



**INSIGHTS** | PERSPECTIVES ON WEALTH MANAGEMENT

## Medicare and Social Security

Understanding the A-B-Cs and 1-2-3s for Your Clients



**CUNA Brokerage Services, Inc.**





## INSIGHTS | PERSPECTIVES ON WEALTH MANAGEMENT

### Summary/Introduction

What can strike fear into the heart of a consumer nearing retirement? Ask them to explain how they're factoring Medicare and Social Security into their retirement planning. Both topics are so complex and dynamic that it's not surprising the average consumer feels overwhelmed by them.

Financial advisors can play an important role in helping their clients better understand these topics and make smart financial choices about them—without having to become subject matter experts themselves. There are a number of financial planning tools that easily allow proactive advisors to help their clients review and understand their expenses and income flow, and online resources that help demystify Medicare.

# Medicare and Social Security

## Two topics consumers can't ignore

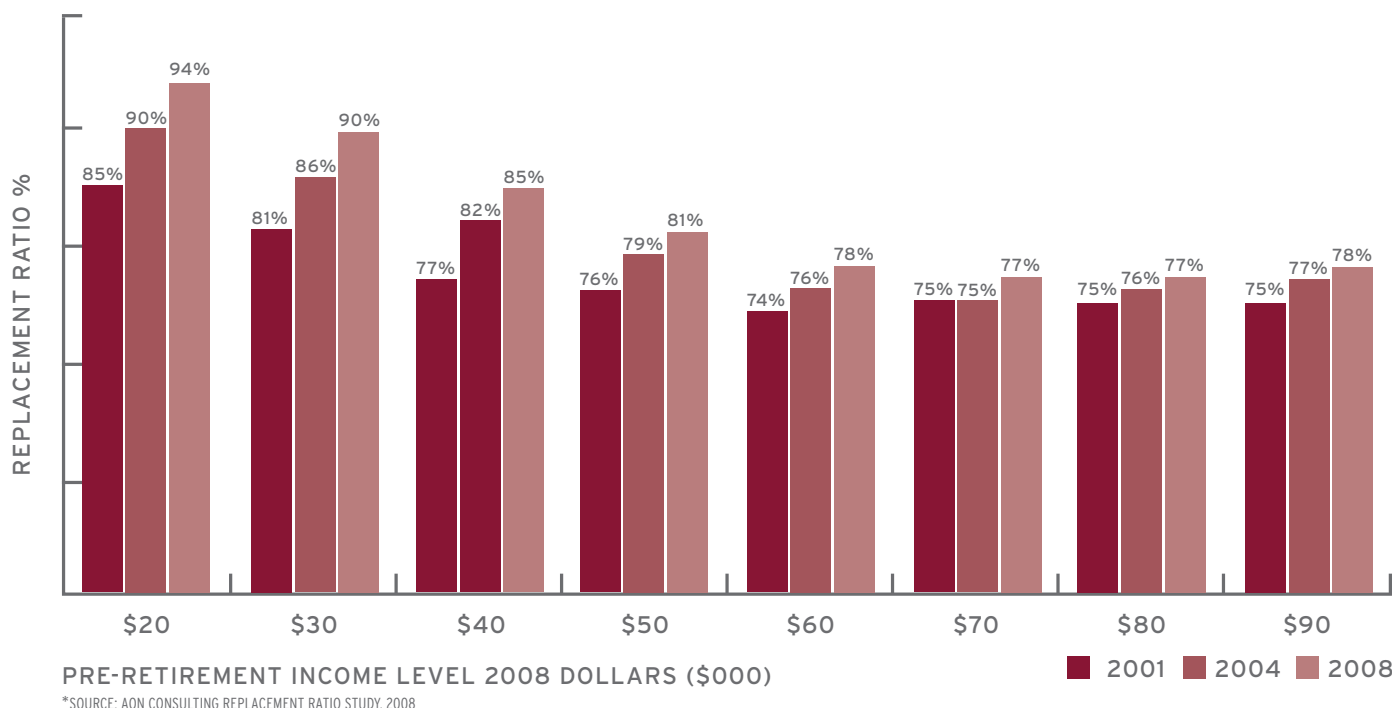
As much as they might like to avoid it when it comes to educating themselves about Medicare and Social Security, what consumers don't know about these subjects could hurt them—and hurt them for a long time. The average consumer will live longer than previous generations and without the safety net of a pension, which means they're likely to be quite dependent on these two programs.

### How much income will consumers need in retirement?

The short answer for most is “more than they think.” A study by Aon Consulting\* showed a concerning trend: on average, retirees of all income levels—but especially low-income retirees—would need to replace an increasing share of their income in retirement. In fact, those at the lowest income levels will almost need to match their pre-retirement income. (see graph below)

“It's important to consider that these numbers are averages,” said Cindi Hill, CFP®, CRPC®, a retirement solutions consultant with CUNA Brokerage Services. “As individuals head into retirement, they need to sit down and figure out their own budget—it might be very different.”

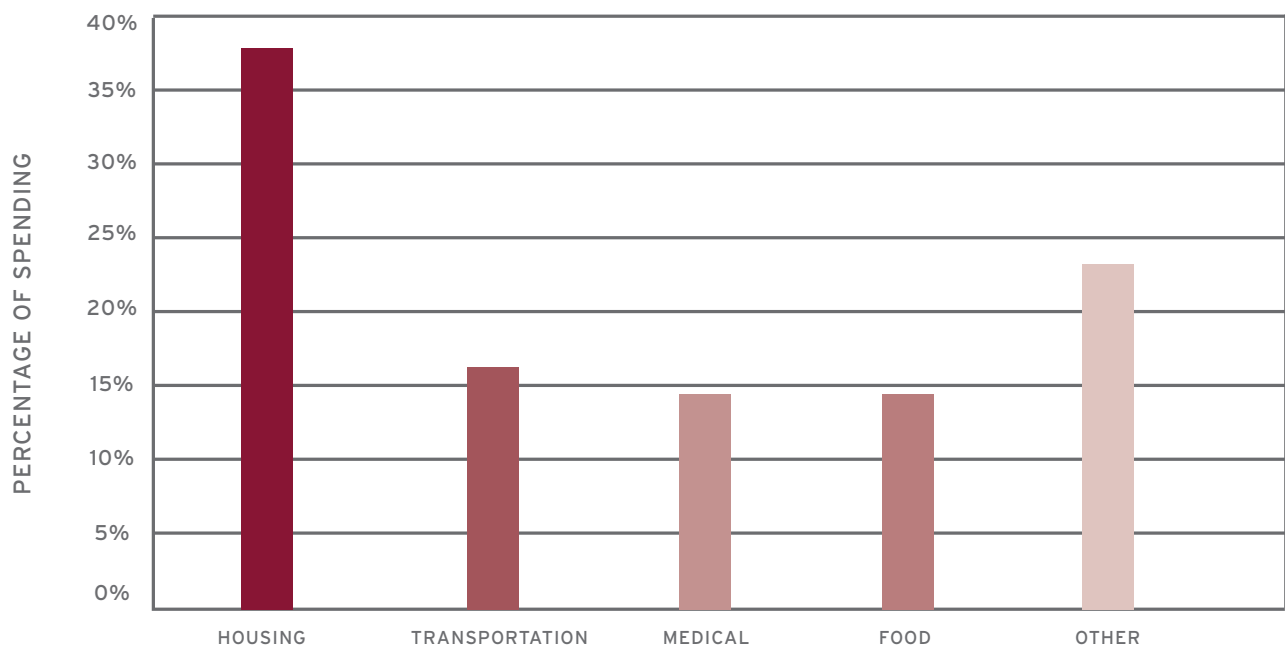
### Comparison of 2001, 2004, and 2008 Required Replacement Ratios, Adjusted for Inflation



## Main expense areas in retirement: housing, transportation, medical/food.

It's probably not surprising that the three main places where retirees will spend money are housing, transportation, and medical/food. It's especially important to consider medical costs because they tend to be much higher than people expected.

### Retiree Spending



SOURCE: "GUIDE TO RETIREMENT," J.P. MORGAN, 2015 EDITION.

Research by the Bankers Life and Casualty Company<sup>1</sup> uncovered the following:

- Over half of Baby Boomers think they'll pay less for healthcare in retirement or have no idea of Medicare costs.
- Almost half of Medicare enrollees paid more for healthcare than expected.
- Over half of boomers say they have a poor understanding or know almost nothing about Medicare.

"Research suggests that only 15% of the population takes the time to estimate future healthcare needs<sup>2</sup>, which means the majority of consumers have no idea what their healthcare costs are likely to be," Hill said. "Healthcare costs tend to rise much faster than other expenses in retirement. Even if they can get a feel for initial costs, consumers have a hard time estimating future expenses."

In addition, many retirees have little understanding of how Medicare works—which is a big concern considering that most will depend on it to cover at least part of their medical expenses.

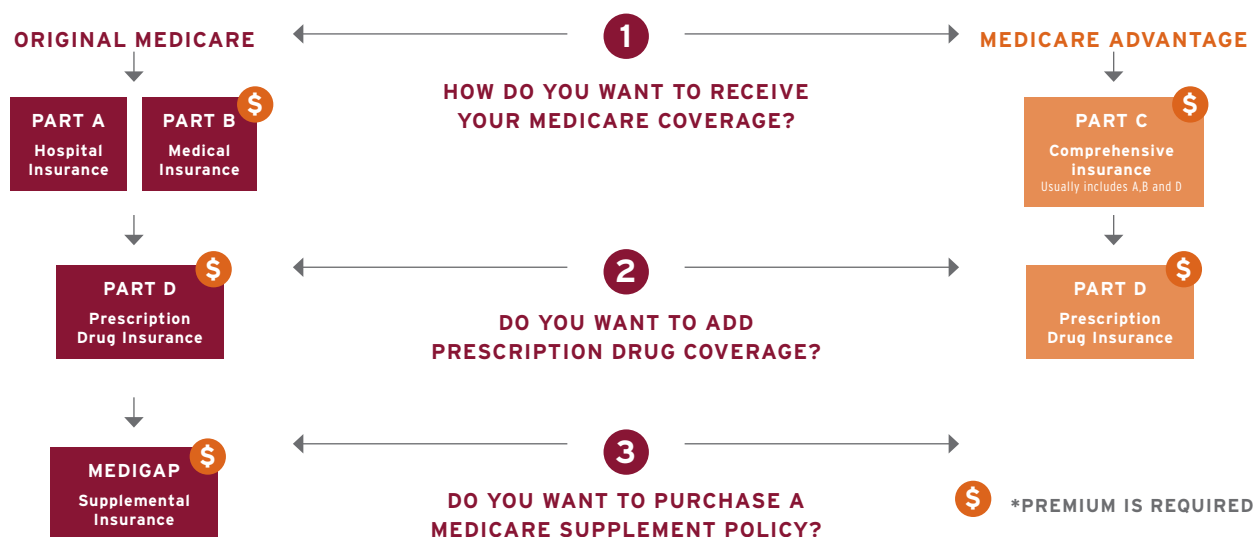
<sup>1</sup>SOURCE: "RETIREMENT HEALTHCARE FOR MIDDLE-INCOME AMERICANS", BANKERS LIFE AND CASUALTY COMPANY, 2012

<sup>2</sup>SOURCE: 2011 MERRILL LYNCH STUDY: HEALTHCARE COSTS IN RETIREMENT GUIDE

# Medicare Made Simple

“There are a number of considerations and costs to weigh when determining the best route to take regarding Medicare,” Hill stresses. “Which benefits you get, which doctors and hospitals are participating, what you’ll pay for a subscription.”

Let’s consider the elements that comprise Medicare and the two paths consumers can take to gain coverage.



SOURCE: CUNA MUTUAL GROUP

- **PART A:** Covers hospital benefits (hospitalization, skilled nursing, home health care, and hospice). It typically doesn’t require a premium but there are deductibles and coinsurance. This benefit is free to anyone who has paid the payroll tax for 40 quarters (those who have worked less can pay monthly premiums) and spouses, ex-spouses, and survivors of those who paid into the system will also be eligible for free coverage.
- **PART B:** Covers medical benefits (physicians’ services, diagnostic x-rays, lab tests, and certain preventative services) and has a premium associated with it. This premium can be higher for those who are subject to income-related adjustments. Anyone who’s eligible for Medicare can purchase this.
- **PART D:** This is the prescription drug benefit and is available to everyone who’s eligible for Medicare. It’s delivered through private insurance companies. Premiums and coverage will vary based on the plan. Higher earners can be subject to an income-related adjustment resulting in higher premiums.
- **PART C:** Also known as Medicare Advantage, this provides an alternative path to coverage and includes Parts A, B, and usually D. It provides some additional insurance to cover the gaps of traditional Medicare, such as vision, hearing, dental, and wellness programs. Recipients still have to enroll in Parts A and B to receive it. If a consumer opts for Part C, they cannot purchase Medigap insurance, which is a way for consumers to cover expenses not met by Medicare.

## Choosing between Original Medicare and Medicare Advantage

### ORIGINAL MEDICARE:

- Allows more hospital and care provider choices—can select any hospital or provider (in any place) as long as they accept Medicare
- Typically better for people who travel a lot
- There are coverage gaps—consumers will typically need to also sign up for Medigap coverage
- Tends to have a more expensive base cost

### MEDICARE ADVANTAGE:

- Works like a PPO/HMO
- Have to use hospitals/providers in network
- Usually covers broader range of services
- Tends to be less expensive—as long as the consumer uses in-network care

## What do financial advisors *really* need to know about Medicare?

“Although it isn’t your job to become a Medicare expert, you should be able to help clients with a few key things,”

Hill recommends. These include the following:

### IT’S CRITICAL TO ALERT CLIENTS TO PERMANENT PENALTIES FOR SIGNING UP AT THE WRONG TIME.

“If your clients don’t sign up for the various elements of Medicare when they’re supposed to, they could be penalized for the rest of their life,” Hill said.

**USE FINANCIAL PLANNING TOOLS TO HELP ESTIMATE HEALTHCARE EXPENSES.** There are a number of financial planning tools that advisors can use to help clients predict and prepare for their healthcare expenses. For instance, MoneyGuidePro®, offers this functionality.

### ILLUSTRATION

Health Care Expenses in Retirement (SMART Goal)

Enter the following information.

Description: 

Health Care

Modified Adjusted Gross Income (MAGI)

The premiums you pay for Medicare Part B (medical insurance) and Part D (prescription drug coverage) are dependent on your MAGI, which is the total of your adjusted gross income and tax-exempt interest income. (See [ssa.gov](https://www.ssa.gov) or SSA Publication No. 05-10536 for more information.)

Select your estimated MAGI in retirement: 

Up to \$170,000

Health Care Cost Schedule

Period	Description	Bob						Betty						Annual Total
		Private Insurance Prior to Medicare	Medicare Part B	Medicare Part D	Medigap Policy	Out-of-Pocket	Bob Total	Private Insurance Prior to Medicare	Medicare Part B	Medicare Part D	Medigap Policy	Out-of-Pocket	Betty Total	
2015 - 2038	Both Medicare	\$0	\$1,259	\$701	\$2,100	\$1,860	\$5,920	\$0	\$1,259	\$701	\$2,056	\$1,860	\$5,876	\$11,796
2039 - 2041	Betty Alone Medicare	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$1,259	\$701	\$2,056	\$1,860	\$5,876	\$5,876
Total Lifetime Cost of Health Care (in current dollars)		\$142,075						\$158,647						

**RECOMMEND AN ANNUAL REVIEW OF MEDICARE PART D USING ONLINE TOOLS.** Ongoing studies have found that just over 5% of Medicare Part D beneficiaries are getting the cheapest plan for their needs<sup>3</sup>. Each year recipients have the opportunity to review their current plan—this currently happens from October 15 to December 7—and decide if it's the best fit. To help determine that, consumers can rely on two tools.

- **MEDICARE.GOV/FIND-A-PLAN** is for those who are more tech-savvy and comfortable navigating the Internet on their own.
- **SHIPTACENTER.ORG** is the State Health Assistance Program website. It's a free call-in service that connects consumers to counselors—either on the phone or face-to-face—who are trained and certified to answer questions about Medicare, Medicare Advantage, Part D plans, Medigap, and Medicaid.

## The income side of the equation

Research by the Social Security Administration reveals that, on average, Social Security is consumers' largest source of retirement dollars. Consumers must know how to optimize this income stream.

### Average monthly income percentage for a retired worker by source

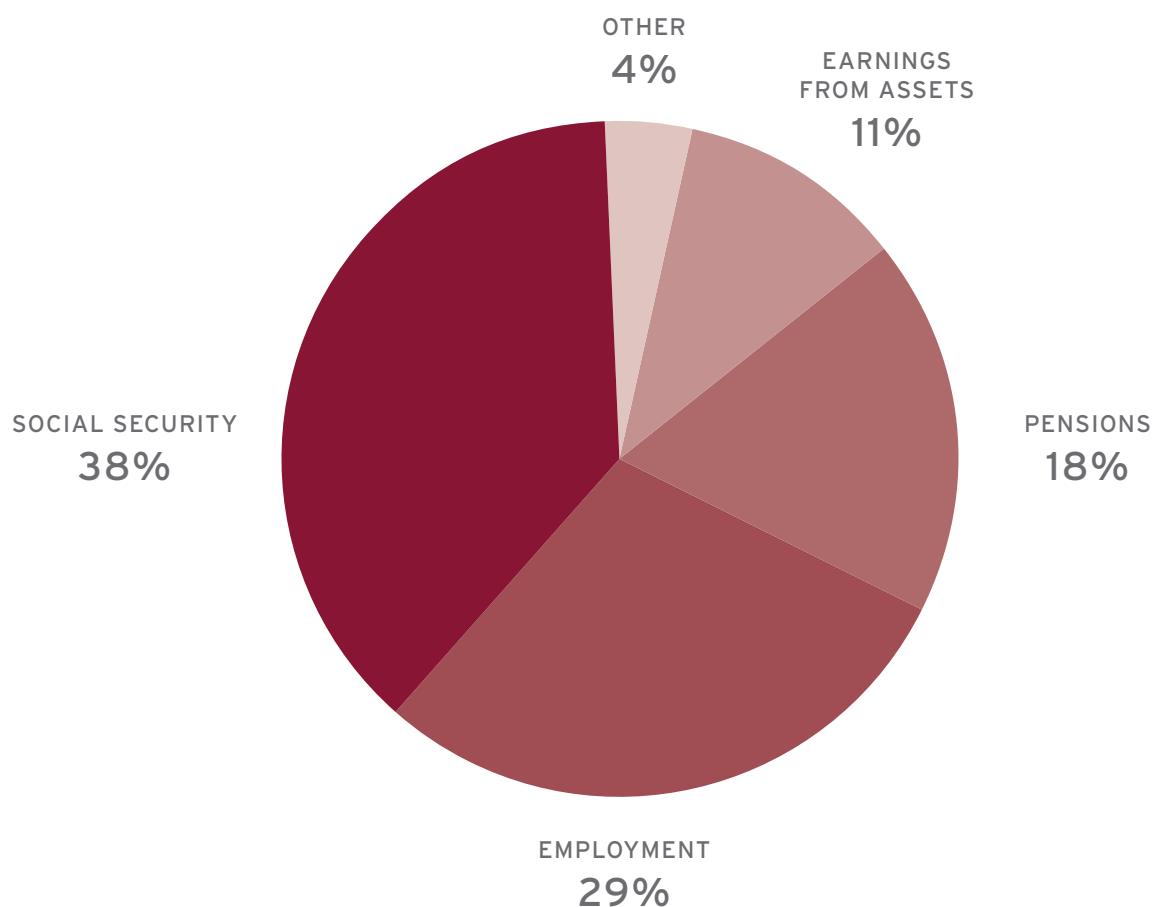


CHART SOURCE: SOCIAL SECURITY ADMINISTRATION, 2014. "2015 SOCIAL SECURITY CHANGES"

<sup>3</sup> SOURCE: "THE VAST MAJORITY OF MEDICARE PART D BENEFICIARIES STILL DON'T CHOOSE THE CHEAPEST PLANS THAT MEET THEIR MEDICATION NEEDS," ZHOU AND ZHANG, 2012



## Ten Rules for receiving and optimizing Social Security income

**RULE 1:** Eligibility. Just like Medicare, the threshold to receive the benefit is a minimum of 10 years of employment—in this case, in a Social Security-covered job. Spouses, ex-spouses, and surviving spouses may also be eligible for benefits based on those received by a working spouse.

**RULE 2:** Benefit formula. The formula for receiving Social Security benefits is as follows:

- The 35 years of highest earnings (any years without income are filled in with “\$0”)
- Earnings are adjusted for inflation and divided by 35 to get an average
- That amount is divided by 12 to calculate the average indexed monthly earnings (AIME)
- Then, a three-part formula is applied to this to determine the primary insurance amount (PIA), aka the monthly Social Security benefit.

**RULE 3:** Full retirement age (FRA). FRA is the age a person can receive their PIA based on their earnings history.

### Full retirement age

YEAR OF BIRTH	FULL RETIREMENT AGE
1937 And Prior	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
1943-54	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

Those born on January 1 should use the full retirement age for the previous year.

SOURCE: SOCIAL SECURITY ADMINISTRATION





**RULE 4:** Recipients can apply for benefits at 62—at a cost. Each person will need to weigh their individual circumstances when determining the right time to start their Social Security benefits. Clients must know that if they apply for benefits before reaching their FRA, they'll receive the reduced amount for the rest of their life.

For instance, someone with a PIA of \$2,000 would get these monthly benefits (at right) if they retire before their FRA of 66.

**RULE 5:** There's a benefit for waiting longer—especially for going past FRA. Just as consumers will receive a lower monthly payment if they collect early, they'll collect a higher one if they wait. Consumers can opt to delay receiving their benefits up until the age of 70 and, if they do, they'll increase their benefits by 8% per year.

To illustrate the benefit, assume a PIA of \$2,000 at FRA. Here's how that would look for each year the recipient waited to start collecting. And they'd receive (at right) this amount each month for the rest of their life.

**START AGE      PERCENTAGE  
APPLIED TO PIA      REDUCED  
LIFETIME BENEFIT**

62	75.0%	\$1,500
63	80.0%	\$1,600
64	86.7%	\$1,734
65	93.3%	\$1,866
66	100.0%	\$2,000

**START AGE      PERCENTAGE  
APPLIED TO PIA      REDUCED  
LIFETIME BENEFIT**

66	100%	\$2,000
67	108%	\$2,160
68	116%	\$2,320
69	124%	\$2,480
70	132%	\$2,640



**RULE 6:** Spouses also qualify for a benefit—even if they weren’t employed. One of the most important benefits of Social Security is that it can provide income to the primary worker (i.e., the one with the higher income) and to their spouse. But be aware: spousal benefits can’t be applied for until the primary earner has applied to receive Social Security. If the spouse was also employed, their benefit will be determined by their own earnings, or set at a maximum of 50% of the spouse’s earnings—whichever is higher.

**RULE 7:** Ex-spouses can receive benefits. An ex-spouse can receive benefits if the marriage lasted at least 10 years and the person receiving benefits remains unmarried.

**RULE 8:** Surviving spouses can also receive benefits. At the death of a spouse, the surviving spouse can receive up to 100% of the deceased spouse’s benefit if it is larger than their own. A surviving spouse can collect benefits as early as age 60.

**RULE 9:** Some benefits may be withheld if a person applies before retirement age and continues to work. Those who are under FRA when they apply for benefits and continue to work could receive a lower Social Security benefit depending on their income. This is adjusted once a recipient hits FRA. “People need to be aware of this penalty if they apply before full retirement age,” Hill emphasized. “If they continue to work and expect to get 100% of their Social Security benefits before they hit FRA, they could be caught off guard.”

**RULE 10:** Social Security benefits can be taxable. Past certain income thresholds, a Social Security recipient will be taxed on between 50% and 85% of their Social Security payments.

**Your social security benefits may be taxable, depending on how much other income you earn.**

**SINGLE OR HEAD OF HOUSEHOLD**

**50% TAXABLE IF YOU HAVE \$25,000 COMBINED INCOME**

**85% TAXABLE IF YOU HAVE \$34,000 COMBINED INCOME**

**MARRIED, FILING JOINTLY**

**50% TAXABLE IF YOU HAVE \$32,000 COMBINED INCOME**

**85% TAXABLE IF YOU HAVE \$44,000 COMBINED INCOME**

Combined income is defined as your adjusted gross income plus nontaxable interest plus 1/2 of your social security benefits.

SOURCE: “SOCIAL SECURITY AND RAILROAD RETIREMENT BENEFITS,” SSA PUBLICATION 915, SOCIAL SECURITY ADMINISTRATION, 2013.

## Helping clients maximize their benefits

As these 10 rules illustrate, there are a number of factors to consider when determining how and when to apply for Social Security benefits. This can become complicated very quickly. For this whitepaper, be aware of these overarching issues:

**DELAYED PAYMENT STRATEGIES ARE CHANGING.** Recent legislative changes have affected advance claiming options for Social Security.

- **THE FILE AND SUSPEND** strategy ended in April 2016—though anyone participating at the time was grandfathered in.
- **THE CLAIM NOW, CLAIM MORE LATER** strategy, which is also known as “restricted application,” will end for those turning 62 in 2016 or later. For those who were already 62 or older in 2016, this will be available until 2020.

**IT CAN STILL MAKE SENSE TO DELAY.** With recent legislative changes it might seem like it doesn’t make sense to have a Social Security strategy. Nothing is farther from the truth: It’s still important to analyze and be aware of how various tactics will play out for clients.

As the example below illustrates, if a primary earner waits until FRA—or even past it—to apply for Social Security benefits, that can add up to a big difference in lifetime benefits for both the retiree and their spouse.

If the primary earner (Bob) waits until 70 to claim benefits and he lives to 85 and his wife, Betty, lives to 90, they’ll receive over \$55,000 more in benefits than they would have at FRA.



### IF BOTH CLAIM AT 66

Bob claims his full retirement age PIA of \$2,000 at 66

### IF BOB WAITS UNTIL 70

Because Bob waited until 70 to claim his benefit, he’s earned delayed retirement credits that increase his PIA to \$2,640



Betty has her own PIA of \$800, but begins the higher \$1,000 spousal benefit at age 66 based on Bob’s benefit.

With Bob waiting until 70, Betty begins receiving her own benefit of \$800 at age 66. At 70, Betty will receive the higher spousal benefit of \$1,000.



At 66, Bob and Betty have a combined payment of \$3,000—at end of retirement\*, they will have received a total of \$840,000\*\*

At 70, their combined payment is now \$3,640—at end of retirement\*, they will have received a total of \$895,680\*\*

\* ASSUMES BOB LIVES TO 85 AND BETTY LIVES TO 90.

\*\* ASSUMES NO COST-OF-LIVING ADJUSTMENTS (COLAs)



## Conclusion

Given their increasing reliance on government programs in retirement, it's vital for consumers to have a strong understanding of their healthcare spending in retirement and to have a strategy in place to optimize their income. Advisors are not required to become experts in Social Security qualifications and Medicare programs. But as new client service standards come into play in 2017 and 2018, it may be increasingly vital that advisors understand how these programs factor into a client's story, and where to direct them for resources that provide greater understanding of their options.

**Cindi Hill**, CFP®, CRPC®, is the Retirement Solutions Consultant for The Center for Advisor Excellence™, the training and consulting group of CUNA Brokerage Services, Inc. Cindi works with financial advisors nationwide consulting on various aspects and issues in retirement planning. Her areas of expertise include IRAs, qualified retirement plans, Social Security claiming strategies and Medicare planning. She provides comprehensive insights into the retirement income planning process by providing strategies and solutions addressing the key areas of risk in retirement.



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