How to Read and Understand Your Social Security Statement – Part 2

In Part 1 of this series we reviewed how to obtain your Social Security statement and looked more closely at some of the items that appear on page 1. Now, we are ready to proceed to:

Page 2. Here's where it gets interesting! Starting at the top, under **Retirement**, we *look* at, but often don't *see*, the following language, which I'm going to bold for emphasis: "At your **current earnings rate**, **if you continue working until**…" We then see figures estimating our benefits if we file for benefits at various ages.

If you are 60 years old, the benefit ages shown will be 66, 70, and 62. If you are already 64, the ages shown will be 66, 70, and 64. In our sample statement, Wanda Worker will be 40 years old in April 2013. That means that her Full Retirement Age will be 67, under current rules, and thus the estimates are for ages 67, 70, and 62. But the key point here is that **those estimates are based on the assumption that she will continue to work and earn the same amount that she earned the previous year (or the year before that) until the age in question**.

In fact, if you look at the last few lines above the thick line that divides this section from the next, you will see in bold print: "**We based your benefit estimates on these facts**:" Then you will see your date of birth and the amount of "**Your taxable earnings per year after 2013**." "Taxable earnings" means earnings that are subject to Social Security taxes. What appears next is the amount SSA assumes you will earn each year going forward to the particular age for which an estimate is given.

In Wanda's case, that turns out to be $44,833, which represents her earnings in the most recent year for which SSA has earnings information for her. If we look briefly at her Earnings Record on page 3, we notice that so far Wanda has 24 years of earnings (assuming that she earned $44,833 in 2012). We can also see that in the earlier years of her working career her earnings were rather modest, even taking into account that they will be increased by inflation adjustments when her average earnings are calculated for benefit purposes. What this means is that if Wanda does not continue earning somewhere around $45,000 (in 2013 dollars) for another 15-20 years, those benefit estimates may be significantly overstated.

In my practice, I discover that many clients have some misconceptions about what they just read. Some think that the only options they have involve claiming at 62, 66-67, or 70. Of course, that is not true, as they can claim at one of those ages or any month in between. But the most common misconception may be the sense that even a fairly young worker has "locked in" a benefit level roughly equal to the estimates shown on the statement, even if he or she stops working or starts earning greatly reduced amounts well before the age in question.

By the way, I also notice that many clients still regard age 65 as a particularly significant milestone age for Social Security. This may be because for the pre-Boomer generation, age 65 was Full Retirement Age; or because Medicare qualification age is 65. A study by the Center for

Retirement Research at Boston College suggests that the more likely explanation may be that people who lack health insurance at work, or whose employer does not provide access to retiree health benefits, are more likely to retire at 65 in order to begin Medicare coverage. Perhaps because I am **not** The Medicare Maven, I find this confusing, as a person does not need to begin receiving Social Security retirement benefits in order to enroll in Medicare at age 65.

Accumulating Credits. Moving back to the top of page 2, we notice that Wanda's statement says: "You have earned enough credits to qualify for benefits." If you move your eyes down the page below the green line, you will see an explanation of what this is all about under the heading: "**How Your Benefits Are Estimated**"

You need 40 "credits" over your working life to qualify for Social Security retirement benefits on your own record. You earn one credit for each $1,160 (in 2013) of Social Security taxed earnings, up to a maximum of 4 credits in a single calendar year if you earn at least $4,640.

In the old days, a credit was called a "quarter," leading to another misconception I encounter frequently: the erroneous impression that one must earn at least $1,160 in each of four quarters to receive 4 credits in a single year. In point of fact someone, for example a commission-based salesperson, could earn $4,640 in a **single day** and thereby amass their yearly maximum of 4 credits.

What is not mentioned in the statement is that earning 40 credits simply gets you a ticket to the game. Your potential benefits are based in large part on the **average of your highest 35 years** of inflation-adjusted Social Security earnings. If, for example, you have an Earnings Record that looks like Wanda's and you decide to stop working after 24 years, your 35-year average will include 11 years of **zeroes**!

This section is followed by an explanation of factors that could affect the retirement benefit estimates shown above. It correctly points out that the further away one is from Full Retirement Age, the less reliable the estimate might be, due to fluctuations in actual earnings; Cost of Living Adjustments (COLAs); possible changes in the law; and pensions you may receive based on earnings on which Social Security taxes were not paid.

WEP and GPO. The remainder of page 2 is devoted to a brief discussion of the **Windfall Elimination Provision** and the **Government Pension Offset**. Let's say that you worked for 20 years in a school system that had opted out of the Social Security system to participate instead in a state pension system. During those 20 years, your earnings were not subject to Social Security taxes. Even though you may have another 20 years of Social Security covered employment earnings, **WEP** will cause your potential Social Security retirement benefits to be reduced in accordance with a specific formula that is **not reflected in the benefit estimates** on your statement. Of course, your average earnings will also be impacted, as all the years of earnings that were not covered by Social Security will count as zeroes in the 35-year average.

GPO affects any <u>spousal</u> or <u>survivor</u> benefits to which you might otherwise have been entitled, requiring them to be reduced by 2/3 of the pension you are receiving from non-covered employment.

Moving back up to the **Estimated Benefits** section, you will note that there is information on benefits you could receive if you became **disabled** in the current year, as well as a general statement that if you receive retirement or disability benefits your **spouse and children** might qualify for benefits. This is followed by a section that outlines how much your spouse and children could receive as **survivor benefits** if you were to die this year. In real life, the implications of this Estimated Benefits section are huge. It is an area that often presents incredible complexity along with some exciting opportunities, and thus is at the heart of the work I do.

In the final of this three-part series, we will explore pages 3 and 4 of the Social Security statement.