ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

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What Part Will Social Security Play in Your Retirement?

While most people think of Social Security as more of a safety net than an investment, for many, the monthly payments are a substantial source of income in retirement, and it's worth gaining a greater understanding of how the program works and how it will fit into your future financial plans.

Most workers are aware of Social Security as a regular deduction from their paycheck and the promise of income from the program come retirement age. It was initially established to help older Americans from falling into poverty, but anyone who qualifies for the program is eligible to receive its benefits once they reach the age of 62 (some before in the case of disability or the death of a spouse or guardian).

The program still serves its initial purpose for nearly half of all recipients, while also accounting for a significant portion of income for many more—in 2011, Social Security represented 36% of all income for those aged 65 and older, and 87% of Americans in that age group were receiving benefits. Social Security provided the majority of income for 52% of beneficiary couples and 45% of non-married beneficiaries. About 32% of beneficiaries were 75 years of age or older in December 2012, a number that can be expected to rise given longevity trends.

While those who have been able to fund a good nest egg won't have to rely as much on Social Security, the monthly check can still be a considerable source of income and should be accounted for when allocating your portfolios ahead of retirement.

Benefits

To receive benefits, you must have worked at least 10 full years at a job covered by Social Security, but to maximize your potential earnings, you need at least 35 years of employment (to determine your benefit amount, the program looks at your highest 35 years of income and then runs a series of calculations to come up with your monthly payment).

So what exactly are the benefits? The primary one is monthly income, obviously, but there are several factors that make this income unique. The first is that once you stop paying into the program, you will have a predetermined amount set aside based on what you earned over your career (this amount can vary depending on when you apply for benefits—we'll get to this more a little further on). That income, as the rules of the program currently stand, will be paid monthly, adjusted for inflation (going up based on increases in the Consumer Price Index) and last for the rest of your life—whether you live another 20, 30 or 40 years, the check will be in the mail every month.

Spousal benefits built into Social Security entitle a spouse (or ex-spouse) to, generally, half of the full earned benefit of his or her better half. These can play an important factor in maximizing benefits regardless of whether one spouse was the primary breadwinner or both earned the same amount of money in their respective careers.

There are also *survivor benefits* for your spouse and/or dependents—the amount will be calculated based on what was contributed to Social Security and their age and relationship to you. If the surviving spouse is a retired worker, he or she is entitled to the higher amount of benefits being paid to the household.

How Much Will You Get?

There are quite a few wrinkles and strategies for maximizing your monthly income (which we will delve into deeper in a future issue), but, as mentioned above, how much you'll receive depends a great deal on when you apply for benefits.

Early eligibility begins at age 62, while eligibility for full benefits begins after age 66 for those born between 1943 and 1954—if you were born after that, the full retirement age could be up to a year older. You also have the option to defer benefits until age 70. In general, the longer you hold off on claiming your benefits, the larger your monthly check will be. Those who start at the earliest eligibility will only receive about 75% of their primary insurance amount (PIA—which is the monthly payment), while those who wait until full retirement age will receive 100% of their PIA. For every year up to age 70 that you defer eligibility, your benefit will increase by 8%, up to 132% of the PIA. For reference, in 2014, the maximum PIA is $2,642 per month, but the average retired worker will receive an estimated $1,294 per month.

A 2012 study by the National Bureau of Economic Research showed that 43% of eligible claimants took Social Security benefits at the earliest possible time (age 62) and that 60% take them within two months of turning 62 or upon full retirement age of 66.

Of course, maximizing benefits is not as simple as picking an age to collect—you also need to take your life expectancy, employment and marriage status, as well as other sources of income and taxes into account. If you need the income for expenses sooner than later or worry that you have a shorter life expectancy, it may make sense to apply for benefits before reaching full retirement age. If you or your spouse plans to work late into your 60s or beyond, it may make more sense to defer until age 70.

There are a number of calculators and articles on the Social Security Administration's website that can help you figure out what your payments might be based on these various factors, but discussing the topic with a trusted financial adviser who can help you navigate the program's complicated rule set and work with you on an overall retirement income plan might be your best option. Since Social Security will likely be a significant portion of your income in your retirement, you owe it to yourself for all of your years of hard work to create a plan that will help you get all that you can.

In a future issue, we'll look at some of the benefits of delaying, strategies to consider, potential pitfalls to avoid and the impact of changing your recipient status.

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