Optimizing Social Security

Investor Education

Five things you need to know

Most people plan to rely on Social Security for retirement income. And the statistics bear that out. Social Security benefits already provide more than half of retirement income for 53% of couples and 74% of individuals.[1]

Those preparing to retire may not understand the different ways to claim Social Security and, depending on their individual financial situations, the strategies to consider for optimizing their benefit amount.

A guaranteed source of income may mitigate risks

Planning for income in retirement involves many variables and risks at the individual level, such as longevity and income, as well as macroeconomic factors, such as inflation, fluctuating markets, and taxes. While Social Security is not the single solution for all of these issues, it may mitigate these risks by guaranteeing a stream of income that is not tied to market performance.

In the past few decades, Americans have seen a dramatic difference in the retirement experience. Today, people are living longer and workers need to plan for 25 to 30 years in retirement, a much longer time horizon than for past generations.

At the same time, the retirement investment landscape has changed. Pension plans, once a source of retirement income for many workers, are now offered by far fewer employers. The defined contribution, or 401(k) plan, has become the most common offering in the workplace. Consequently, plan participants have taken on more responsibility for managing their retirement savings and planning for income in retirement.

Guaranteed income, like Social Security, can act as a stabilizing factor in market downturns. While variable retirement savings vehicles can lose money in a market decline, a guaranteed source of income can offer consistency and may help clients avoid liquidating other investments to meet expenses.

Social Security also carries tax advantages that other forms of retirement savings, like Individual Retirement Accounts, do not offer. Some retirees will receive benefits free of taxes.

The bottom line is that Social Security can be an important part of a retirement income plan because it provides a lifetime stream of guaranteed income that is not dependent on markets and also adjusts periodically to keep pace with inflation.

Fundamentals of Social Security	
Eligibility	At least 40 quarters of work
Individual contributions	Social Security payroll tax of 6.2% on first $117,000 of earnings
Benefits	Calculated based on average monthly earnings indexed for inflation
Retirement age	Reduction in benefits before full retirement age (currently 66), increase in benefits if delay (up to age 70)
Early retirement	Available at age 62 with 25% decrease in benefits
Spousal benefits	Spousal benefit (50% of covered spouse's benefit) and survivor benefit (100% of covered spouse's benefit)

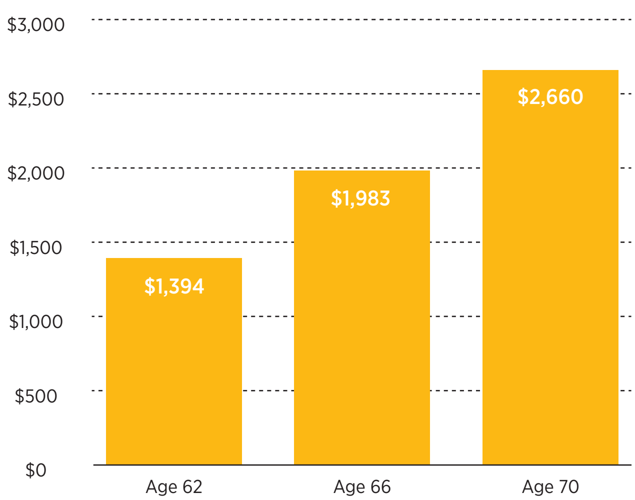
Timing makes a big difference

While available to millions of workers, it's not a one-size-fits-all plan, because many variables influence Social Security benefits. It is important to make the right decisions in order to mitigate the risks of longevity and inflation. Understanding how Social Security benefits are calculated is important, and identifying the opportune time to file a claim can have a major impact on financial success in retirement. The following are five essential things to know about determining a strategy for Social Security benefits.

1. Claiming benefits too early can cause problems

One of the greatest challenges for savers is estimating their longevity. Some savers are likely to outlive their retirement nest egg.

Monthly benefits increase as you delay Social Security



Source: Social Security Quick Calculator benefit estimate based on an individual age 62 with $75,000 in current earnings. Does not include increases in benefit levels due to regular cost-of-living adjustments.

However, the more common problem is not living beyond life expectancy, but claiming benefits too early. This reduces the income potential of full benefits. About 75% of workers sign up for Social Security before reaching full retirement age. At this point, the benefit is significantly lower and may be more likely to be subject to taxation for those still working.

Waiting can help. By delaying the start of Social Security benefits, retirees will receive more money. In essence, they receive an 8% "raise" for every year they delay taking benefits.

Once you claim your benefit, you are generally locked into that benefit amount, unless you change your mind within 12 months of starting benefits and withdraw your request to begin. If this request is approved, you must repay all the benefits you and your family received based on your retirement application.

If you're still working, the timing of your claim can have an impact on the amount of Social Security benefits you receive. For 2014, your Social Security benefits are reduced by $1 for each $2 in earnings above $15,480.[2] If you claim benefits at full retirement age or older, there is no limit on the amount you can earn by working in retirement.

2. Couples should consider joint life expectancy

When couples plan Social Security benefits, timing is particularly critical. It is important to consider income needs in terms of joint life expectancy.

Historically, spouses who are the primary wage earners in their household have tended to take Social Security benefits before full retirement age. However, taking a step like this exposes the surviving spouse to longevity risk. If the primary earner is in poor health and has a short life expectancy, beginning benefits early can subject the surviving spouse to a much lower survivor benefit for life. This can have a drastic impact on long-term quality of life.

If possible, it's best to maximize the higher earner's benefit in order to provide a higher lifetime benefit for the surviving spouse.

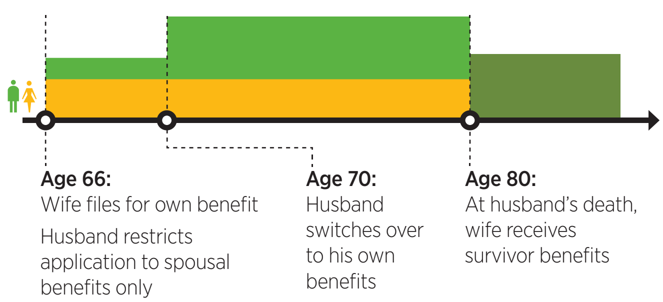
3. Couples can claim benefits at different times

Because of the availability of Social Security spousal benefits, married couples have more choices of how they claim Social Security in retirement. There are some unique strategies that combine spousal benefits with a delay in retirement benefits. In certain cases, this can mean a significant increase in lifetime and survivor benefits. Here are two of the most prevalent strategies — restricted application and file and suspend.

Restricted application

This can be an effective strategy for a married couple where both spouses have similar earnings records and are looking to address longevity and inflation risk. First, the lower-earning spouse files for retirement benefits at full retirement age. This allows the higher-earning spouse to restrict his or her application for spousal benefits only while delaying his or her own retirement benefits (preferably to age 70 if possible).

Workers who can delay taking their benefits have an advantage because the monthly benefit increases until age 70 by 8% each year. At that age, workers can file to receive their individual benefits at the highest monthly amount. This strategy also preserves the highest possible survivor benefit to help the surviving spouse maintain his or her standard of living.

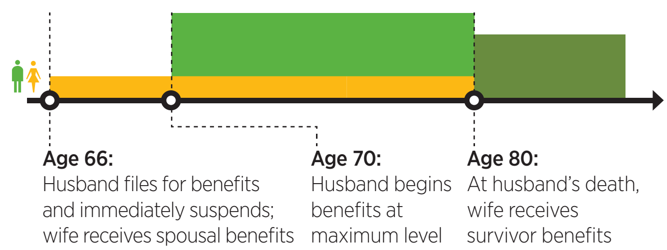


Example is hypothetical.

One spouse can file and suspend payments

This strategy can be effective for couples where one spouse is the primary wage earner and the other spouse has low or no earnings history. In this strategy, the primary earner waits until full retirement age to file for retirement benefits. This allows the other spouse to file and begin collecting spousal benefits. After filing for retirement benefits, the primary earner immediately suspends benefits to take advantage of the delayed retirement credit and increase benefits by 8% each year. Then, at age 70, preferably, the higher earning spouse begins receiving the highest possible retirement benefit for life.

Similar to restricted application, this strategy also preserves the highest possible survivor benefit to help the surviving spouse maintain his or her standard of living. This is even more important when one spouse has drastically lower lifetime earnings than the other.



Example is hypothetical and assumes the husband is the primary earner and the wife has little to no earnings.

Determining the best time to apply for Social Security benefits also depends on a couple's financial and tax situation, age difference, and life expectancy. It can be an important discussion for clients to have with an advisor so that they understand that claiming benefits early can affect not only the monthly benefit amount, but also the benefits received by the spouse, and, ultimately, the survivor benefits.

4. Special rules for divorced and widowed individuals

Divorced individuals may receive benefits based on the ex-spouse's earnings record. There are certain conditions that must be met:

- The marriage lasted 10 years or more
- The ex-spouse is eligible for Social Security benefits (even if he or she has not filed for benefits yet)
- The spouse making claim on the ex-spouse's record is unmarried and age 62 or older.

Unlike spouses or ex-spouses, widows may receive benefits as early as age 60. However, the benefit amount for beginning benefits that early would be 71.5% of the full amount and is based on the deceased spouse's earnings. The longer benefits are delayed, the greater the amount. However, unlike retirement benefits, survivor (and spousal) benefits do not increase if claimed after full retirement age.

5. Social Security is not guaranteed to be tax free

For retirees with moderate or higher incomes, it is likely that some portion of benefits will be taxed. Depending on the income level, up to 85% of benefits may have to be reported as taxable income.

Income level*	Taxation
Between $25,000 and $34,000 *($32,000 and $44,000 for couples)*	Up to 50% of benefits reported as taxable income
Over $34,000 *($44,000 for couples)*	Up to 85% of benefits reported as taxable income

*IRS Notice 703. Income calculation for taxation of Social Security benefits equals your adjusted gross income (AGI), one half of Social Security benefits, and tax-exempt municipal bond interest. Income from Roth accounts does not negatively impact taxation of Social Security benefits.

Clients should seek to maximize their benefits

Recently, 77% of workers surveyed by the Employee Benefit Research Institute[3] indicated they will rely on Social Security as a source of retirement income, making it likely that workers will want to calculate their benefits and explore strategies to optimize the program.

Whenever possible, people should try to maximize their Social Security benefit, even if it means delaying retirement. It is challenging to plan savings to generate sufficient income in retirement, and easy to underestimate expenses, inflation, and the cost of future health-care needs. Not having a clear understanding of how spousal benefits work is another area where retirees can make a mistake and lose out on benefits. Consulting a financial advisor or tax professional can be a great way to determine the optimum time to claim Social Security benefits and which strategies may benefit your personal financial situation.

1 Social Security Administration, Statistical Supplement, 2012.

2 This earnings test applies in years before attaining full retirement age. A higher earnings amount ($41,400 for 2014) applies during the year of attaining full retirement age. If retirement benefits are withheld because of earnings, benefits will be increased starting at full retirement age to take into account the benefits that were withheld.

3 Employee Benefit Research Institute, Retirement Confidence Survey, 2013.

This information is not meant as tax or legal advice. Please consult with the appropriate tax or legal professional regarding your particular circumstances before making any investment decisions.

Putnam Retail Management

Putnam Investments | **One Post Office Square** | **Boston, MA 02109** | **putnam.com**

II937 285126 1/14