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White Paper:

Electing Early Social Security Retirement Benefits

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Electing Early Social Security Retirement Benefits

What is it?

You can elect to receive retirement benefits early

As you approach retirement, you must decide when to start receiving your Social Security retirement benefits. You may elect to start receiving Social Security retirement benefits at age 62 rather than waiting until normal retirement age.

Tip: Normal retirement age is gradually increasing from age 65 to age 67. However, you will still be able to elect early retirement benefits at age 62. For more information, see Social Security Retirement Benefits.

Your retirement benefit will be permanently reduced

If you start receiving retirement benefits early, you will get less per month than if you start receiving them at normal retirement age. This benefit reduction will be permanent. If your benefit will be based on your own earnings record, it will be reduced by 5/9ths of 1 percent for each month of early retirement up to 36 months, and by 5/12ths of 1 percent thereafter. If your benefit is based on your living spouse's record, it will be reduced by 25/36ths of 1 percent for each month of early retirement. If your benefit is based on your deceased spouse's record, it will be reduced by 19/40ths of 1 percent for each month of early retirement.

Example(s): Earl Lee Jones decides to retire at age 62. If he waits to retire at age 65 (his normal retirement age), he will be entitled to a benefit of 100 percent of his primary insurance amount (PIA) (\$600). At age 62, however, his benefit will be reduced by 5/9ths of 1 percent (.55556 percent) for each of the 36 months prior to normal retirement age. Thus, his benefit at age 62 will be \$480, 20 percent less (.55556 x 36) than it will be at age 65.

Tip: As normal retirement age increases, the benefit reduction factor will change. If your normal retirement age is 67, your benefit will be reduced by 30 percent (instead of 20 percent) if you choose to retire at age 62.

When can it be used?

You must be eligible to receive early retirement benefits. For more information on eligibility criteria, see Determining Your Eligibility for Social Security Benefits. In general, you must be:

- At least age 62 and

- Fully insured by age 62 for retirement benefits (in most cases, you must have earned 40 Social Security credits)

You must be eligible whether you are retiring voluntarily or involuntarily

Most likely, you are retiring early because you want to. However, you may need to retire early due to factors beyond your control. Perhaps you are sick or injured, or maybe you've been terminated from your job. If you are retiring sooner than you'd like, you still need to meet the same eligibility requirements as someone who is retiring voluntarily. In cases where you don't meet the eligibility requirements, however, you may have other options. If you are sick or injured, for example, you may qualify for a disability benefit, which may be larger than your early retirement benefit. For more information, see Social Security Disability Benefits.

You must apply for benefits

Receiving benefits at age 62 is not automatic. The Social Security Administration (SSA) recommends that you contact a representative two or three months before your 62nd birthday to begin the application process. To reach the SSA, call (800) 772-1213.

Strengths

You will receive more monthly benefit checks if you retire early

If you retire early, you will receive more benefit checks than if you retire at normal retirement age. For instance, if your normal retirement age is 65 and you retire at age 62, you will receive 36 more benefit checks than you will if you wait until normal retirement age to retire. Even though your benefit at age 62 will be 20 percent less than it will be at age 65, those three years of extra benefit checks add up to a lot of money. In fact, the SSA estimates that if a worker waits until age 65 to begin receiving benefits (and his PIA remains the same), it will take him until age 77 to make up for those three years of benefit payments.

Example(s): At a meeting with his financial planner, Ned is trying to decide whether to retire when he is 62 or wait until he is 65. His PIA is \$900. He compares what his benefit would be at age 62 to what it would be at age 65:

- Age 62: Benefit is 80 percent of his PIA, or \$720
- Age 65: Benefit is 100 percent of his PIA, or \$900

Example(s): Based on this information, Ned thinks that he should retire at age 65 because his monthly benefit will be higher. However, when his financial planner calculates how long it will take Ned to make up for the three years of payments he will miss out on if he retires at 65, he changes his mind:

Ned will earn \$180 extra dollars per month if he waits until age 65 to retire (\$900 - \$720), but he will receive \$25,920 in benefits during the three years between age 62 and age 65 if he retires early (\$720 x 36). Therefore, at \$180 extra per month, it will take Ned 12 years to make \$25,920 after he retires at age 65 (\$180 x 144 months = \$25,920).

Thus, if Ned retired at age 65, it would take him until age 77 to make up the three years of extra benefits he would have received if he retired at age 62. To put it another way, it would take Ned 15 years from the time he retired at age 62 to reach the point at which his retirement benefits would crossover¹:

By this age	Accumulated Benefit if Retirement Age is 62	Accumulated Benefit if Retirement Age is 65
65	\$25,920	\$0
68	\$51,840	\$32,400
71	\$77,760	\$64,800
74	\$103,680	\$97,200
77	\$129,600	\$129,600

You can invest your Social Security retirement benefit

Investing your Social Security retirement benefit is an option if you don't need to use all of it for living expenses. If you are able to invest all or part of your Social Security benefit, receiving early retirement benefits might be advantageous. Not only would you receive more benefit payments, but also you would earn money on those payments when you invest them. The rate of return you would receive would depend upon your investment.

Example(s): Ned decides to invest \$500 per year of his Social Security benefit. If he invests in a money-market account paying 4 percent a year, he will earn approximately \$20 in interest during that year. If, however, he invests in a mutual fund (assuming a 10 percent annual return), he will earn approximately \$50 during that year.

Of course, your rate of return (or inflation-adjusted yield) also depends on how inflation affects your investment. Assuming that the rate of inflation for the year is 3 percent, Ned's rate of return on his investment paying 4 percent a year is approximately 1 percent; his rate of return on his investment paying 10 percent a year is approximately 7 percent. In addition to inflation, you also have to consider how taxes may reduce your yield. As the real rate of return increases, the advantage of taking early retirement benefits increases.

¹ Does not take into account annual cost-of-living increases, which would delay the crossover point even further.

Example(s): If Ned retires at age 62 and invests his money conservatively, his after-tax rate of return might be 0 percent. So, his benefit crossover point would be age 77. If he receives a 1 percent after-tax rate of return on his investment, however, his benefit crossover point would rise to age 78. If he receives a 7 percent after-tax real rate of return on his investment, his benefit crossover point would be greater than age 100. At this point, there would be no advantage to him postponing retirement until age 65.

Ned begins to realize that he might receive a greater lifetime Social Security retirement benefit if he retires at age 62. His financial planner, however, points out that there are tradeoffs to retiring early that Ned should consider before making his final decision.

Tradeoffs

Your retirement benefit is permanently reduced

You will receive less per month if you retire early rather than at normal retirement age. This gives you less money to meet your expenses each month, even though your total lifetime benefit may be more than if you waited until normal retirement age to retire. Since some people underestimate how much income they will need when they retire, the reduced benefit may cause them financial hardship.

You will have less chance to increase your average indexed monthly earnings (AIME)

In general, if you were born after 1928, your benefit is calculated by averaging your 35 highest years of indexed earnings to determine your AIME, then applying a formula to that amount. If you made little or nothing in one or more of those 35 years, waiting to retire until normal retirement age might increase your benefit because each year you wait to retire gives you a chance to earn enough to replace a lower year of earnings in the calculation.

You may live longer than you expect (is that really a tradeoff?)

When you're planning your retirement, consider your life expectancy. Although you can't know for sure how long you might live, you can make an educated guess based on your current health, your family's history of longevity, and the average life expectancy for someone your age. If you don't expect to live past age 77, you will receive a greater lifetime benefit if you retire early. However, if you do expect to live past age 77, you may outlive the financial value of receiving your benefits at age 62 instead of at normal retirement age.

Your surviving spouse's benefits may be reduced

If you die after beginning retirement benefits at normal retirement age, your surviving spouse's benefit at normal retirement age will be 100 percent of your primary insurance amount (PIA). However, if you elect early retirement benefits, then die, the highest benefit your spouse can receive based on your

earnings will equal the reduced benefit you were receiving (but not less than 82.5 percent of your PIA). This tradeoff is mitigated somewhat for a working surviving spouse, because at normal retirement age he or she can choose to receive benefits based on his or her own earnings record if that benefit would be greater.

Your family's benefits may be limited by the family maximum

When you retire, your spouse and dependent children may be entitled to benefits based on your earnings record. If eligible, they can each receive a monthly benefit equal to 50 percent of your unreduced PIA. However, the benefit paid to each family member will be reduced if your combined family benefit exceeds the family maximum (150 percent to 180 percent of a worker's PIA). Therefore, if you retire early, you will be penalized twice. First, your benefit will be reduced for each month you retire early, and secondly, your family members will each receive a reduced benefit if the family maximum has been exceeded.

An earned income limit applies to earnings before normal retirement age

If you retire early (prior to normal retirement age), money you earn after you retire may reduce your Social Security benefit. However, if you wait to retire until your normal retirement age, you can earn as much as you like without reducing your Social Security benefit. This means that if you plan on earning a lot of money after you retire, it might be advantageous for you to retire at normal retirement age rather than earlier.

How to do it

Prepare for retirement by ordering a Social Security Statement from the SSA

For more information, see Estimating Your Social Security Benefits. Using this statement, you can:

- See your earnings history--Check to make sure your earnings history is accurate. Then, use your earnings history to determine whether delaying retirement past age 62 would make sense. You should look to see whether or not you have any years of zero earnings or very low earnings that might be included in the calculation of your AIME. If you do, you might want to consider working longer in order to replace those years with years of higher earnings. For a more detailed discussion of this strategy, see Increasing Your Average Indexed Monthly Earnings (AIME).
- Check your insured status--Look at how many Social Security credits you have in order to determine whether you will be fully insured at age 62 for retirement benefits. Most people need to have 40 credits (10 years worth) in order to be fully insured.
- Find out what your benefit will be at a certain age--You can use the information on your benefit statement to compare what benefit you might receive at your normal retirement age with the benefit you might receive at age 62 (or another early retirement age). You can use this to determine if you would earn more overall by retiring early or by waiting to retire.

Decide whether you want to retire early by weighing your options

Although for many people, the financial advantage of retiring early will outweigh other concerns, you should carefully consider all aspects of retirement before deciding to retire early. Consider the following questions:

- Will your lifetime benefit be higher if you retire early or you retire at normal retirement age?
- Can you wait to receive benefits, or will you need retirement income as soon as you retire?
- Are you emotionally ready to retire?
- Do you anticipate going back to work after you retire?
- How will your early retirement affect your family? Will their Social Security benefits be affected? Will your benefits be subject to the family maximum?
- How will you pay for medical insurance coverage until age 65 (when you become eligible for Medicare)?

Fill out an application with the SSA

If you are eligible for retirement benefits and want to retire early, fill out a benefit application two or three months before your 62nd birthday (or before your retirement date, if later). For more information, see Social Security Retirement Benefits.

Tax considerations

If you retire early, will your benefits be taxed differently?

Social Security retirement benefits received at any age are not taxed if your total income (modified adjusted gross income) plus one half of your Social Security is \$32,000 or less if you file a joint tax return or \$25,000 or less if you file a single tax return. If your total income plus one half of your Social Security exceeds this amount, then up to 85 percent of your Social Security benefit may be taxed, depending on the circumstances. If you think that your earnings prior to normal retirement age will make your Social Security benefits taxable, you can either try to reduce your earned income or consider retiring later (if doing so would lessen your tax liability).

Tip: Special rules may apply if you file as married filing separately and you lived with your spouse at any time during the year.

Questions & Answers

If your company is downsizing and you are close to age 62, should you apply for early retirement benefits or look for another job?

Retiring early may be the right decision for you, but don't decide hastily. Take time to consider both your personal needs and your financial ones. If you weren't being laid off, would you retire early

anyway? If the answer to this question is yes, then early retirement might be right for you. If the answer is no or if you're not sure, consider other options. If your employer is giving you severance pay, you might have enough income to be able to postpone retirement past age 62. For every month you postpone retirement, your monthly benefit will increase. You might also be eligible for unemployment benefits that will enable you to postpone retirement.

If you become disabled at or after age 62 and have not yet retired, is it better to apply for Social Security disability benefits or early retirement benefits?

If you're unable to work because of illness or injury at any age, you may qualify for Social Security disability benefits. Although there is a five-month waiting period for benefits, once you begin receiving benefits you will receive 100 percent of your primary insurance amount (PIA). Even though there is no waiting period for early retirement benefits, you will receive only 80 percent of your PIA at age 62. In addition, once you have disability status, you will be eligible for a trial work period. You have nine months to try to work and still receive your disability benefit. If you retire early, you can always go back to work, but your earnings may reduce or eliminate your benefit. However, be aware that qualifying for Social Security disability benefits may be difficult. For more information on disability benefits, see Social Security Disability Benefits.

If you want to elect delayed retirement benefits and you are married, does this mean that your spouse won't be able to elect early retirement benefits?

Not exactly. Your spouse can begin collecting Social Security retirement benefits based on his or her own earnings record at age 62, whether or not you are retired. However, if your spouse wants to base his or her benefit on your earnings record, he or she has to wait until you retire to begin receiving benefits.

How will your spouse's benefit be affected if you elect to receive early retirement benefits but your spouse is already at normal retirement age and wants to receive benefits based on your PIA?

Your spouse's benefit will not be reduced if you retire early. A spouse's retirement benefit is only reduced if the spouse is under normal retirement age and decides to receive retirement benefits early. Because your husband is already normal retirement age, his benefit will be 50 percent of your PIA, the same benefit he would receive if you retired at normal retirement age.

Will your dependent child receive less benefit if you elect early retirement benefits than he or she would if you retired at normal retirement age?

No. If you retire early, your child will receive a benefit equal to 50 percent of your PIA, the same benefit he or she will receive if you retire at normal retirement age.

Disclosures

This material does not constitute the rendering of investment, legal, tax or insurance advice or services. It is intended for informational use only and is not a substitute for investment, legal, tax, and insurance advice.

State, national and international laws vary, as do individual circumstances; so always consult a qualified investment advisor, attorney, CPA, or insurance agent on all investment, legal, tax, or insurance matters.

The effectiveness of any of the strategies described will depend on your individual situation and on a number of other factors. After reviewing your personal situation, we may recommend that you not use any strategy in this document but instead consider various other strategies available through our practice.

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