WELLS FARGO ADVISORS

Important Social Security claiming strategy changes

New rules highlight the value of planning ahead

The Bipartisan Budget Act of 2015 (enacted on November 2, 2015) includes a mixed bag of changes to Social Security claiming rules. Congress described these actions as "closing unintended loopholes" to protect the overall Social Security system's solvency. The changes may provoke dismay from some individuals and sighs of relief from others. This report looks at what's changing and who may be affected.

Keep in mind, this report is a simplified explanation of a very complex topic. We'll discuss some common scenarios, but your own situation likely differs. Be sure to explore your options thoroughly. Before you visit your local Social Security office, discuss your situation with your Financial Advisor, who can help put your choices in perspective with a personalized analysis.

The Bipartisan Budget Act of 2015 impacts two important claiming strategies: "restricted application" and "file and suspend."

What's changing

Restricted application strategy

The first change will limit use of this strategy. If you haven't reached age 62 by the close of 2015, it will no longer be possible to file a restricted application to receive spousal benefits (based on someone else's earnings record) while delaying your own retirement benefit (based on your own earnings record).* Instead, an application for *any* Social Security benefit will be deemed to be an application for all benefits you might be entitled to, and you will receive the highest benefit you are eligible for.

However, if you are already age 62 or older on December 31, 2015, these changes do not apply to you. In other words, if your date of birth is *before* January 2, 1954, you will still be able to file a restricted application when you reach full retirement age to receive spousal benefits (to receive benefits based on your spouse's earnings) while deferring your own retirement benefit (based on your own earnings record).

Individuals not in the protected group (those who turn age 62 in 2016 or later years) will not be able to file a restricted application. But planning will still be valuable; attractive claiming strategies will still be available and should be considered.

Important to know

If you have already elected to use the restricted application strategy, this change does not affect you. You can continue to draw benefits based on your spouse's earnings record. You will continue to earn deferred retirement credits and can "switch" at any time to a retirement benefit based on your own earnings record.

File-and-suspend strategy

The second change will limit (but not eliminate) advantages of using this strategy. In the future, if you voluntarily suspend receiving a Social Security benefit, this will also mean that while your benefit is in suspense:

- No one else can draw benefits based on your earnings record
- You cannot simultaneously draw benefits based on someone else's earnings record

* Under Social Security regulations, a person "attains" a particular age on the day before their birthday. So individuals born on January 1, 1954, will "attain" age 62 on December 31, 2015.

It will still be permissible to suspend a benefit, but the consequence will be that you draw nothing until you choose to reinstate your benefit. In most circumstances, the same individual will not be able to claim one benefit now and a larger one later.

Also, under previous law, a person who voluntarily suspends a benefit can later "unsuspend" and request a retroactive lump sum payment of benefits they didn't receive. Under the new rules, you can still change your mind and elect to unsuspend going forward, but you won't be able to recover benefits you declined in the past. However, these new rules will not apply to individuals who have already chosen to file-and-suspend.

Important to know

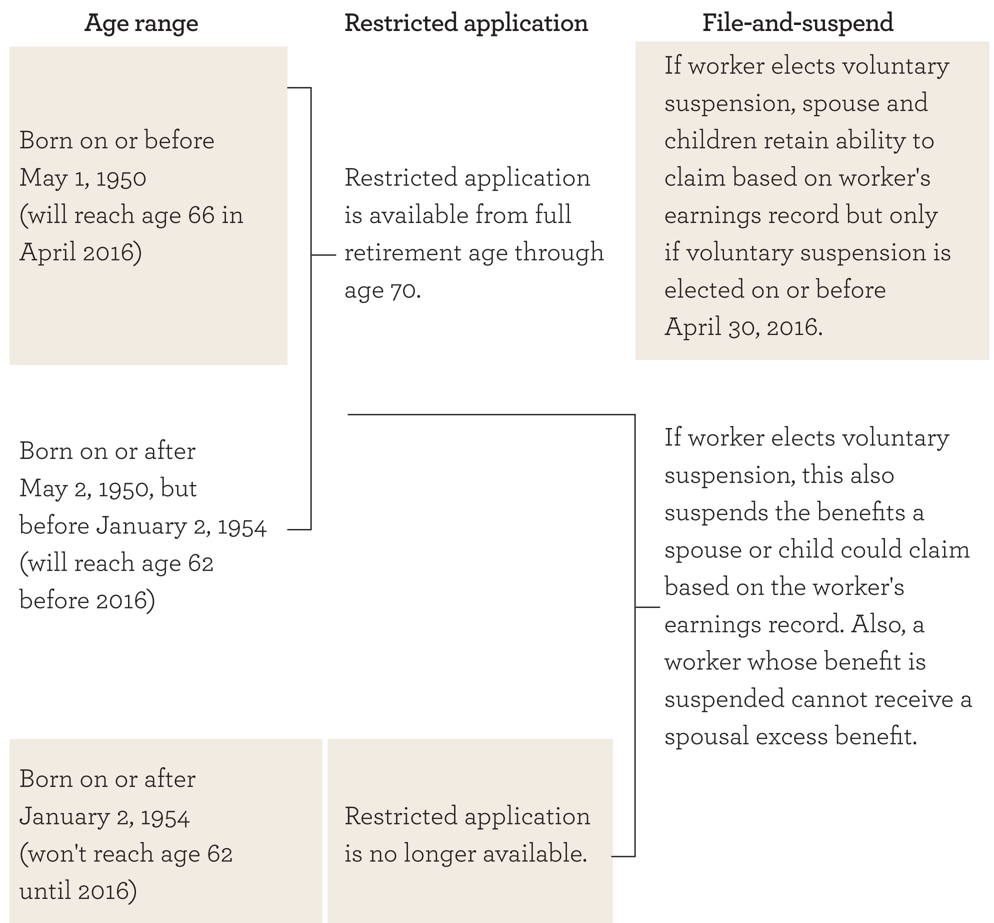
If you have already elected to file and then suspend your benefit, this change does not affect you. Auxiliary beneficiaries, such as a spouse or dependent child, can continue to draw benefits based on your earnings record, even if your own benefit is suspended. You will continue to earn deferred retirement credits while your benefit is suspended. And you retain the ability to change your mind and recover suspended benefits retroactively.

There is a short "grace period" before these rules kick in. The new consequences for file-and-suspend become effective for applications submitted more than 180 days after the date of enactment. The legislation was signed on November 2, 2015. Therefore, the new rule becomes effective on May 2, 2016, and the last business day to file an application under the old rule would be April 30, 2016. This creates an important — but brief — window of opportunity for individuals who have reached age 66 but not yet 70 years of age. (those who have reached full retirement age and also have some time left during which a suspended benefit could grow).

Timely planning tip

If you are already eligible to file-and-suspend (or will be eligible before May 2, 2016), there is a limited time during which you can still choose to suspend your own benefit (in order to be eligible for a larger benefit later) without affecting a spouse's, ex-spouse's, or child's eligibility. Also, if you elect to suspend benefits on or before April 30, 2016, this should preserve your ability to request a retroactive lump sum if you change your mind prior to attaining age 70. **After April 30, 2016, these planning opportunities will disappear.**

Impact on two important claiming strategies



Why delay benefits?

You may be wondering why anyone would want to delay benefits. After all, isn't a bird in the hand worth two in the bush? If that's the case, this may help you understand:

The starting point for determining Social Security benefits is your "full retirement age":

Birth year	Full retirement age
1943-1954	66 years
1955	66 years + 2 months
1956	66 years + 4 months
1957	66 years + 6 months
1958	66 years + 8 months
1959	66 years +10 months
1960 or later	67 years

Source: Social Security Administration, 2015

If you can afford to postpone the start of benefits for a time after full retirement age, you qualify for delayed retirement credits, and your benefit will be increased. The rate of increase is substantial — 8% for each year (or 2/3 of 1% for each month) you wait after full retirement age.

One common motivation for delaying the start of benefits is to "hedge" against longevity and the risk of outliving your savings. If you forgo some benefits early in retirement, you can secure a higher benefit (and a higher base for possible inflation increases) when you are older.

Married couples have an additional motivation. In situations where a lower-earning spouse is likely to outlive a higher-earning spouse, it could be wise to think about securing a higher survivor benefit for the spouse with a more limited earnings record.

Of course, these planning strategies are based on assumptions and probabilities, and our lives do not always play out as expected. There is no guarantee that postponing the start of benefits will produce a superior result. But there are both practical and logical reasons why many individuals and couples should seriously explore a choice to delay the start of Social Security benefits.

Understanding the restricted application strategy

In this strategy, a lower-earning spouse chooses to claim a spousal benefit (based on someone else's earnings record) at or after full retirement age while deferring his or her own retirement benefit (based on his or her own earnings record) to earn deferred retirement credits and qualify for a larger retirement benefit at age 70. This could benefit couples whose earnings records are similar and tends to work best when the higher-earning spouse is the same age or older than the lower-earning spouse.

Here's a hypothetical example:

Martha is 66, and Raymond is 67; both have reached their respective full retirement age. Martha is eligible for a $1,000 per month retirement benefit. Raymond is eligible for a $1,600 per month retirement benefit.

- Martha could draw an $800 per month spousal benefit based on Raymond's earnings record, or Raymond could draw a $500 per month spousal benefit based on Martha's earnings record. (Only one spouse can draw a spousal benefit at any given time; the rules do not permit both to simultaneously draw a spousal benefit from each other.)
- Raymond files first and begins to draw his own $1,600 per month retirement benefit. Martha then files for benefits but indicates she is filing a restricted application for spousal benefits only. Martha begins to receive an $800 per month spousal benefit.
- At age 70, Martha files for retirement benefits based on her own earnings record. Because she waited four years past full retirement age, her retirement benefit at age 70 will be $1,320 per month – 32% higher.

If Raymond and Martha had both claimed their own benefits at full retirement age, their combined benefits would have been $2,600 per month. By using the restricted application strategy, they receive a combined $2,400 per month benefit until Raymond reaches age 70 and $2,920 per month thereafter.* If Raymond and Martha both live beyond their mid-70s, the restricted application strategy would result in arithmetically greater cumulative lifetime benefits.

Of course, under current law this works only if we assume Raymond and Martha were born after May 2, 1950, and before January 2, 1954.

* Note we're ignoring potential inflation adjustments in this hypothetical.

Timely planning tip

Couples who (1) fit the profile for this strategy, (2) are in the protected age group, and (3) have reached their full retirement age may still benefit from filing a restricted application. Even if you are already receiving benefits, it makes sense to re-evaluate your choices.

Understanding the file-and-suspend strategy

In this strategy, a higher-earning spouse claims a retirement benefit based on his or her own earnings record but then chooses to suspend receiving payments. This strategy may fit for married couples when there is a significant disparity between each spouse's earnings records. Prior to the act:

- Once the higher-earning spouse had filed a claim for retirement benefits, the lower-earning spouse would be able to claim a spousal benefit based on the higher-earning spouse's earnings record.
- During the suspension period, the higher-earning spouse would accumulate delayed retirement credits.
- At the death of the higher-earning spouse, the lower-earning spouse would be able to claim a survivor benefit based on the deceased spouse's increased benefit.
- The higher-earning spouse would retain the flexibility to "unsuspend" at any time and reclaim benefits retroactive to the suspension date.

To explain this better, let's walk through a hypothetical example. Fred is age 66 and has reached his full retirement age; Gina is age 62. Fred is eligible for a $2,400 per month retirement benefit.

- Gina is eligible for a $400 per month retirement benefit (based on her own earnings history).
- At full retirement age, she would be eligible for an approximately $1,200 per month spousal benefit (based on Fred's earnings record); however, if she claims at age 62, her benefit would be reduced to approximately $840 per month.
- Fred could file-and-suspend to let his own benefit grow until age 70, *and* Gina could elect to begin receiving her spousal benefit immediately. So the couple would begin receiving $840 per month immediately.
- When Fred reaches age 70, his benefit would have grown to about $3,168 per month. So after four years, their combined benefits would be $4,008 per month.*

If Fred and Gina were in reasonably good health and lived to their statistical life expectancies, Fred's choice to delay benefits would produce a favorable result. If for some reason there was a change in Fred and Gina's financial situation, Fred would also have the option to change his mind at any point before age 70 and retroactively recover the benefits he delayed.

* Again, we're not taking possible inflation adjustments into account.

Under the new law, Fred and Gina will still be able to achieve their goal **but *only* if Fred makes his application to file-and-suspend by April 30, 2016.** After that date:

- Fred would still have the option to file-and-suspend his own benefit, but Gina could not receive any spousal benefit based on his earnings history during the time Fred's benefit was suspended.
- Gina could still file for her own $400 per month retirement benefit (based on her own work record, not Fred's).
- If Fred later changes his mind, he would not be able to recover any of his suspended benefits; however, he would retain the option to unsuspend and begin receiving benefits at any time prior to age 70.

Timely planning tip

Married couples who fit the profile for this strategy but did not use it still have a short time to reconsider. Even if the higher-earning spouse is currently receiving benefits, he or she can choose to file-and-suspend by April 30, 2016, and obtain the benefits available under the "old" rules (including the ability to change your mind and recover the benefits you would have received if you had not suspended).

Deferring the start of a higher-earning spouse's Social Security benefit will continue to be a sensible choice for some (but not all) individuals and couples. Before making a decision, it's important to consider all the pros and cons. The "optimal" choice will vary depending on your unique situation and objectives. When evaluating your options, be sure to consider factors, including your own earnings record(s), your spending needs and desires, affordability, your health, your age, the rate of return you could achieve if you were disciplined enough to take benefits early and invest them, and whether you are emotionally comfortable making a decision based on reasonable expectations that may or may not come to pass.

Potential impact on divorced individuals

The loss of the restricted application strategy could have an impact on divorced individuals who, in some circumstances, are eligible to claim benefits based on an ex-spouse's earnings record. Changes to the file-and-suspend rules could also impact benefits for the dependents of divorced individuals. Divorced individuals who were born on or after May 2, 1950, but before January 2, 1954, should revisit their Social Security options and claiming strategies.

No apparent impact on surviving spouses' benefits

The new law does not appear to change the rules for surviving spouses (widows and widowers). Accordingly, a widow or widower should still be able to choose whether and when to file for survivor benefits (based on a deceased spouse's earnings record) or retirement benefits (based on one's own earnings record). All of the planning opportunities available in the past will remain available.

Pro-active planning is more important than ever

The budget compromise will gradually shut the door on some popular claiming strategies, but Congress left some windows open. The restricted application strategy will continue to be available for some people; that window will close after approximately four years. The window to take advantage of the file-and-suspend strategy is much shorter and will close on April 30, 2016.

Your Financial Advisor with Wells Fargo Advisors has access to sophisticated software that can help analyze many of the Social Security benefit scenarios available to you and help you evaluate which one may best fit your personal circumstances.

You can start the evaluation process by completing a brief questionnaire. To do this, you will need to have information on the projected Social Security benefits available to you (and your spouse, if applicable). This can come from a statement received from the Social Security Administration, by using the retirement estimator at **ssa.gov,** or preferably by creating an account at **ssa.gov**. Your Financial Advisor will use this information to evaluate your Social Security benefit options and help you create a retirement income plan that fits your unique situation and objectives.

These changes highlight an important fact: When it comes to Social Security, it's more important than ever to pay attention, understand your options, and periodically review your choices. Even though some strategies have been taken away, there are still many opportunities to increase potential lifetime Social Security benefits.

Important: Wells Fargo Advisors does not provide individual calculations of projected or total benefits. You should talk with the Social Security Administration representative or go online to get an estimate of benefits. Then work with your accountant or tax advisor to determine which strategy may be most suitable for your retirement needs. Married investors, in particular, will want to discuss any strategy they are considering with their local Social Security Administration representative who may offer other spousal strategies.

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