WHAT, *when*, *who*, HOW? THE SOCIAL SECURITY DECISIONS

ENSEMBLE
WEALTH MANAGEMENT

HOW TO POTENTIALLY MAXIMIZE

SOCIAL SECURITY BENEFITS

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EXECUTIVE SUMMARY

The biggest story in Social Security today concerns the large number of baby boomers set to retire over the next 20 years and the relatively smaller younger generations feeding Social Security payroll taxes into the system.

On average, today's seniors are living longer than any previous generation. While that's good news, it also presents several new challenges. A longer life increases the likelihood that you'll have increased medical and long-term care expenses throughout much of your retirement. This is particularly true if you've been active all of your life – as many of today's baby boomers have been.

Furthermore, the value of your nest egg could be more significantly impacted by increases in the cost of living over a longer term. Quite simply, you could outlive your savings. When you consider all of these factors, it is important to make informed decisions about when to begin receiving Social Security benefits within the context of your overall retirement income strategy.

Other sources of retirement income, such as pension plans, 401(k) plans, IRAs, annuities, tax-exempt and taxable securities should be carefully evaluated in light of various factors. For example, generating a reliable fixed income versus variable, at-risk income. You may want to consider speaking with a financial advisor or insurance agent to help develop a retirement income strategy before you apply for Social Security benefits.

There are strategies you can employ to help reduce the risks of outliving your money. These strategies may be directly related to when you start taking Social Security benefits and how you should position assets for a surviving spouse.

WHAT'S THE STATUS OF SOCIAL SECURITY?

Social Security benefits are largely funded by today's workers via payroll taxes. In 2011, the Old-Age and Survivors Insurance and Disability Insurance Trust Funds collected $805.1 billion in revenues from the following sources:[1]

- 82.8% from payroll taxes and reimbursements from the General Fund of the Treasury
- 3.0% from income taxes on Social Security benefits
- 14.2% from interest earned on the government bonds held by the trust funds

The number of retired workers is projected to double in less than 30 years. Adding to the Social Security funding dilemma, people are also living longer and the national birth rate is low. As a result, the ratio of workers paying Social Security taxes to people collecting benefits is projected to fall from 2.9 to 1 in 2011 to 2.0 to 1 in 2034. The Trustees Report projects that there will be a shortfall in payroll taxes needed to fund benefits, yet the redemption of trust fund assets will be sufficient to allow for full payment of scheduled benefits until 2032. At that point, payroll taxes and other income will be sufficient to pay only 75 percent of program costs.[1]

[1] Social Security Administration; Fast Facts & Figures About Social Security, 2012; www.socialsecurity.gov/policy/docs/chartbooks/fast_facts/2012/fast_facts12.html#page35

WHEN SHOULD YOU DRAW BENEFITS?

As of 2013, full retirement age (referred to as FRA) is age 66 for anyone born in 1943 or earlier. If you were born between 1943 and 1962, full retirement age is 66 plus two-month increments depending on the month of your birthday. If you were born in 1960 or later, full retirement age is 67. You may begin taking benefits starting at age 62, but they will be permanently reduced.

Covered workers need 40 credits to be eligible for their own benefit, which works out to about 10 years of work history. Your benefit is calculated based on your average earnings over the highest-earning 35 years.

Working up to full retirement age may increase your benefit while at the same time any contributions you continue to make to a 401(k) plan and/or investment portfolio will have more time to potentially accrue higher gains.

If you begin drawing benefits before full retirement age, they are reduced as shown in the accompanying table.[3]

In 2012, the maximum payout for any beneficiary was $2,513 per month.[2]

FULL RETIREMENT AND AGE 62 BENEFIT BY YEAR OF BIRTH[3]

Year of Birth[1]	Full (normal) Retirement Age	Months between age 62 and full retirement age[2]	A $1000 retirement benefit would be reduced to	The retirement benefit is reduced by[4]	A $500 spouses's benefit would be reduced to	The spouses's benefit is reduced by[3]
1937 or earlier	65	36	$800	20.00%	$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	25.00%	$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 and later	67	60	$700	30.00%	$325	35.00%

1. If you were born on January 1st, you should refer to the previous year.

2. If you were born on the 1st of the month, SSA figures your benefit (and full retirement age) as if your birthday was in the previous month. If you were born on January 1st, SSA figures your benefit as if your birthday was in December of the previous year.

3. You must be at least 62 years old for the entire month to receive benefits.

4. Percentages are approximate due to rounding.

5. The maximum benefit for the spouse is 50 percent of the benefit the worker would receive at full retirement age. The percentage reduction for the spouse should be applied after the automatic 50 percent reduction. Percentages are approximate due to rounding.

[2] Social Security Administration; Fast Facts & Figures About Social Security, 2012; www.socialsecurity.gov/policy/docs/chartbooks/fast_facts/2012/fast_facts12.html#page35

[3] Social Security Administration, www.socialsecurity.gov/retire2/agereduction.htm , Retrieved January 8, 2013

No matter what age you begin receiving Social Security benefits, your payout will receive an automatic annual cost of living adjustment when there is a comparative increase in the consumer price index.

HOW DO SPOUSAL BENEFITS WORK?

Spousal or "derivative" Social Security benefits are determined by each of their work history and earnings, and the age at which they apply for and/or begin drawing benefits. (According to the Defense of Marriage Act, information presented applies to opposite sex spouses.)

The spousal – or derivative – benefit is 50 percent of the higher earner's accrued benefit at the spouse's full retirement age. Should the higher-earning spouse start taking benefits earlier than full retirement age, the spouse's derivative benefit will be less.[4]

When women take time off the workforce to have children, raise children or even provide care for senior parents, years with part-time or zero earnings may factor into the 35 years and result in a much lower benefit than people who work full-time throughout their adult lives. This is why many women might qualify for a higher benefit based on their husband's work history.

Plan for Surviving Spouse

Common sense may tell you that – among couples – the higher earner should claim benefits as early as possible and the lower earner should delay in order to receive a higher benefit. In reality, the exact opposite may be the better option because if the higher earner claims early and then dies first, he or she is likely to have shortchanged the lower earner's survivor benefit.

In this scenario, the higher earner should delay claiming benefits so the lower earner can claim the highest possible benefit for life – whether it's the lower earner's own benefit or a derivative of the higher-earner's highest available benefit. If the lower earner dies first, there is no lost benefit, as the higher earner simply keeps his or her own benefit.[5]

[4] Social Security Administration; Retirement Planner, December 10, 2012; www.socialsecurity.gov/retire2/yourspouse.htm#a0=0

[5] Social Security Administration; Retirement Planner, October 18, 2012; www.ssa.gov/retire2/otherthings.htm

File and Suspend

In order for the lower-earning spouse to collect benefits based on the higher earner's history, the higher earner must apply for Social Security retirement benefits first. However, if the higher-earning spouse has reached full retirement age, he or she may apply for benefits and then file to suspend drawing benefits until later. This enables the higher-earner to accrue a higher benefit via more earnings contributions and Delayed Retirement Credits (DRC)[6].

Spouse with Two Options (applicable to an opposite sex spouse)

If you are married and have reached full retirement age, you have a couple of options. You may claim benefits either on your work history or your spouse's. You can also draw the spousal benefit and allow your own benefit to accrue Delayed Retirement Credits until you turn age 70. At that point, you can apply for your own work history benefit and switch over to yours (assuming it is higher than the derivative amount).[7]

Here is an example of how it works:

- Ed and Sarah both turn age 66 (full retirement age)
- Ed's monthly benefit is $1,400; Sarah's is $1,000
- Ed files for benefits and Sarah begins drawing her spousal benefit (50% of Ed's = $700)
- Sarah continues working and earning toward her own benefits, while also earning Delayed Retirement Credits
- At age 70, Sarah applies for her own benefit based on her work history, which is now $1,370 a month
- Her payout automatically switches to the higher benefit amount

Delayed Retirement Credits

If you do not feel the need to draw benefits at full retirement age and/or would like to continue working, you are eligible to earn Delayed Retirement Credits (DRC) for each month that you do not start receiving benefits.

- Currently, the full year Delayed Retirement Credit for those born in 1943 or later is 8% per year (pro-rated monthly)
- The credit stops once you reach age 70
- A spouse may draw benefits while the higher earner accrues Delayed Benefit Credits
- Derivative benefits for your spouse do not include any Delayed Retirement Credits

[6] Social Security Administration; Retirement Planner, October 18, 2012; www.socialsecurity.gov/retire2/delayret.htm

[7] Social Security Administration Publication No. 05-10035, July 2012.

In 2010, the average annual Social Security income received by women 65 years and older was $11,794, compared to $15,231 for men.[10]

Restricted Benefit[8]

Once you reach full retirement age, you may apply for a restricted benefit based on your spouse's earnings as long as that earner is already receiving benefits. Even if you are the higher earner, you may instruct Social Security to restrict your benefit to your spouse's earnings – which means you will be entitled to up to 50 percent of the benefit your spouse is receiving. This strategy enables you to earn Delayed Retirement Credits up until age 70, at which time you can switch to your own benefit. This option is not available prior to full retirement age.

Divorced Spouse[9]

If a couple was married for at least 10 years and then divorces, either one of the spouses may qualify for Social Security benefits at age 62 under the other's work history. Even if the higher-earning ex has not applied for benefits yet, as long as he or she is eligible for them and the couple has been divorced for at least two years, the other ex may apply for a derivative benefit.

Once an ex-spouse remarries, he or she is no longer eligible to receive a benefit based on the first spouse's work history unless the second (third, forth, etc.) marriage ends in divorce, annulment or death. You are eligible for the highest derivative available from any number of ex-spouses as long as each marriage lasted at least 10 years and you are not currently married.

Widowed Opposite Sex Spouse[11]

Among married couples, the age at which the higher-earning spouse applies for Social Security benefits is very important, since the surviving spouse is entitled to the higher of his or her own or the deceased spouse's benefit. The higher earner can increase the survivor's benefit by waiting to receive any benefits until age 70.

[8] Social Security Administration; Program Operations Manual System-GN00204.020 Scope of the Application; July 26, 2012; https://secure.ssa.gov/poms.nsf/lnx/0200204020

[9] Social Security Administration; Retirement Planner, October 19, 2012; www.socialsecurity.gov/retire2/yourdivspouse.htm

[10] Social Security Administration, www.socialsecurity.gov/pressoffice/factsheets/women.htm, retrieved June 28, 2012

[11] Social Security Administration; Survivor's Planner, October 19, 2012; www.socialsecurity.gov/survivorplan/onyourown5.htm#a0=1

If the higher-earning spouse dies, the widow(er) is entitled to the higher earner's full retirement benefit and may begin receiving benefits starting at age 60 (or at any age if he or she has a child under age 16 or is disabled). Should the widow(er) remarry, the Social Security benefit for the widow(er) will terminate, but the benefit for the eligible child will not.

A surviving spouse may also claim a reduced benefit on the deceased's working record and then switch to his or her own later. The surviving spouse may wait until full retirement age to accrue a higher benefit, or even delay benefits until age 70 to accrue Delayed Retirement Credits based on his or her own work history. Once the survivor applies for his or her own benefit, the payout will automatically be at the highest amount.

Lower-wage earners receive a higher percentage benefit than higher-wage earners.[12]

How a Job Impacts Benefits[13]

Once you reach full retirement age, there is no longer an earnings limit – meaning you can earn any amount of income without it impacting your benefits.

However, if you begin drawing Social Security benefits before you reach full retirement age and your earnings exceed the eligible limit, your benefits will likely be taxed – yielding an even lower amount. You may earn up to $15,120 in 2013 before your Social Security benefits will be reduced. Thereafter, $1 in benefits will be deducted for every $2 earned above $15,120.

In the year you reach full retirement age, you may earn up to $40,080 (in 2013) ending the month before your birthday before benefits are reduced. Thereafter, $1 for every $3 earned above $40,080 will be deducted from your benefits.

In both scenarios, however, your benefit will be increased at full retirement age to account for benefits withheld due to earlier earnings.

[12] Social Security Administration; Social Security is Important to Women; January 2012; www.socialsecurity.gov/pressoffice/factsheets/women.htm

[13] IRS.gov, 2013 Social Security Changes, October 16, 2012.

HOW TO PREPARE FOR RETIREMENT BENEFITS

According to the 2011 Risk and Process of Retirement Survey by the Society of Actuaries, only 35% of Americans age 45 to 80 report they have a detailed retirement income plan designed to manage the risk of running short of money.[14] To help you prepare for a possible reduction in Social Security benefits and/or an overall shortfall in your retirement income, calculate the general amount of income you expect to need in retirement.

Add up your monthly expenses and factor in a 3.23 percent long-term annual inflation rate (the average annual inflation rate from 1913 through 2012).[15] If the retirement age increases in the future, you may be able to continue working and delay your own retirement. However, if you need to retire before the full retirement age, you'll need to factor in the potential for reduced Social Security benefits during those years.

You may receive a personalized estimate of your Social Security benefits by using the online Retirement Estimator at http://ssa.gov/estimator.

Once you've identified your level of benefits, subtract this amount from the total income you've calculated that you need. The balance will give you an idea of the amount that could need to come from other sources.

(Please note, this is a general calculation and not intended to be the sole basis of any financial decisions.)

Other Income Sources

One way to supplement your Social Security benefits is to save and invest as much as you can now toward your retirement. Other ideas include maximizing your contributions to an employer plan, such as a 401(k) or 403(b), or contributing whatever you can to a Roth or traditional IRA. If you are not eligible for a tax deduction on IRA contributions due to your participation in an employer retirement plan, you may want to consider contributing to a Roth as well, so you can benefit from tax-free distributions in retirement.

Where Do You Apply

Contact Social Security at (800) 772-1213 or TTY (800) 325-0778 about three months before the date you'd like your benefits to start. You may also visit your local Social Security office or apply online at https://secure.ssa.gov/iCLM/rib.

[14] The Society of Actuaries, "The 2011 Risk and Process of Retirement Survey," 2012.
[15] InflationData.com; Average Inflation Rates by Decade; November 5, 2012; http://inflationdata.com/Inflation/Inflation/DecadeInflation.asp

2013 Contributions:[16]

- Participants in employer-sponsored retirement plans, such as 401(k)s, 403()s, 457s or Thrift Savings Plans may contribute up to $17,500 in 2013 ($23,000 for employees 50 or older)
- 2013 annual limit for all IRAs combined is $5,500 ($6,500 for age 50+)

Long-Term Care Insurance

Because Americans are living longer than they ever have before, the chances of needing long- term care are much higher, and this is an expense that could be far greater than your Social Security benefits will cover. In fact, the median annual cost for care in an assisted living facility is $39,600 nationally.[17]

Medicare pays for acute care but not long-term residency. Medicaid requires that you spend down your wealth before coverage kicks in. One of the ways that you can prepare for your future is to buy a long-term care insurance (LTCI) policy. Long-term care covers costs that Medicare and other health insurance policies don't cover, such as in-home care, assisted living, adult daycare, nursing home care and hospice care.

Long-term care insurance can offer a more flexible and sensible choice for those who are still in good health. We recommend purchasing a long-term care policy before retirement as premiums get significantly more expensive with age. If you are in poor health or already receiving long-term care services, you may not qualify for long-term care insurance. The older you are, the higher your premiums will be. As a general rule, the best time to buy a policy at lower rates is around age 55.

Life Insurance with LTC Payout Riders

Another alternative to the traditional LTCI policy is to purchase a universal life policy that offers a long-term care insurance rider and/or a return of premium rider for an additional fee. You generally purchase this type of policy with a one-time lump sum, which will pay out two or three times that amount in long-term care cost coverage.

Shopping Tips for Long-Term Care Insurance

When shopping for an LTCI policy, consider these tips:

- Buy from an issuing company with an "A" or better insurance rating. Ratings are determined by objective third-party entities as an indicator of a company's overall performance and ability to meet its obligations to policyholders over a long period of time.
- Frequently, you can get a discount if both spouses buy policies at the same time.
- Policies typically cover a benefit period or lifetime dollar amount maximum, including two, three, four and five years, and lifetime or unlimited coverage.
- In general, you may select a daily benefit amount (for example, $100/day). Most policies let you choose from $50/day to as much as $500/day.
- You may choose the type of coverage you prefer; for example, "comprehensive" (which includes payouts for in-home care) or "facility care only." Obviously, comprehensive gives you more flexibility, but at a higher premium.

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[16] IRS; IRS Announces 2013 Pension Plan Limitations; IR-2012-77, Oct. 18, 2012; www.irs.gov/uac/2013-Pension-Plan-Limitations

[17] Genworth Financial, Genworth 2012 Cost of Care Survey, 2012.

Should you ever need to pay for long-term care the policy will pay accelerated death benefits to help cover those costs. Furthermore, the "return of premium rider" allows you to access your initial purchase amount should you ever need it. This would, however, reduce the death benefit. In contrast to a traditional long-term care insurance policy, a life policy also offers tax-free proceeds to beneficiaries upon your death.

Longevity Annuity

In early 2012, the Treasury Department proposed new rules to encourage plan sponsors of employer-based pension and 401(k) plans to enable retirees to use a portion of their 401(k) plan to purchase a Longevity Annuity. With this option, a portion of their balance would be reserved for conversion to annuity income starting later in life, around age 80 or 85. There may be no cash value on the death benefit during the deferral period; the rest of the account would be available for withdrawals for the first phase of retirement. This arrangement can assure that you have a second leg of income available should you run out midway through retirement.

Annuities with Long-Term Care Riders

There are also annuities available that offer long-term care benefit riders for contract owners who need additional care as they age, either at home or in a nursing facility. One example is a rider that increases the annuity payout for a specific period of time if the contract owner becomes unable to perform a certain number of basic activities of daily living set forth in the rider. This type of rider may have a waiting period and a physician's statement may be required in each of the years the contract owner exercises the rider. (Riders may be available at additional cost.)

Shopping Tips for Long-Term Care Insurance (continued)

- An important rider option to consider purchasing is Inflation Protection, which guarantees* that benefits will reflect the rising cost of care later in life.
- Other options to consider include Guaranteed* Renewal, to ensure that you won't be turned down when you go to renew your policy, and a Non-Forfeiture benefit, guaranteeing you will still get paid a good portion of your benefit even if you terminate your policy or let it lapse unintentionally (not uncommon with seniors).
- Also, carefully consider the wait period that may come with your policy, which often ranges from one to 180 days. Choosing a longer waiting period may yield a less expensive premium, but during that length of time you will have to pay for long-term care on your own.

*Guarantees are backed by the financial strength and claims paying ability of the issuing company, and may be subject to restrictions, limitations or early withdrawal fees. Annuities are not FDIC insured.

[18] Bankrate.com. New: a hybrid annuity with LTC coverage. www.bankrate.com/finance/insurance/new-a-hybrid-annuity-with-ltc-coverage-1.aspx Retrieved January 9, 2013.

Long-Term Care Annuity

There are also long-term care annuities you can purchase for a single premium that offer double (with inflation protection) or triple (no inflation protection) the amount of long-term care coverage. Your premium will grow tax-deferred, and taxes are waived on distributions that are used to pay for long-term care. You may redeem the accumulated value at the end of the policy term or allow the policy to remain in force. When you pass away, your beneficiaries will inherit the greater of the accumulated annuity value if you have not made any withdrawals or the single premium you paid initially minus the amount of any long-term care paid.[18]

Be aware that purchasing a long-term care annuity will tie up your premium for a specific period (up to 20 years), subject to penalty fees/surrender charges that may be longer and higher than annuity contracts with no long-term care rider, if you need to access cash. They are also not known for generating significant credited interest. However, the underwriting is usually less stringent and does not require a physical. In addition, the annuity and the cost of your long-term care are fully funded, so you won't lose coverage if you forget to make a payment – which sometimes happens with long-term care insurance policies.

Obviously, it's important to build a savings/investment nest egg to help supplement Social Security benefits with your personal retirement income sources. However, given today's health and longevity among older Americans, it is equally important to create a long-term health care plan to help prepare for a more satisfactory quality of life in your senior years.

CONCLUSION

The simple fact is that Social Security may not always be straightforward. Just like every other facet of retirement planning, there are strategies you can employ to optimize the benefits you are eligible to receive – particularly among married couples.

Many people are hesitant to delay receiving benefits because they don't want to lose money they've contributed to the system for the last 35 years. While people who apply for Social Security benefits early may get more dollars if they die soon after, the opposite may also be true – they may receive less if they live significantly longer.

The monthly benefit paid out at age 62 is actuarially reduced to account for the eight more years that the recipient will be paid benefits as compared to someone who begins drawing payouts at age 70. Furthermore, the person who waits to claim benefits at age 70 will receive 76 percent more (real) dollars per month for the rest of his life than if he claimed benefits at age 62.

What's most important in making Social Security decisions for your situation is at what point you can no longer live comfortably without those benefits due to job loss, health care expenses or other issues. The question isn't how to beat the system, but rather how to optimize the amount of income you receive for the length of time that you need it.

For this reason, it's important to consult with a financial professional experienced in Social Security distributions to review different payout scenarios to help determine the optimal time to file and when to actually begin drawing your benefits.

**This document is designed to provide general information of the subjects covered Pursuant to IRS Circular 230, it is not, however, intended to provide specific legal or tax advice and cannot be used to avoid tax penalties or to promote, market or recommend any tax plan or arrangement. Please note that we do not give legal or tax advice. All clients are encouraged to consult their tax advisor or attorney.*

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