JVL Associates, LLC
NEWSLETTER

September 2016

Social Security

Social Security is one of the foundations of retirement income. As more and more baby boomers move towards retirement age, the "security" in social security takes on an increased level of importance.

Origination

The idea of "securing" or "insuring" the welfare of those who could not provide for themselves has deep roots in our nation's history. While families and communities took primary responsibility for assisting those in need, the original colonies and later state governments followed the European practices of taking care of "the poor." After the Civil War the federal government provided pensions for disabled soldiers who could not work and widows and orphans of soldiers who were killed in the war. As the U.S. moved into the industrial age, corporations began to establish pensions that paid benefits to their retired workers. The election of Franklin D. Roosevelt during the great depression brought the issue of "securing" the financial future of retired workers into the national spotlight.

> *"Security was attained in the earlier days though the interdependence of members of families upon each other and of the families within a small community upon each other. The complexities of great communities and of organized industry make less real these simple means of security. Therefore, we are compelled to employ the active interest of the Nation as a whole through government in order to encourage a greater security for each individual who composes it ... This seeking for a greater measure of welfare and happiness does not indicate a change in values. It is rather a return to values lost in the course of our economic development and expansion ..."*
>
> **Franklin D. Roosevelt:** ***Message of the President to Congress, June 8, 1934***

The Social Security Act was signed into law in August, 1935. It originated as a reimbursement to states who adopted their own state plan to pay benefits to retired workers. The cost came out of the Federal Treasury. Michigan was the very first state to have their plan approved by the national Social Security Board. The first checks to retirees went out in 1936.

Beginning in January, 1937, employees and employers became subject to a payroll tax - 1% of the first $3,000 in wages. The taxes were collected at the Federal level. At the same time employees began to earn "credits" towards future retirement benefits.

In January, 1940, the Federal Old-Age and Survivor's Insurance Trust Fund took over payment of benefits and brought Social Security under the Federal government's control. [1]

Program Expansion

Over the next 50 years, Social Security was expanded many times to include benefits beyond retired workers age 65 and older. The expansions included paying benefits to surviving spouses and dependent children of deceased workers and later added benefits to divorced spouses. In 1956, under President Eisenhower, disabled workers were included under the Act. At the same time the qualifying age for benefits to widows and surviving female parents was lowered from 65 to 62. In 1961, under President Kennedy, the early retirement age for all workers was lowered to 62. President Nixon added the COLA (Cost of Living Adjustment) provisions in 1972. And President Clinton brought the program into the modern banking era by requiring that benefits be paid by EFT (Electronic Funds Transfer) and later changed the payment date from the first of the month to be based on the recipient's date of birth to spread out the payments within the banking system. [1]

Participants and Benefits

The first table summarizes the number of workers paying into the program ("covered workers") versus the number of beneficiaries receiving benefits out of the program. At its origination there were 42 workers for every 1 beneficiary. In 1965 there were 4, and currently there are 2.8 workers paying into the program for every 1 beneficiary receiving benefits out of the program. The latest projection estimates that by 2075 there will only be 2 workers paying into the program for each beneficiary. [2]

	In Millions				*Covered*
Year	***# of Covered Workers***	***# of Retired Beneficiaries***	***# of Disabled Beneficiaries***	***Total # of Beneficiaries***	***Workers Per Beneficiary***
1945	46.4	1.1	0.0	1.1	41.9
1965	80.5	18.5	1.7	20.2	4.0
1985	120.4	32.7	3.9	36.6	3.3
2005	159.0	39.9	8.2	48.1	3.3
2015	168.9	48.7	10.8	59.5	2.8
2035	192.2	76.6	12.4	89.0	2.2
2055	212.5	85.1	14.7	99.8	2.1
2075	232.7	98.4	16.2	114.6	2.0

	U. S. Population in Millions				*Percent Age*
Year	***Under Age 20***	***Age 20 - 64***	***Age 65 and Over***	***Total Population***	***65 and Over to Total***
1945	49.1	88.1	10.9	148.1	7.4%
1965	80.0	104.9	19.1	204.0	9.4%
1985	73.0	144.5	29.2	246.7	11.8%
2005	84.0	180.9	37.2	302.1	12.3%
2015	85.2	193.9	47.8	326.9	14.6%
2035	96.5	209.1	78.8	384.4	20.5%
2055	104.1	232.1	89.7	425.9	21.1%
2075	113.5	250.8	105.9	470.2	22.5%

This next table summarizes the U.S. population by those under age 20 (below full time working age), those age 20 - 64 (normal full time working age) and those over age 65 (normal retirement age). The data shows that in 1945 only 7.4% of the U.S. population were at retirement age while currently this percentage is over 14% and projected to reach 20.5% within the next 20 years. [3]

Life Expectancy				
	Male	***Female***	***Male***	***Female***
Year	***At Birth***	***At Birth***	***At Age 65***	***At Age 65***
1945	62.9	68.4	12.6	14.4
1965	66.8	73.8	12.9	16.3
1985	71.1	78.2	14.4	18.6
2005	74.8	80.0	16.7	19.5
2015	76.8	81.5	18.1	20.6
2035	79.3	83.4	19.6	21.9
2055	81.3	85.1	20.8	23.0
2075	83.1	86.5	21.9	23.9

There are many factors that go into the data shown above, but one of the main drivers of the data is that American seniors are living longer. A male born in 1945 had an actuarial life expectancy of less than 63 years and if they did reach retirement at age 65 they were expected to survive another 12.6 years. A female born in 1945 had a life expectancy of 68.4 years and if they reached age 65 they were expected to survive another 14.4 years. Contrast that with today, when a male born in 2015 has a life expectancy of 76.8 years and upon reaching age 65 is expected to survive another 18.1 years. A female born in 2015 has a life expectancy of 81.5 years and if they reach age 65 are expected to survive another 20.6 years. Looking out another 60 years we see from the table, to the left, that life expectancy at birth and upon reaching age 65 is expected to be extended by an additional 3 - 6 years. [4]

Tax Assessed

Workers pay into the Social Security program through payroll tax deductions withheld from their paycheck. The tax is computed on all earnings up to a maximum annual limit. Employers are required to match the employees' tax withheld resulting in a doubling of the amount paid into the program. Self-employed persons pay both the employee and the employer share. Since the program's inception both the wage base and the tax rate have been increased as the table to the right shows. [5]

Social Security Tax			
	Maximum	***Tax***	***Maximum***
Year	***Wage Base***	***Rate***	***Tax Paid***
1945	$ 3,000	1.00%	$ 30.00
1955	4,200	2.00%	84.00
1965	4,800	3.63%	174.24
1975	14,100	4.95%	697.95
1985	39,600	5.70%	2,257.20
1995	61,200	6.20%	3,794.40
2005	90,000	6.20%	5,580.00
2015	118,500	6.20%	7,347.00

Benefit Computation

Social Security computes monthly benefits based on a formula. First, a worker's annual earnings (up to the maximum Social Security wage base) are indexed to take into account inflation over the worker's employment years. Second, the formula looks for the highest 35 years of these indexed earnings, adds them together and divides that number by 420 months (35 years X 12 months) to arrive at an ***average indexed monthly earnings*** amount. This average indexed monthly earnings amount is divided into 3 buckets. The first bucket contains up to the first $856 earned and is multiplied by 90%. The second bucked contains up to the next $4,301 earned (or less if the average indexed monthly benefit is under $5,157) and is multiplied by 32%. And the third bucket contains the next $4,306 earned (or less if the average indexed monthly benefit is under the maximum benefit of $9,462) and is multiplied by 15%. The following chart shows the estimated monthly retirement benefit based on a persons hypothetical average earnings. [5]

Social Security Monthly Benefit Calculation					
	Hypothetical Average Annual Earnings				
	$ 25,000	*$ 50,000*	*$ 75,000*	*$ 100,000*	*Maximum*
Average Indexed Monthly Earnings	$ 2,083.33	$ 4,166.67	$ 6,250.00	$ 8,333.33	$ 9,462.27
First Bucket - Multiply first $856 x 90%	$ 770.40	$ 770.40	$ 770.40	$ 770.40	$ 770.40
Second Bucket - Multiply amount > $856 up to $5,157 x 32%	392.75	1,059.41	1,376.32	1,376.32	1,376.32
Third Bucket - Multiply amount > $5,157 up to $9,462 x 15%	-	-	163.95	476.45	645.79
Total Monthly Benefit at Full Retirement Age	$ 1,163.15	$ 1,829.81	$ 2,310.67	$ 2,623.17	$ 2,792.51
Retirement Benefit as % of Average Earnings	56%	44%	37%	31%	30%

As the above table points out, the benefit formula is constructed to "secure" a higher percentage of "benefits to earnings" for those workers at the lower end of the earnings scale. As earnings increase the percentage returned in benefits decreases as a percent of the worker's earnings. This is in line with the originator's intent to "secure" a "safety net" for those with the greatest need.

The average monthly benefit as of January, 2016 is $1,341. According to recent data Social Security benefits represent 50% or more of the income for 53% of married couples and 74% of unmarried individuals. It represents 90% or more of the income of 22% of married couples and 47% of unmarried individuals. [6]

Claiming Benefits

The decision of when to start claiming Social Security benefits involves a combination of math and guesswork. For individuals born in 1937 or earlier the FRA (Full Retirement Age) is 65. For persons born between 1938 - 1942 it is 65 + 2 months for each year over 1937. For those born between 1943 and 1954 the FRA is age 66. For persons born between 1955 - 1959 it is 66 + 2 months for each year over 1954. And for those persons born in 1960 or later the FRA is age 67.

FRA is important because that is the age when a person is entitled to claim 100% of their computed monthly benefit. An individual can claim earlier but their monthly benefits decrease by approximately 6% for each year they claim early. Thus, a retired person claiming at age 62 is entitled to 75% of the monthly benefit they would have received at FRA. Conversely, delaying benefits will increase the monthly amount owed at FRA by 8% for each year the person delays - up to a maximum of 132% at age 70. [5]

The math part is easy - the guesswork involves "knowing" how long you will live. An individual who decides to start collecting Social Security benefits at their FRA 66 would have to live to age 80 before their cumulative benefits are greater than if they had started collecting early retirement benefits at age 62. Additionally, that individual would have to live to age 85 before delaying benefits to age 70 is better than starting at their FRA 66. While Social Security payments last for the recipient's remaining lifetime it has no residual value to be passed on to their heirs upon death.

Every individual has the right to claim benefits based on their own earnings record. As an alternative, a spouse always has the right to collect 50% of the higher earning spouse's benefit if that amount is greater than the benefit they would receive on their own earnings record. Thus, the decision of when to start claiming benefits in cases where there is one high wage earner and one low wage earner has an effect on both of the spouses' benefits. When the higher earning spouse dies, the program allows the lower earning spouse to receive the higher earning spouse's monthly benefit. [5]

Status of Social Security Trust Fund

Social Security Trust Fund	In Billions $ Retirement	In Billions $ Disability	In Billions $ Total
Asset Reserves - December 31, 2014	$ 2,729.2	$ 60.2	$ 2,789.4
Payroll Tax Collections	679.5	115.4	794.9
Interest Earned	91.2	2.1	93.3
Taxation of SS Benefits	30.6	1.1	31.7
Other Income Reimbursed	0.3	-	0.3
Benefits Paid	(742.9)	(143.4)	(886.3)
Administrative Expenses	(3.4)	(2.8)	(6.2)
Other Expenditures	(4.2)	(0.4)	(4.6)
Asset Reserves - December 31, 2015	$ 2,780.3	$ 32.2	$ 2,812.5
Increase (Decrease) During 2015	$ 51.1	$ (28.0)	$ 23.1

The Social Security program operates as a separate "Trust Fund" on the Federal government's books. Collections of taxes and payments of benefits are included in the annual Federal budget, but the activities are separately accounted for to determine if sufficient assets exist to pay future benefits. Unlike a 401(k) plan, the taxes withheld from the employee and matched by their employer are not set aside in "your" account to be available to pay "your" future retirement benefit. Each month, the Trust Fund collects all taxes, pays all benefits and then "loans" the monthly excess to the Federal government in exchange for a note. Since the Federal government has borrowed all of the excess receipts, spent all of the money in the general fund, and issued a note back to the Trust Fund - we have to "Trust that the Fund" will be repaid out of the future generation's tax payments. The chart, above, summarizes the activities of the Trust Fund for 2015. [7]

On an annual basis the Trustees of the Social Security program prepare a report that projects the Trust Fund's ability to meet future obligations. The 2016 report projects that through 2019 the receipts collected will be greater than the expenses paid out but that expenses paid out will exceed receipts starting in 2020. The current Trust Fund reserves are projected to be depleted in 2034. For the 75 year period projected in the report the Trust Fund has unfunded future obligations on 11.4 trillion dollars. [8]

Possible Solutions

While finding common ground is difficult in Washington there are a number of possible solutions in discussion stages. In no particular order, the following is a list of possible solutions being discussed:

1) Increasing the maximum annual Social Security taxable wage base (currently $118,500)

2) Increasing the payroll tax rate (currently 6.2%)

3) Delaying the Full Retirement Age for younger workers (currently age 67)

4) Subjecting a greater amount of benefits to Federal income tax (currently capped at 85%)

5) Reducing the benefit formula for future retirees (see ***Benefit Computation*** above)

6) Inserting means testing to make Social Security based on “need”

Given the magnitude of the problem some combination of the above may be the most likely course of action for maintaining the Trust Fund solvency.

Conclusion

Social Security has been around for 80 years. Almost 60 million Americans are currently receiving monthly benefits and another 30 million are expected to be added over the next 20 years. It has become a significant portion of the retirement income for too many people who have not provided for their own retirement through savings and investments. Eventually Washington will have to come together to keep the Trust Fund solvent.

At JVL Associates, LLC we deal with the uncertainties in life. Our planning can model retirement years with and without Social Security, assist you in selecting the best claiming strategies for your particular situation and develop financial plans together with investment plans tailored to help meet your specific retirement needs. If you know of someone who could benefit from our services please feel free to let us know. All of our newsletters are archived on our website www.jvlassociates.com.

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References

[1] Information obtained from - History of Social Security - Social Security Administration website: http://www.ssa.gov

[2] Information obtained from *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance And Federal Disability Insurance Trust Funds - Page 63 - Long-Range Estimates Table IV.B3 - Covered Workers and Beneficiaries, Calendar Years 1945 - 2090.*

[3] Information obtained *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance And Federal Disability Insurance Trust Funds - Pages 95-96 - Demographic Assumptions and Methods Table V.A3. - Social Security Area Population on July 1 and Dependency Rations, Calendar Years 1945 - 2090.*

[4] Information obtained *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance And Federal Disability Insurance Trust Funds - Page 98 - Assumptions and Methods Table V.A4.- Period Life Expectancy.*

[5] Information obtained from Social Security Administration web site: http://www.ssa.gov

[6] Information obtained from Financial Planning Association Annual Conference - Business & Education 2016 - *Social Security Understanding How to Work the System* - Social Security Facts - From 2015, Presented by: Theodore J. Sarenski, CPA/PFS, CGMA, CFP, AEP of Blue Ocean Strategic Capital, LLC.

[7] Information obtained from *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance And Federal Disability Insurance Trust Funds - Page 7 - Calendar Year 2015 Operations, B. Trust Fund Financial Operations in 2015 Table II.B1 - Summary of 2015 Trust Fund Financial Operations.*

[8] Information obtained from *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds - Pages 2-5 - II. Overview, A. Highlights.*