

Finance Essentials

# Social Security

A solid foundation for retirement income



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# at a glance

## What is Social Security?

The Social Security Act was signed by President Franklin D. Roosevelt on August 14, 1935. It began as a measure of alleviating poverty among the elderly in the wake of the Great Depression, when the stock market crash of 1929 and bank failures had destroyed the value of many American's retirement savings. This federal program was originally established to pay retired workers age 65 or older a continuing income after retirement. The Act has evolved since it was signed, and now pays benefits to the elderly, disabled individuals, spouses, divorced spouses, and survivors and dependents of workers who have died.

While it was never intended to take care of all financial needs in retirement, for many people, Social Security is their primary source of retirement income. For others, it's an important supplement to pensions and personal savings that can help them maintain their standard of living. Over the years, the program has evolved from a safety net designed to relieve poverty to the foundation on which to build a secure retirement.

## We all depend on Social Security for retirement

Retirement and Social Security go hand-in-hand for a great number of people—and for good reason. Some depend on the income provided by Social Security to help maintain their standard of living. For others, Social Security becomes the foundation on which to build a secure retirement.

### 1

#### **A steady stream of income**

Social Security offers the elderly and disabled individuals and their families protection against financial hardship by providing them with a steady stream of income for life.

### 2

#### **A solid foundation for retirement income**

While Social Security benefits can provide a solid base, the bulk of retirement income will most likely come from personal savings, investments, and employer-sponsored retirement plans.

### 3

#### **Today's workers provide for today's retirees**

The taxes you pay toward Social Security do not go into a personal account. Instead, the program is designed to pool all Social Security taxes collected from current workers to pay Social Security benefits to current retirees.

### 4

#### **Inflation-adjusted income helps protect purchasing power**

Rising consumer prices can erode your purchasing power, so Social Security may declare annual cost-of-living adjustments (COLA) to help your retirement income keep pace with inflation.

### 5

#### **Maximize your lifetime benefits**

Just because you may be ready to retire doesn't necessarily mean you should immediately begin collecting your Social Security check. There are a number of considerations that can help you maximize your Social Security income.

## 1 A steady stream of income

### Social Security helps provide a financial safety net

Social Security provides benefits to American citizens to help protect them from financial distress that can be caused by old age, disability, and family loss. The program offers four unique benefits:

- 1. Predetermined amount of income.** Your Social Security income is tied to your earnings history. The exact amount of your monthly benefit is based on a mathematical formula and when you apply for benefits.<sup>1</sup>
- 2. Lifetime income.** Social Security is designed to provide a reliable source of income for life.
- 3. Steady income.** Once you begin receiving Social Security benefits, the amount of your income is set and will not fluctuate on a monthly basis. This helps provide a solid foundation for retirement income planning.
- 4. Inflation-adjusted income.** Social Security benefits may be increased each year, based on increases to the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W).<sup>2</sup> When issued, the cost-of-living adjustments (COLA) help retirees keep pace with the rising cost of living.

#### Who Collects Social Security Benefits?

Retirees	When you retire, Social Security provides a monthly benefit that helps to replace a portion of preretirement earnings. Social Security also provides monthly benefits to both current and divorced spouses (if married at least 10 years).
Disabled People	If you become severely disabled and can no longer work, Social Security provides you and your family members with monthly benefits.
Survivors	In addition to a small death benefit, Social Security provides a lifetime benefit to the family of the deceased. <sup>3</sup>

## 2 A solid foundation for retirement income

### The bulk of income will come from personal sources

Many assume that Social Security payments are determined in the same manner as distributions from investment accounts—by a rate of return on invested capital for an individual account. Instead, your benefit amount is based on your earnings history and age at retirement.

#### Benefits are based on your total average career earnings

Your exact monthly benefit is not calculated until you turn age 62. The formula used by the Social Security Administration to calculate your primary insurance amount (PIA)—the base on which your benefit is determined—is designed to give you credit for your highest 35 years of earnings. At its core, this is how the formula works:

- Your lifetime earnings are adjusted for inflation to be counted at their current value.
- Your highest 35 years of earnings are totaled and divided by 35 to obtain your average indexed monthly earnings, or AIME.
- Your permanent monthly base benefit is calculated based on your AIME.

#### Social Security is designed to replace a portion of your earned income

While Social Security benefits can provide a solid base, they will likely not cover all of your retirement expenses. On average, Social Security replaces less than 40% of an individual's income.<sup>4</sup> For high-net-worth individuals, Social Security makes up just over 15% of their income.<sup>5</sup> The bulk of retirement income will most likely come from personal savings, investments, and employer-sponsored retirement plans.

How Much Can You Expect in 2016?	
Maximum monthly benefit for a retired individual	\$2,639
Average monthly benefit for a retired individual	\$1,341
Average monthly benefit for a retired couple	\$2,212

Social Security Administration, 2016 Social Security Changes, [ssa.gov](http://ssa.gov), 2015.  
Monthly benefits based on an individual starting to collect benefits at full retirement age.

## 3 Today's workers provide for today's retirees

### Social Security and your retirement

Today, Social Security is the most popular government program in the United States. It refers to the Federal Old-Age (retirement), Survivors, and Disability Insurance (OASDI) program and consists of several social welfare and social insurance components. Under the current system, when you work you pay taxes into Social Security, which are used to pay benefits to retirees, disabled individuals, and survivors.

Employers and employees are required to pay into the Social Security system in the form of taxes, equal to 6.2% of annual income up to your first \$118,500 of earnings.<sup>6</sup> The funds collected from today's workers are paid out as benefits to current retirees.

#### You must qualify to collect Social Security

You are entitled to receive full monthly Social Security benefits if you have contributed to the system through payroll taxes, attained your full retirement age (FRA)—as determined by Social Security—and accrued 40 credits over your working career.

Generally, you earn 40 credits over a 10-year career, with a maximum of four credits per year. Credits are tied to your earnings, and the earnings required for a single credit increase annually. For example, in 2016, you will earn one credit for each \$1,260 earned, compared to one credit for each \$970 earned in 2006.<sup>7</sup> All credits earned remain permanently on your work record, even if you leave the workforce for a period of time.

“The system is not intended as a substitute for private savings, pension plans, and insurance protection. It is rather intended as the foundation upon which these other forms of protection can be soundly built.”

*Dwight D. Eisenhower*  
January 14, 1954

**Your full retirement age (FRA) is determined by the Social Security Administration**

FRA is when you will be eligible to receive your regular retirement benefits and is based on the year you were born. For today's retirees, FRA ranges from 65–67. Due to greater life expectancies, FRA is gradually increasing.

**FRA by Year of Birth**

Year of Birth*	Full (normal) Retirement Age
1937 or earlier	65
1938	65 and 2 months
1939	65 and 4 months
1940	65 and 6 months
1941	65 and 8 months
1942	65 and 10 months
1943–1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

Social Security Administration, Retirement Planner: FRA, ssa.gov, 2015.

\*If born on January 1st, refer to the previous year.

# 4

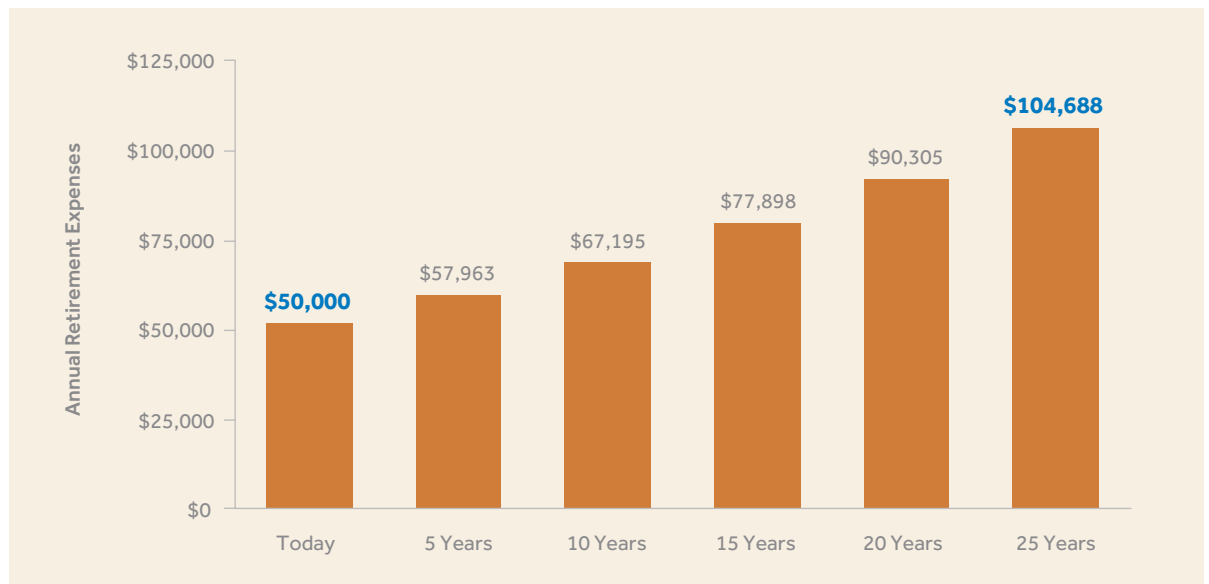
## Inflation-adjusted income helps protect purchasing power

A steady income stream

### Incorporate the impact of inflation into your retirement income plan

Inflation makes goods and services more expensive by decreasing the value of money. Most working people adjust to increasing inflation levels because their earnings tend to keep pace with inflation. But, when faced with the decision of consuming retirement assets, near and new retirees will need to reassess their ability to maintain their desired lifestyle.

### A 3% Annual Rate of Inflation Can Double Expenses Over a 25-Year Period



This chart illustrates how 3% annual inflation can double living expenses over a 25-year period. The hypothetical example is for illustrative purposes only and assumes a 3% annual rate of inflation and annual retirement expenses of \$50,000 at the start of retirement. MainStay Investments, 2015.



## Cost-of-living adjustments (COLA) can help you keep pace with inflation

One of the benefits of Social Security is the steady income that it provides. Once you begin receiving Social Security benefits, the amount of your income is set and will not fluctuate on a monthly basis.

Each October, the Social Security Administration may announce a cost-of-living adjustment (COLA)—the amount by which monthly benefits may be increased, starting the following January. The purpose of the COLA is to ensure that the purchasing power of Social Security benefits is not eroded by inflation. COLA is based on the increase in the CPI-W.<sup>2</sup> However, if the CPI-W doesn't show an increase in a particular year, there is no COLA increase for that year.

Social Security Automatic COLA (1985–2016)			
1985	3.5%	2001	3.5%
1986	3.1	2002	2.6
1987	1.3	2003	1.4
1988	4.2	2004	2.1
1989	4.0	2005	2.7
1990	4.7	2006	4.1
1991	5.4	2007	3.3
1992	3.7	2008	2.3
1993	3.0	2009	5.8
1994	2.6	2010	0.0
1995	2.8	2011	0.0
1996	2.6	2012	3.6
1997	2.9	2013	1.7
1998	2.1	2014	1.5
1999	1.3	2015	1.7
2000	2.5*	2016	0.0

Social Security Administration, [ssa.gov](http://ssa.gov), 2015.

\*The COLA announced in December 1999 for 2000, was originally determined as 2.4%, based on CPIs published by the Bureau of Labor Statistics. Pursuant to Public Law 106-554, however, this COLA is effectively now 2.5%.

# 5

## Maximize your lifetime benefits

### Timing is everything

There are many factors that need to be considered before claiming Social Security benefits.

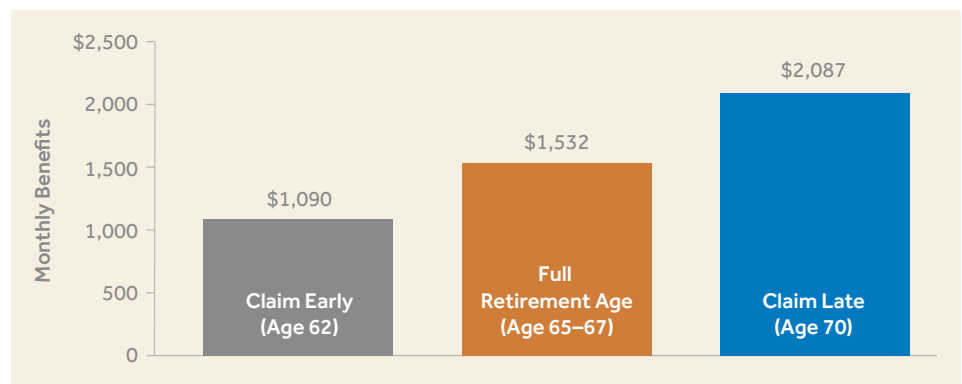
Factors	What Needs to be Considered													
Break-Even Age	This is the point at which your lifetime benefits received will become equal whether you begin collecting Social Security early, at FRA or later. Determining the optimal age to begin collecting benefits can be difficult, but can help maximize your benefits.													
Spouse's Benefits	There are a number of factors that will affect how much Social Security both you and your spouse can collect. Even if a spouse has never worked, he/she may be able to receive spousal benefits, which can be up to 50% of the other spouse's benefits.													
Employment Status <sup>8</sup>	If you choose to work while receiving Social Security benefits, your benefit amount will be reduced until you reach your FRA. If you're under FRA for the entire year, \$1 will be deducted from your benefit payments for every \$2 you earn above the annual limit. For 2016, that limit is \$15,720. In the year you reach FRA, Social Security will deduct \$1 in benefits for every \$3 you earn. For 2016, the limit on your earnings is \$41,880, but earnings are only counted before the month you reach your FRA.													
Life Expectancy	People are living longer than ever due to medical advancements and healthier lifestyles. This means that you can anticipate spending a significant portion of your life in retirement.													
Health Care	Health care costs are high and rising faster than other expenses. Over the past 20 years, the percentage of companies offering retiree health benefits has been steadily decreasing. <sup>9</sup> Affording health care is considered to be one of the most basic needs in retirement. <sup>10</sup>													
Other Sources of Income	When laying out a retirement income plan, make sure to include employer-sponsored plans, retirement plans, your home if you plan to sell and downsize, and additional sources of income.													
Taxes on Benefits	Depending on your total annual income in retirement, a portion of Social Security benefits—or those of your spouse, if filing jointly—may be subject to income tax. To help determine if your benefits will be taxable, Social Security establishes base amounts. <table border="1" data-bbox="451 1520 1529 1696"> <thead> <tr> <th>Filing Status</th> <th>Combined Income</th> <th>Taxable Up To</th> </tr> </thead> <tbody> <tr> <td rowspan="2">Married and Joint</td> <td>\$32,000–\$44,000</td> <td>50%</td> </tr> <tr> <td>More than \$44,000</td> <td>85%</td> </tr> <tr> <td rowspan="2">Single</td> <td>\$25,000–\$34,000</td> <td>50%</td> </tr> <tr> <td>More than \$34,000</td> <td>85%</td> </tr> </tbody> </table>	Filing Status	Combined Income	Taxable Up To	Married and Joint	\$32,000–\$44,000	50%	More than \$44,000	85%	Single	\$25,000–\$34,000	50%	More than \$34,000	85%
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Social Security Administration, Taxation of Social Security Benefits, ssa.gov, 2015.

## The age you decide to claim Social Security will affect your benefits

Retiring is one of the most important decisions you'll make. Your decision of when to receive benefits will depend on your personal situation and retirement plans. If you'll largely depend on income from Social Security, it may be beneficial to collect as early as possible. But if you don't need the extra income when you become eligible to collect, it may make more sense for you to claim later.

## What's the Optimal Age to Collect Benefits?



Social Security Administration, Quick Calculator Benefit Estimates, [ssa.gov](http://ssa.gov).  
Based on an individual who was born in 1954, current earnings \$50,000 and FRA is 66.

**Claim Early (Age 62).** You may collect Social Security as early as age 62. This will provide payments for a longer period of time and will permanently reduce your monthly income for each month prior to your FRA.

**Full Retirement Age (65-67).** Your FRA depends on the year you were born and generally ranges from age 65-67. You can receive your regular monthly Social Security benefit based on your work history and average lifetime earnings.

**Claim Late (Age 70).** You may decide to work past your FRA and collect benefits as late as age 70. For each year you delay the start of Social Security beyond your FRA, your benefit will increase by 8%, up to age 70.

## Don't go it alone

Social Security helps many individuals maintain their standard of living in retirement. However, applying for benefits can be a confusing and complicated process. In addition to contacting your local Social Security office for assistance, tax and financial professionals can help you understand your Social Security benefits and navigate the application process. Your financial professional can also help determine the most advantageous time to claim your Social Security benefits, as well as how to best use your payment to maximize your retirement income potential. All information provided is as of December 2015. You are strongly encouraged to visit the Social Security web site for the most up-to-date information at [ssa.gov](http://ssa.gov).

1. To help you plan for your retirement income, benefit calculators are available on the Social Security Administration's web site, [ssa.gov](http://ssa.gov).
2. The COLA is based on the increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) from the third quarter of one year through the third quarter of the following year. If there is no increase to the CPI-W, then there can be no COLA increase. If a COLA is declared, it is applied to benefits currently being paid, as well as benefits that have not yet been paid.
3. A one-time payment of \$255 can be made only to a spouse or child if they meet certain requirements. Survivors must apply for this payment within two years of the date of death.
4. Social Security Administration, [ssa.gov](http://ssa.gov), Understanding the Benefits, 2015.
5. MainStay Investments, 2015. Actual percentage is 15.9% based on receiving the maximum yearly Social Security benefit and a minimum annual income of \$200,000.
6. Social Security Administration, Contribution and Benefit Base, [ssa.gov](http://ssa.gov), 2015. In 2011 and 2012, employees were required to contribute 4.2% of earnings up to \$106,800 and \$110,100, respectively, as part of the government's economic stimulus program, while employers continued to contribute 6.2%.
7. Social Security Administration, Latest Amount and QC Explanation, [ssa.gov](http://ssa.gov), 2015.
8. Social Security Administration, [ssa.gov](http://ssa.gov), Cost-of-Living Adjustment (COLA) Information for 2016, Frequently Asked Questions.
9. Becker's Hospital Review, 2014.
10. Consumer Retirement Income Planning Study, conducted by MainStay Investments and Harris Interactive, May 2010.



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