Bedrock Newsletter

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Social Security

"Today more people believe in UFOs than believe that Social Security will take care of their retirement." - Scott Cook- Founder of Intuit

In this newsletter, Bedrock has taken a crack at offering a roadmap of the Social Security system and Medicare in an attempt to explain these complex systems so you can maximize your benefits to positively impact your future wealth.

We give a detailed review of how Social Security benefits are calculated and how a person may increase their benefits while they are still working. We give our take on what some of the proposed future changes being considered will do to insure the Social Security system will survive for future generations. Probably the most important article addresses strategies on maximizing your personal benefit. We also outline how Social Security benefits are taxed. On the practical side of the subject we give guidelines on how to check your Social Security benefits and when the time comes how to apply for your benefits. We also include a checklist for applying for Medicare and an explanation of the various Medicare plan choices you must make.

As you will notice the author of the majority of the following articles in the newsletter is Sharon Lacy, Bedrock's Wealth Planning Manager and resident Social Security guru. Sharon speaks regularly on Social Security strategies at national and regional conferences in the financial planning community. Sharon also put her skills and expertise to good use when she created SSAnalyze!, Bedrock's proprietary Social Security forecasting tool. We offer this free tool through the Bedrock website to other planners, our clients and the public at www.bedrockcapital.com to do a personal analysis to optimize your own social security benefits.

We at Bedrock do not really believe in UFOs so I guess we do think Social Security is here to stay.

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Bedrock Capital Management has been managing our clients' wealth for over 25 years. Our comprehensive wealth management approach coordinates our client's financial universe to develop a plan to achieve their vision and goals. The components we address with our clients include investments, tax strategies, financial independence and retirement planning, estate planning and wealth transfer issues, cash flow and spending plans, asset protection and insurance analysis, survivor income needs, employee benefits and stock options and education funding. The clients that are the best fit for our firm want an approach that orchestrates all of the parts of their financial world to make their aspirations a reality.

The Bedrock organization includes five CERTIFIED FINANCIAL PLANNER™ practitioners, two are Chartered Financial Analyst charterholders and another that is also a CIMA® designee. Each has completed the examination, experience, ethics commitment and education required to provide sound, professional advice.

Social Security Basics

By Sharon Lacy, CFP®

Social Security was introduced in 1935 to help workers (and their dependents) have a secure source of retirement income. It was designed to replace a portion of a worker's pre-retirement earnings (the replacement rate) with the balance coming from pensions and retirement accounts. Over the last 30 years companies have moved from pensions and defined benefit plans to defined contribution plans, transferring the responsibility for retirement funding to the employees.

If Social Security payroll taxes are deducted from your paycheck, you are probably eligible (or will eventually be eligible) for Social Security benefits. I say "probably" because you need to earn a minimum amount ($1,160 in 2013 – the minimum goes up every year) to earn one credit — up to a maximum of four credits ($4,640 in earnings for 2013) per year. Once you have 40 credits (10 years of work) you qualify for retirement benefits. Fewer credits are required to be eligible for disability benefits or survivor's benefits.

Your Social Security benefit is based on your lifetime earnings. The Social Security Administration calculates your benefit in two steps. First your "average indexed monthly earnings" (AIME) is calculated by adjusting or "indexing" your earnings to account for changes in average wages, then taking the average of your 35 highest years of indexed monthly earnings. The second step is to apply a formula to calculate your basic benefit, or "primary insurance amount" (PIA). The formula gives the wage earner a percentage of their AIME based on "bend points" that are determined by your year of birth - see Chart for 2012 example.

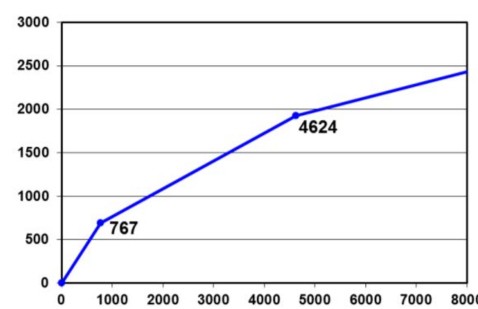
The actual benefit that you receive is also based on when you begin receiving your benefit. You may begin receiving your benefits as early as 62 or as late as 70. If you start your benefit early, the benefit you receive will be lower and if you delay your benefit until 70 the benefit will be higher. For example, if your FRA is 66 and you start your benefit at 62 you will receive 75% of your full retirement age benefit. If your FRA is 66 and you start your benefit at 70 you have "delayed" your benefit and you will receive 132% of your full retirement age benefit.

There are basically three ways to increase the benefit you receive:

1. Increase you AIME by working longer, assuming that the money you earn is high enough to replace an earlier year of lower "indexed" earnings.

2. Increase the benefit you receive by delaying your benefit for as long as possible.

3. If you are married (or divorced and were married at least 10 years) take advantage of coordinating your spousal benefits.



90% of AIME up to bend point 1
($767 for wage earners turning 60 in 2012).

32% of AIME between bend point 1 and bend point 2
($4,624 for wage earners turning 60 in 2012)

15% of AIME above bend point 2

Future Options for Social Security

By Sharon Lacy, CFP®

When you look at your paystub and you see that 6.2% of your pay is going to FICA you might assume that the money will be there the day you retire. Well, it doesn't actually work that way. The Social Security taxes deducted from your paycheck are not sitting in an account somewhere, waiting for you. Instead, Social Security is a "pay as you go" system. The taxes you are paying today are used to pay the benefits of current retirees. When you retire your benefits will be paid with the taxes that will be collected from the people working at that time. This functions well as long as there are enough people employed and paying FICA taxes. But the number of people still working, compared to the number of people receiving benefits, has been decreasing (from 5:1 in 1960 to 3:1 today), and will continue to decrease as the baby boomers retire and file for their benefits (the number is expected to stabilize at about 2:1). Until 2011 the system was taking in more money than it was paying out. Since then the shortfall has been covered by the interest on the Social Security trust fund, a stash of treasury bonds paid for by past surpluses (1983 – 2011). Starting in about 2021 the shortfall will be covered by liquidating the trust fund,and beginning in about 2033, the trust fund is projected to be completely depleted. After that, payroll taxes from workers will only cover about 75% of the scheduled payouts.

Under current law, the government would still be obligated to pay full benefits. However that could always change and our objective here is to examine what might be done to strengthen the current system. The solutions that have been proposed relate to reducing expenditures or increasing revenues. Some of the proposals you may have heard discussed include:

1-Increase the cap on earnings taxed for Social Security (increase revenue). There is currently an earnings cap on Social Security payroll taxes. Everyone pays 6.2% of their earnings into Social Security up to the earnings cap ($113,700 in 2013). Any amount over that is not taxed. So, an individual earning $120,000 would pay as much into Social Security as an individual earning $400,000 or $4,000,000.

2-Increase the Social Security tax rate (increase revenue). The current Social tax rate is 12.4% (6.2% paid by employee, 6.2% paid by employer).

3-Continue to increase the Full Retirement Age (FRA) to 69 and higher (reduce benefits). Currently FRA ranges from ages 65-67 depending in what year you were born.

4-Means-test Social Security benefits (reduce benefits). Currently you receive your benefit regardless of your annual income.

5- Change the way the cost-of-living adjustment (COLA) is calculated by basing it on an index that grows more slowly than the current index (e.g. chained -CPI) (reduce benefits). The COLA is currently based on the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W)

The National Academy of Social Insurance (www.NASI.org) recently released a paper called "Strengthening Social Security: What Do Americans Want" that discusses options that would actually allow the Social Security Administration to INCREASE benefits. Some of these proposals include: 1- Reinstate student benefits to children whose working parents have died up to age 22 if they are still in school. The current survivor's benefit for children ends when the child is 18. 2- Change the way the cost-of-living adjustment (COLA) is calculated by basing it on an index that reflects the inflation experienced by the elderly (possibly increase benefits, depending on inflation). 3- Raise Social Security's basic minimum benefit so that someone who paid into Social Security for 30 years can retire at 62 or later and not be poor

Social Security has been hugely successful based on its original goals: providing a secure source of retirement income while also protecting disabled people and families after the death of a breadwinner. Before Social Security was enacted about half of America's senior citizens were officially poor. Today, less than 10% live in poverty.

Strategies to Maximize Your Benefits

By Sharon Lacy,CFP®

Coordinating spousal benefits

If you are married (or divorced, still single and were married at least 10 years) you have the option to coordinate spousal benefits. A spousal benefit is defined as ½ of your spouse's full retirement age benefit. The basic idea is that if your spouse has filed for their own benefit and you are full retirement age or older, you can take a spousal benefit based on your spouse's work record and still delay your own benefit (and receive delayed retirement credits).

An example is appropriate here. Dick and Jane are both 62 and their full retirement age (FRA) is 66. Dick has a FRA benefit of $2,000 per month. Jane has a FRA benefit of $1,600. Using this scenario:

- If Dick and Jane each file for their benefit at 62 he will receive $1,500 per month and she will receive $1,200 per month

- If Dick and Jane each file for their benefit at 66 (their FRA) he will receive $2,000 per month and she will receive $1,600 per month

- If Dick and Jane both delay their benefit until 70 he will receive $2,640 per month and she will receive $2,112 per month.

If Dick and Jane both decide to delay their benefit until 70, one or the other (but not both) can take a spousal benefit on the other's work record. This is called a "restricted application" because one spouse files for a benefit but restricts the scope of their application to a spousal benefit.

In our example, Jane will restrict her application and receive $1,000 per month between her 66th and 70th birthday. Jane takes the spousal benefit because her spousal benefit ($1,000) is more than Dick's spousal benefit would have been ($800). But wait you say – a couple of paragraphs ago you said that Jane can't take a spousal benefit until after Dick has filed. Correct! Fortunately, as soon as Dick turns 66 (his FRA) he has the option to file for his benefit (thus enabling Jane to take her spousal benefit) and then immediately suspend his benefit allowing him to earn delayed retirement credits.

The unique circumstances of a particular couple (disparity in age, disparity in benefit amount) can make the choice of how to optimize benefits very complicated. If you have a complicated situation you can use the tool, SSAnalyze! – developed by Bedrock to analyze the scenario. Go to our website (www.bedrockcapital.com) and follow the link to "SSAnalyze!".

Coordinating Survivor's Benefits

If you are widowed and you have not started your own benefit you have the option to coordinate survivor's benefits. If you were divorced from the deceased worker you can still receive a survivor's benefit if you were married for at least 10 years and you are either single or you remarried after you were 60.

Coordinating survivor's benefits is very straightforward. The first thing is to determine the amount of your survivor's benefit. If your spouse filed for their own benefit before their death, the survivor's benefit is whatever they were receiving when they died. If your spouse had not filed for their benefit and they were younger than their FRA when they died, the survivor's benefit is their FRA benefit. If your spouse had not filed for their benefit and was older than their FRA, the survivor's benefit is whatever it would have been if they had filed the day they died.

Now, compare the survivor's benefit with the benefit you would receive if you delayed your benefit until 70.

- If the survivor's benefit is higher, file for your own benefit at 62 (or immediately if you are between 62 and your FRA) and switch to the survivor's benefit at your full retirement age.

- If your delayed benefit is higher, file for the survivor's benefit at 60 (or immediately if you are between 60 and 70) and switch to your own benefit when you are 70.

Bedrock is here to help with any of these strategies . Please feel free to use us as a resource to help you determine the best approach for your personal situation.

How to Check Your Benefits

To get an estimate of your Social Security benefits:

1. If you have a current Social Security statement the benefit estimates are valid. If you have an old Social Security statement (less than 3 years old) you can get a pretty good idea of your current benefit estimate by applying cost-of-living adjustments to the numbers on your statement. Recent cost-of-living adjustments are 0% in 2011, 3.6% in 2012 and 1.7% in 2013. So, if you have a 2010 or 2011 statement you would multiply the estimate by 1.054 (1.036 * 1.017) or if you have a 2012 statement you would multiply the estimate by 1.017. Remember that this estimate does not consider possible increases to your benefit because you may have added high earnings years to your average earnings.

2. You can get a current estimate of your benefit by going to www.ssa.gov/estimator and answering a few questions.

3. You can sign up for "my Social Security" at the following link: http://www.ssa.gov/myaccount.

If you currently receive Social Security benefits or Medicare, you can use your "my Social Security" account to: get your benefit verification letter; check your benefit and payment information and your earnings record, change your address and phone number; start or change direct deposit of your benefit payment

If you have not started receiving Social Security benefits or Medicare you can use your "my Social Security" account to get your Social Security Statement and review: estimates of your retirement, disability, and survivors benefits; your earnings record; the estimated Social Security and Medicare taxes you've paid.

To create an account, you must provide some personal information about yourself to create a username and password to access your online account.

How to Apply For Your Benefits

There are basically three ways to apply for your Social Security benefits. They are:

1. You may apply online using the following link: https://secure.ssa.gov/iCLM/rib

2. You may apply by phone at 1-800-772-1213. If you are deaf or hard of hearing you may apply by phone at 1-800-325-0778.

3. You may apply in person at your local Social Security Office (you should make an appointment before going). To find an office near you go to https://secure.ssa.gov/apps6z/FOLO/fo001.jsp

If your application is straightforward any of these options will work.

If you are implementing any of the strategies listed below, we recommend that you make an appointment and visit your local Social Security Office. If you are told that you cannot implement the filing strategy that we have recommended, ask to speak with a supervisor. We have thoroughly researched these filing strategies, and we would not recommend one that could not be implemented (based on what we know of your work record).

• You are between your full retirement age and 70, and you plan to take a spousal benefit while continuing to delay your own benefit

• You are between your full retirement age and 70 and you plan to file for and then immediately suspend your benefit in order to earn delayed retirement credits

• Your spouse has predeceased you, you are between 60 and 70, and you plan to take a survivor's benefit while continuing to delay your own benefit

• Your spouse has predeceased you, you are between 62 and your full retirement age, and you plan to take your own benefit and delay your survivor's benefit

Medicare Checklist

Medicare is the federal health insurance program for people who are 65 or older, certain people with disabilities or end-stage renal disease.

Filing Checklist

1. Fill out an "Initial Enrollment Questionnaire" (IEQ). About 3 months before your Medicare coverage starts you'll get an IEQ in the mail. You can also fill out the IEQ online at MyMedicare.gov.

2. Fill out an Authorization Form if you want your family or friends to be able to call Medicare on your behalf.

3. Make a "Welcome to Medicare" preventive visit appointment during the first 12 months you have Medicare. This is a free, one-time comprehensive preventive visit.

4. Sign up for MyMedicare.gov so you can access your personal Medicare information 24 hours a day, every day.

5. Choose and join a Medicare Drug Plan (Part D) within the first 7 months you have Medicare.

Types of Medicare coverage:

Medicare Part A (Hospital Insurance) covers inpatient hospital stays, care in a skilled nursing facility (but not Long-term care), hospice care, and some home health care.

Medicare Part B (Medical Insurance) covers certain doctors' services, outpatient care, medical supplies, and preventive services.

Medicare Part C (Medicare Advantage Plans) is a type of Medicare health plan offered by a private company to provide you with all your Part A and Part B benefits. Medicare Advantage Plans include HMOs, PPOs and some other special plans. Most Medicare Advantage Plans offer prescription drug coverage.

Medicare Part D (prescription drug coverage) adds prescription drug coverage to Original Medicare as well as some other special plans. These plans are offered by insurance companies and other private companies approved by Medicare.

A Medicare supplement (Medigap) insurance, sold by private companies, supplements your Original Medicare benefits and can help pay some of the health care costs that Original Medicare doesn't cover. Every Medigap policy must follow federal and state laws designed to protect you, and be clearly identified as "Medicare Supplement Insurance." Insurance companies can sell you only a "standardized" policy identified in most states by letters-See Chart.

All policies offer the same basic benefits, but some offer additional benefits, so you can choose which one meets your needs. Each insurance company decides which Medigap policies it sells, although state laws might affect which ones they offer.

Medigap Plans

Medigap Benefits	A	B	C	D	F	G	K	L	M	N
Part A coinsurance & hospital costs (add'l 365 days after Medicare used up)	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Part B coinsurance or copayment	Y	Y	Y	Y	Y	Y	50%	75%	Y	Y
Blood (first 3 pints)	Y	Y	Y	Y	Y	Y	50%	75%	Y	Y
Part A hospice care coinsurance or copayment	Y	Y	Y	Y	Y	Y	50%	75%	Y	Y
Skilled nursing facility care coinsurance	N	N	Y	Y	Y	Y	50%	75%	Y	Y
Part A deductible	N	Y	Y	Y	Y	Y	50%	75%	0.5	Y
Part B deductible	N	N	Y	N	Y	N	N	N	N	N
Part B excess charges	N	N	N	N	Y	Y	N	N	N	N
Foreign travel exchange (up to plan limits)	N	N	Y	Y	Y	Y	N	N	Y	Y
Out-of-pocket limit	N/A	N/A	N/A	N/A	N/A	N/A	$4,800	$2,400	N/A	N/A

Taxes and Social Security

By Eric Lewis, CFA, CFP®

Social Security is taxed, albeit differently than other types of income. Between 15% and 100% of Social Security benefits are Federal tax-free, with the proportion taxed varying according to a complicated income-based formula. These calculations create situations where moderate-income taxpayers may face surprisingly high marginal tax rates.

To determine how much of your Social Security is taxable, the law has you calculate a number that the Social Security Administration terms "combined income". This is basically your Adjusted Gross Income without Social Security, plus one-half of your Social Security benefit, plus non-taxable interest (such as from tax-free muni bonds.)

Your "combined income" is then compared to certain thresholds. If it is less than $25,000 (for married couples, $32,000), then all of your Social Security benefit is tax-free. Between $25,000 and $34,000 (married $32,000 and $44,000), up to 50% is taxable. Over $32,000 (married $44,000), up to 85% of your Social Security is included in your taxable income.

You can see that Social Security is tax-free for low-income households, while 85% of benefits are counted as income for upper-bracket taxpayers. In between is where the pitfalls and planning opportunities lie. The trap for the unwary is that your marginal tax rate may be much higher than the nominal tax bracket. This is because an additional dollar of income can cause an extra $0.50 or $0.85 of benefits to also become taxable. Thus, for an individual in the 25% tax bracket, they can actually incur a 46.25% Federal tax rate. This can turn an otherwise sensible action, such as a Roth conversion, into a costly move.

This article necessarily simplifies a complex issue. It is not intended to provide tax advice for any individual's situation. You should check with Bedrock or your tax professional if you have questions about how these rules affect you.

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