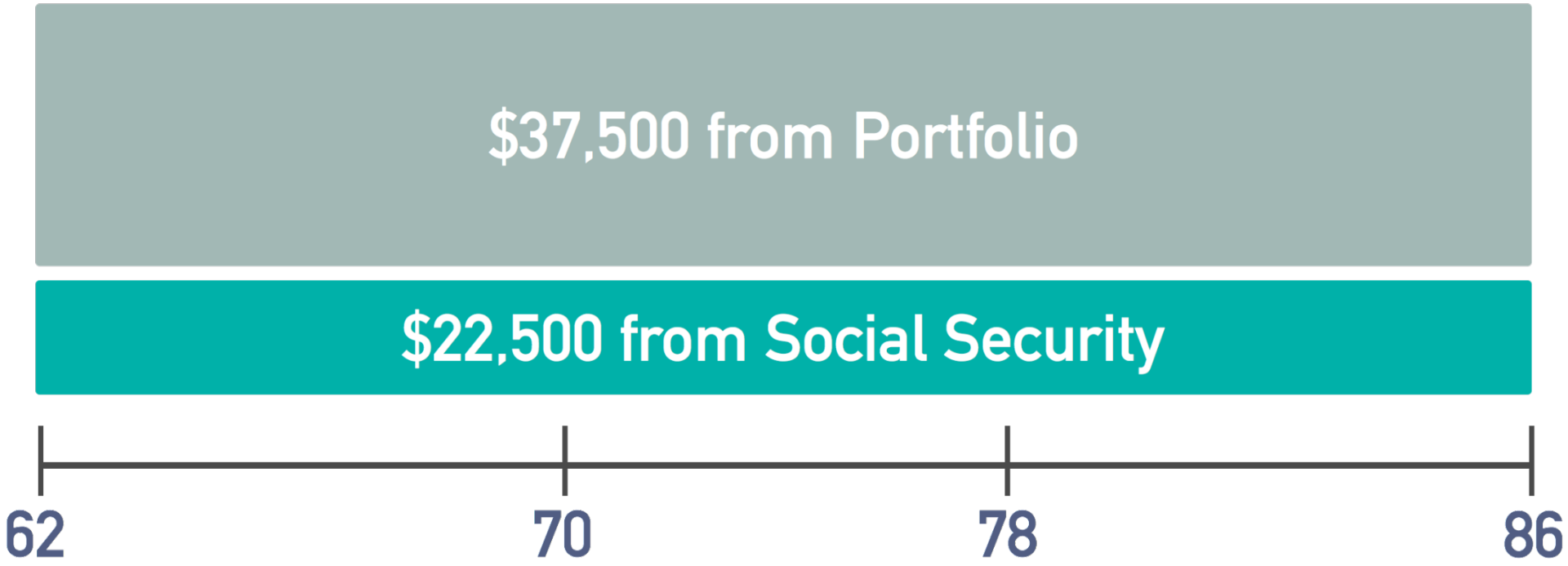

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Real Spending in Retirement

Delay to 70

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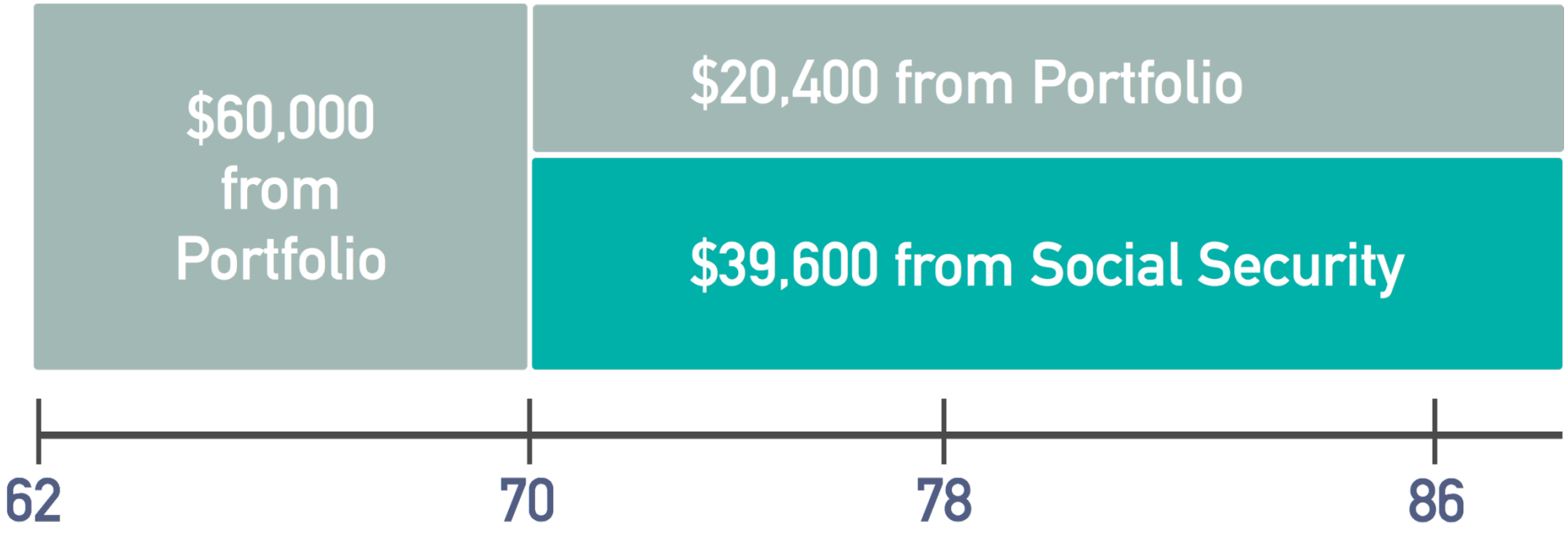

Retirement Income Plan

Impact of Social Security Delay on Retirement Withdrawal Rates		
	Claim at Age 62	Claim at Age 70
Spending Goal	$60,000	$60,000
Social Security Benefit	$22,500	$39,600
Portfolio Withdrawal	$37,500	$20,400
Investment Portfolio	$800,000	$800,000
Set Aside for Social Security Delay	$0	$316,800
Remaining Portfolio	$800,000	$483,200
Withdrawal Rate	**4.69%**	**4.22%**

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Retirement Income Plan

Present Values (Assumes Live to 90)				
Real Discount Rate		Claim at 62	Claim at 70	**Difference**
0%	Social Security	$652,500	$831,600	**$179,100**
	Portfolio Needs	$1,087,500	$992,400	**($95,100)**
2%	Social Security	$491,499	$574,949	**$83,450**
	Portfolio Needs	$819,164	$793,790	**($25,374)**
6%	Social Security	$305,791	$292,285	**($13,507)**
	Portfolio Needs	$509,652	$552,682	**$43,030**

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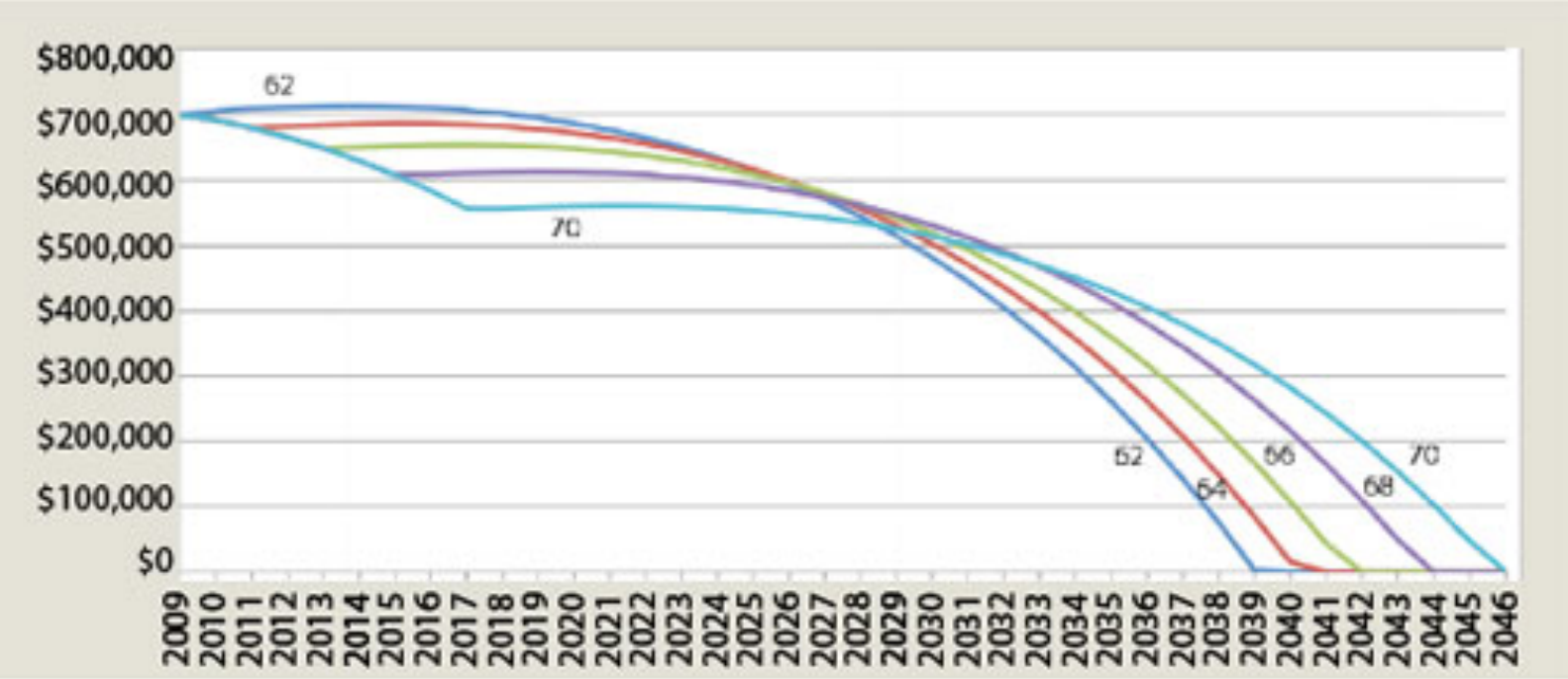
Figure 1: Household Assets



This example assumes the asset(s) earn 5% per year with inflation at 3% per year. He begins retirement on his 62nd birthday at the beginning of 2009. This example comes from a model developed at Retiree Inc. This example assumes each year's taxes are based on current tax brackets, standard deduction amounts, personal exemption amounts, and deduction amount for being 65 or over all adjusted each year with inflation. It uses the three IRS formulas to calculate the taxation portion of Social Security benefits. See www.retireeinc.com for more information.

Source: William Reichenstein & William Meyer, "Social Security: When Should You Start Benefits and How to Minimize Longevity Risk?" *Journal of Financial Planning*, March 2010

Tax Opportunities

Social Security Benefits Taxation		
Provisional Income		Taxable Benefits
Single Filers	Married Filing Jointly	
Under $25,000	Under $32,000	0%
$25,000 - $34,000	$32,000 - $44,000	up to 50%
Over $34,000	Over $44,000	up to 85%
Provisional Income = AGI + 1/2 Benefit + tax-exempt interest		

Tax Opportunities

62-year old retiree:

no labor income + no Social Security benefits

= opportunity to

make Roth conversions

realize long-term capital gains

so that taxes are paid at a lower marginal rate

Ex. 62-year old couple with $20,600 of Roth conversions and $74,900 of long-term capital gains/qualified dividends is still paying $0 in federal income tax

To keep $0 tax, potential added spending sources: Roth IRA, cost-basis on taxable investments, HECM line of credit, HSA (for medical expenses), life insurance cash values

Helps later in retirement: lower RMDs, higher cost-basis, less pressure to make taxable withdrawals to meet spending needs

Arguments Used to Justify Early Social Security Claiming

1. Terminal illness
2. Breakeven age for Social Security delay is too late
3. Social Security's end is near, so get something now
4. Investments can easily earn higher returns than implied by Social Security delay
5. Some retirees simply need the income to live
6. Delayed claiming amplifies sequence of returns risk

Social Security benefits for terminally ill

- Compelling argument for claiming early
- Caveat: don't forget about survivors benefits.

BREAKEVEN AGES

62 vs. 70 decision

For 62 vs. 70 decision, breakeven age is around 80 to 84. One has to live longer to benefit from delay. That's too long.

Pascal's Wager

Remember: Pascal's Wager and Social Security's insurance value

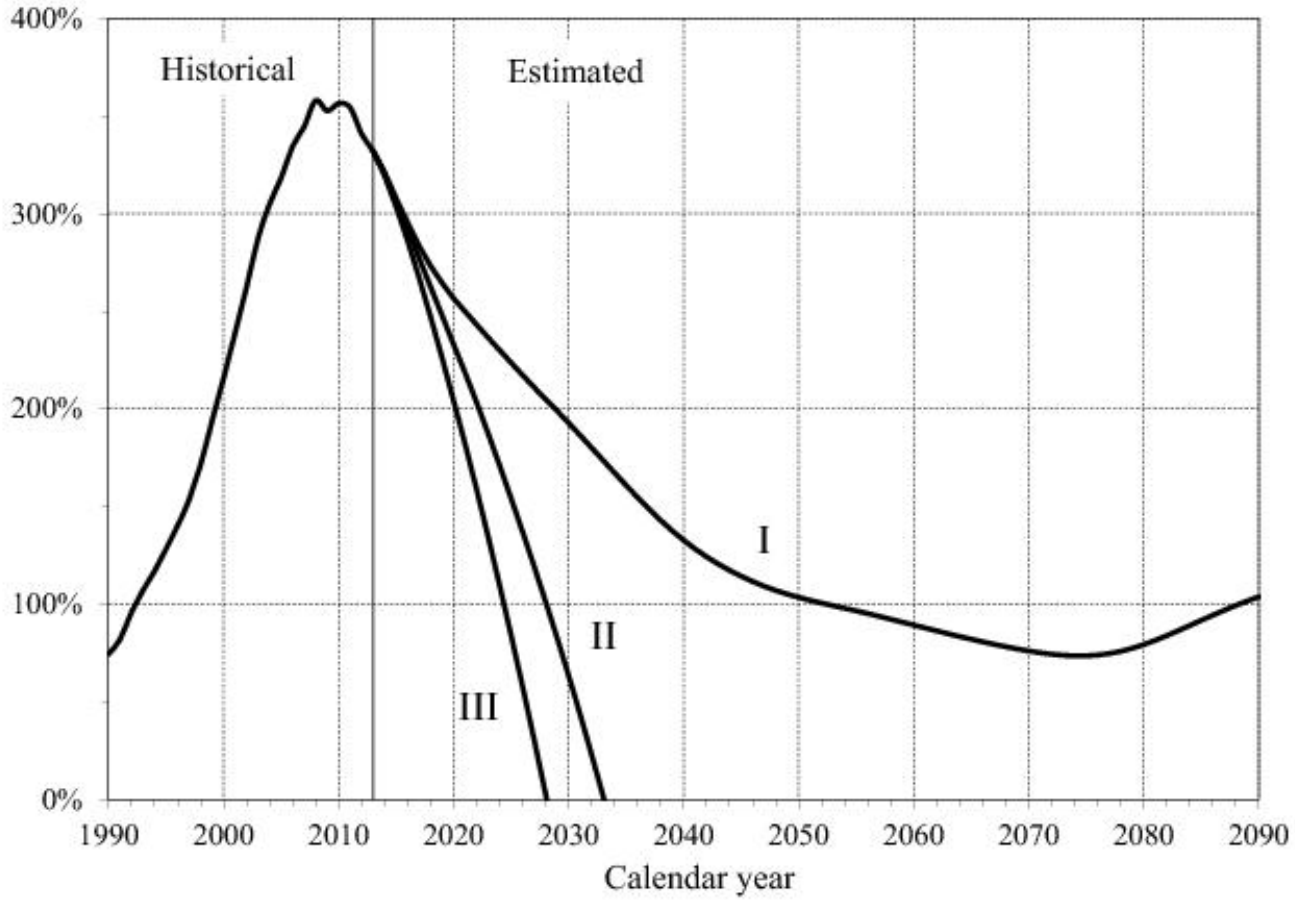
Besides, 80 to 84 is less than life expectancy

The end of Social Security?

- In stable systems, **benefits received** equals **payments collected**.
- Many PAYGO pensions are financially unstable. Instability is coming from:
  - Improving mortality rates
  - Declining fertility rates
  - Overly generous benefits relative to worker contributions.

2014 Social Security Trustees Report

Evolution of the Trust Fund



What happens in 2033?

- New Contributions will cover 75% of presently legislated benefits — across the board 25% benefit cut

Social Security won't disappear

- Raising the payroll tax by 2.88% now will cover 75-year projected funding needs

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Reforms Impacting Current or Near Retirees	Other Reforms
Use a Smaller COLA than CPI	Increase payroll tax rate
Use more than top 35 years of earnings	Increase maximum taxable earnings
Reduce Benefits to Reflect Increasing Longevity	Raise Full Retirement Age
Means testing for benefits	Switch from “wage indexing” to “price indexing”
Eliminate "file and suspend" & related strategies	Expand Trust Fund Beyond US Treasuries
Allow individuals to purchase additional annuity income when claiming benefits	Carve-Out Personal Retirement Accounts

Investments can beat the returns on delay

"But what if the Social Security payments received starting at the age of 62 were invested in an index fund like the S&P 500 Index? Would these smaller but earlier benefits grow over an 8-year period to off set the larger monthly Social Security payments received by a retiree waiting until age 70? ...

If these monthly Social Security benefits were invested in the S&P 500 Index and dividends reinvested the man in our example would have an investment portfolio of $ 245,322 at age 70, **assuming a compound annual return of 10.5%**."

-from an unpublished article

Some retirees must claim early to survive

- For underfunded, delaying retirement would be desirable, but may not always be possible
- Unfortunate reality for some
- Not having the flexibility to delay Social Security means locking in a permanently lower standard of living

Delaying Social Security increases sequence risk

- True, if retirement income based solely on volatile investments
- But carving out the 8-years of missing benefits can be a solution

- Social Security delay = buying an income annuity at a better rate than anything commercially available

Social Security Delay Bridge

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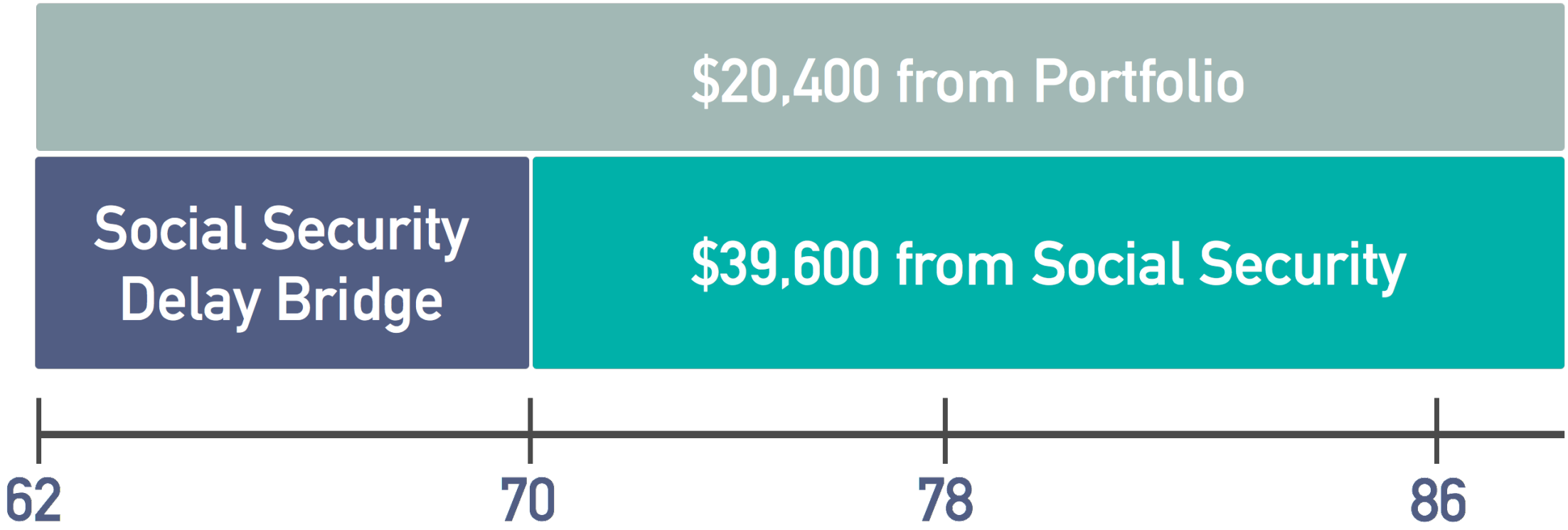

Thank you! Any Questions?

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