Nationwide®
is on your side

Social Security

White paper

NATIONWIDE RETIREMENT INSTITUTE®

The Nationwide Retirement Institute® provides practical thought leadership through timely insights and education, client-ready tools and consultative support. Our comprehensive approach helps financial advisors, plan sponsors and clients break down and simplify the most complex retirement challenges.

Your Social Security Opportunity

Identify clients able to take advantage of a closing loophole

Steve Calandra

Vice President, Nationwide Retirement Institute®

Steve has more than 18 years of financial industry experience and is dedicated to educating advisors, clients and plan participants about the latest retirement income planning trends. His areas of focus include Social Security, Medicare, health care, long-term care and retirement income planning. Steve has his FINRA Series 7, 63, life and annuity licenses, is certified in long-term care (CLTC), achieved his Registered Corporate Coach (RCC) designation, and is recognized by the National Speakers Association.

After Congress passed the Bipartisan Budget Act of 2015, many financial professionals were unsure how it affected certain Social Security filing strategies. Namely, was the valuable strategy of filing a "restricted application for spousal benefits" now a thing of the past? The simple answer is no. While this strategy has already begun being phased out, there are clients who will be reaching their full retirement ages (FRA) over the next year who are still able to take advantage of it. Therefore, 2019 and the following four years hold tremendous opportunity for financial advisors to identify these clients and help them consider this soon-to-be eliminated filing strategy.

This paper will provide some historical perspective for how the strategy came into existence, discuss the current opportunity and explore additional considerations you and your clients should be aware of.

Terms used throughout this paper:

Participant – Refers to an individual receiving Social Security benefits.

Full retirement age (FRA) – The age when a participant receives 100% of their Social Security benefit.

Primary Insurance Amount (PIA) – The monthly Social Security benefit a participant receives at their full retirement age.

The strategy and its history

To start, it's important to discuss the two basic classes of Social Security retirement benefits:

- Retirement insurance benefits (RIB), which are based on a participant's work record
- Auxiliary benefits[1], introduced with the 1939 amendments to the Social Security Act, which were created to provide support to those who didn't have their own work record and were dependent on the earnings of a primary wage earner

In general, when a participant files for Social Security benefits, the application is treated as an application for all benefits they are eligible for upon the date of filing. In a two-earner household, this means the participant will receive his or her own benefit automatically (their RIB), plus any excess that is provided by the benefit based on their spouse's work record (an auxiliary benefit). For example, if a higher-earning spouse had a $2,500 benefit at FRA, based upon their own work, and a $900 spousal benefit, based upon the work of their spouse, they would receive $2,500, effectively forfeiting the benefit based on their spouse's work. In this example, we've outlined the "naïve" Social Security strategy in which a participant either files online with no special instructions or visits a field office and files a standard application for benefits.

Over the last several years, many financial advisors began helping their clients employ more sophisticated claiming strategies aimed at helping them obtain the largest possible lifetime benefit for their household.

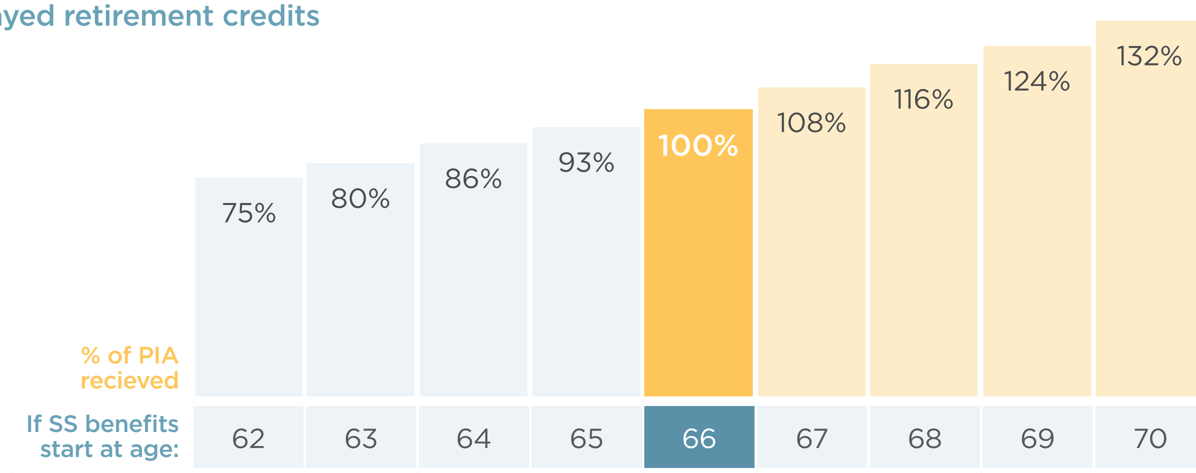
One of these strategies includes filing a "restricted application for spousal benefits." Let's explore the example to help explain the strategy and its benefits:

Rather than filing a standard application, the higher earner could restrict their benefit application to only receive spousal benefits, which would allow them to claim the $900 monthly benefit based on their spouse's work record. While collecting the spousal benefit, they are also able to delay and increase their own benefit, to be used at a later date. The advantage is two-fold:

- The higher earner receives a spousal benefit that would have simply been forfeited. This alone can be worth tens of thousands of dollars.
- While receiving the spousal benefit, the higher earner is delaying and increasing their own benefit for each year of delay, up to age 70 (see chart below on delayed retirement credits). That increased benefit continues for the rest of their life and, importantly, is passed on to the surviving spouse as a larger survivor benefit. The household value of an increased survivor benefit is regularly in the tens of thousands and can be worth hundreds of thousands of dollars.

While filing a restricted application for spousal benefits can significantly boost a household's lifetime benefit, it's not a strategy for everyone. Considering it for a client assumes they can afford to delay one of their two Social Security benefits - which means sacrificing retirement income in their early and mid-60s for the potential upside of a larger benefit (for each year of delay up to age 70). It's important to understand your clients' unique situations and to discuss this trade-off with them when evaluating the strategy.

Delayed retirement credits



The restricted application is not a strategy that Congress intended to exist. It came about due to the intersection of various changes to Social Security rules[2], specifically:

- the ability to claim early retirement benefits, in 1956 and 1961
- the adjustment of delayed retirement credits, to be actuarially fair, beginning in 1972.

One of the original goals of the 1935 Social Security Act was to allow, and potentially incentivize, older workers to retire from the workforce to make room for younger workers[3]. From 1935 to 1956, Social Security benefits were only available to an individual participant over age 65 who had stopped working. In 1956 for women and in 1961 for men, amendments made it possible to claim retirement benefits as early as age 62, with a reduction in monthly benefits for claiming early. To prevent people from "gaming" the new rules, a provision called "deemed filing" was introduced[2], requiring any claim for benefits prior to FRA to be treated as a claim for all benefits available to the participant. In other words, a participant should not be able to claim a reduced retirement benefit at 62, then switch over to an unreduced spousal benefit at 65. At that time, there was no incentive to delay past FRA, so there was no reason for deemed filing to apply past FRA.

The 1972 amendments changed that, as a 1% per year delayed retirement credit was introduced for retirement benefit claims that occurred after FRA. The credit was modified in 1977 to 3% and again in 1983 to the current structure that provides 8% per year of delay for people born 1943 or later[2] (again, see chart on previous page on delayed retirement credits). Thus, the ability to file a restricted application for spousal benefits has existed for decades, but it was a losing proposition. As life expectancies have increased, interest rates have fallen, and the amount of the delayed retirement credits have increased, the results of the calculation have changed such that most couples with average life expectancies could benefit by delaying the benefits of at least one member of the couple. When delaying is valuable, filing a restricted application becomes increasingly so because it allows a participant to collect a spousal benefit, while their own benefit grows due to delay. Yet, of the total population of Social Security claimants, few have used the strategy. According to the Social Security Administration, "as of December 2014, less than 0.2% of Old-Age and Survivors Insurance beneficiaries were using these aggressive claiming strategies." ("Old-Age and Survivors Insurance beneficiaries" refers to Social Security participants claiming *retirement* benefits and does not include those claiming *disability* benefits.)

The opportunity

Significant changes to Social Security claiming rules occurred in November of 2015 with the passage of The Bipartisan Budget Act, in which Congress intended to eliminate two advanced filing strategies, including filing a restricted application for spousal benefits. The legislation imposed a deadline of 180 days to eliminate another advanced filing strategy known as "file and suspend" (which has already sunset), while the restricted application for spousal benefits strategy faced a considerably more lenient deadline, **allowing anyone born on or before January 1, 1954 to continue to use the strategy**[2]. Fast forward to today, and the last of this age group will have recently reached their FRA in 2018 or be reaching it in 2019.

As financial professionals, there is an opportunity to increase the value to our clients by ensuring they are aware of their options and understand the impact to their retirement. Congress wasn't blind to the fact that they were preserving this valuable strategy for near-retirees. This was an intentional effort not to remove this option for people on the edge of retirement who may have been counting on it as part of their overall retirement income strategy. Many are not aware that this strategy is still viable; therefore, it's important to educate the greatest number of your clients on the opportunity Congress allowed by phasing out the strategy rather than abruptly cutting it off.

With the remaining clients able to take advantage of this strategy being at or on the cusp of reaching their FRA, there is still a small window to identify these clients, quantify the value this strategy could have on their retirement and help them understand how to claim these benefits. **Financial advisors should consider going through their book of business to ensure that all clients who were born on or before January 1, 1954 are aware of the option to file a restricted application for spousal benefits.**

Let’s demonstrate the strategy and its value

Jim and Linda, a married couple, are working with their financial advisor and comparing three different Social Security filing options to see how each decision would impact their retirement.

- Jim was born December 15, 1953 and Linda was born June 1, 1957 (65 and 61 years old, respectively, at the beginning of 2019)
- Jim’s PIA, which is the technical term for the monthly benefit one receives at their FRA, is $2,300, and Linda’s PIA is $1,600
- Assumes a life expectancy of 85 for Jim and 88 for Linda and an annual cost of living adjustment of 2.5%

Both claim as early as possible		
Retirement	**Spousal**	**Survivor**
$1,031,927	$0	$308,835
Total benefits: $1,340,762		
Increase vs. filing early: N/A		

PLEASE NOTE:
- Jim files a standard application at age 65.
- Linda files a standard application at age 62.

Both file at their FRAs		
Retirement	**Spousal**	**Survivor**
$1,083,058	$0	$317,594
Total benefits: $1,400,652		
Increase vs. filing early: $59,890		

PLEASE NOTE:
- Jim files a standard application at his FRA of 66.
- Linda files a standard application at her FRA of 66 years 6 months.

Utilize the restricted application for spousal benefits strategy		
Retirement	**Spousal**	**Survivor**
$1,110,331	$40,765	$419,284
Total benefits: $1,570,380		
Increase vs. filing early: $229,618		

PLEASE NOTE:
- Jim files a restricted application for spousal benefits based on Linda’s earnings record at age 66.
- Jim then files for his own benefit at age 70.
- Linda files a standard application at age 62 years 7 months.

Example is for illustrative purposes, and individual results will vary.

As is seen in the chart above, the restricted application for spousal benefits strategy boosts the couple’s Social Security benefits on three fronts:

- It increases the couple’s individual retirement benefits (labeled “Retirement”)
- It’s the only strategy that earns spousal benefits (which are forfeited with the other two strategies)
- Most notably, it boosts the survivor benefit by over $100,000 versus the other two strategies

It’s imperative to stress the importance of Social Security survivor benefits with your clients: upon the death of the first member of a couple, the larger of the two retirement benefits is inherited by whomever lives longer and will continue for the rest of their life. **So, when one member of a couple maximizes their Social Security, creating the largest possible benefit, it lasts for as long as either member of the couple is alive.**

A common reason for not using a restricted application may be the uncertainty of how long the higher wage earner will live. Helping clients understand that even if the higher wage earner doesn’t live a long time, delay is often still valuable because of the protection it affords the survivor.

Additional considerations for filing a restricted application

One spouse must be claiming benefits

The most basic consideration with filing a restricted application for spousal benefits is determining if there is a retirement benefit to claim the spousal benefit under. More simply, have either member of the couple claimed a benefit yet? That's because for one spouse to claim a spousal benefit, the other must have claimed their retirement benefit already. For many couples, the greatest upside is when the lower wage earner claims their retirement benefit first, enabling the higher wage earner to file a restricted application for spousal benefits, thus collecting spousal benefits while also delaying and growing their own benefit to be used later.

Divorced and widowed clients can utilize this filing strategy too

The same filing strategy can be employed by those who were married at least 10 years and have been divorced less than two years. Those who have been divorced greater than two years are considered "independently entitled" to ex-spousal benefits, meaning they do not need their ex-spouse to have already claimed benefits. The ex-spouse must only be old enough to receive benefits (age 62 or older) and have earned enough retirement credits to qualify for Social Security. Many divorced clients are not aware of ex-spousal benefits, let alone the ability to leverage the more advanced strategy described in this paper. Helping them understand their benefit options continues to be a large opportunity.

A final group for whom the restricted application will continue to represent a large opportunity are widows and widowers. People who were married at least nine months, then widowed, are able to receive a survivor benefit as early as age 60. As a result, two potential strategies exist for widows and widowers:

- They could file a restricted application for survivor benefits as early as age 60, then switch to their own retirement benefit as late as age 70; or
- They could claim their own retirement benefit as early as age 62, then switch to a survivor benefit at their FRA.

It's prudent for financial advisors to compare these two options to help their widowed clients determine the approach that creates the largest lifetime benefit. Also of significant note, the restricted application for widows and widowers was not impacted by the Bipartisan Budget Act of 2015. So, the restricted application strategy for this group will continue to be an opportunity going forward.

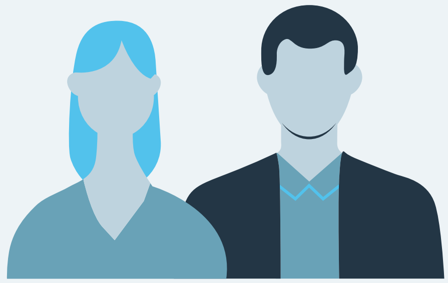
The "retirement earnings test" may complicate matters

A final and key consideration is how "the retirement earnings test" could affect the strategy. The retirement earnings test is a provision that withholds benefits for retirees who file before their FRA and have income above certain levels. In 2019, the income threshold is $17,640, and for every two dollars above this threshold, one dollar in benefits is withheld.

With the restricted application for spousal benefits strategy, the younger member of the couple often files first, before their FRA, and therefore the retirement earnings test comes into play.

Let's look at an example on the next page to better understand this implication.

Consider married couple Bill and Sarah, and the impact of the retirement earnings test



Bill turns 66 and his wife Sarah turns 63, both in March of this year

- Bill's PIA is $2,500, and Sarah's is $1,800
- Bill and Sarah have decided to delay Bill's benefit to age 70, to maximize his benefit and to create the largest possible survivor benefit
- Sarah continues to work full time, earning $30,000 per year, and the couple plan to claim Sarah's benefit in March of this year
- Bill and Sarah plan to utilize the restricted application for spousal benefits strategy

To understand the impact of the retirement earning's test, we'll start by taking Sarah's salary of $30,600 and subtracting the income limit of $17,640. This results in a balance of $12,960. Next, we take that figure and divide by 2 (one dollar is withheld for every two above the limit), which equals $6,480.

STEP 1	STEP 2	RESULT
$30,600 - $17,640 $12,960	$12,960 2 = $6,480	**$6,480** Annual benefits withheld due to the retirement earnings test

Under a standard application for benefits, Sarah would have five months of benefits withheld to account for the $6,480. However, because Bill is filing a restricted application for spousal benefits, under which he will receive $900 per month based on her work record, his spousal benefits are also applied to the withholding. So, rather than five months of benefits being withheld, the couple will experience three months of withholding. Below you will see a table of cash flows for their situation; notice:

- **Year 1** of benefits is a partial year as they begin their benefit claim in March (annotated as 1)
- **Year 2** is their first full year of benefits, but they only receive nine months of benefits due to the three months of withholdings (annotated as 2)
- **Year 3** they also receive nine months of benefits as Sarah is still younger than her FRA
- **Year 4** the benefit amount increases as Sarah has reached her FRA and the penalty no longer applies (annotated as 3)

Also, very important to note, when the retirement earnings test applies and benefits are withheld, there is an increase to benefits once the participant reaches their FRA to account for the previous withholdings. Therefore, withheld benefits are not necessarily lost – they begin being recouped at FRA and continue through the participant's life expectancy. The increased benefit is adjusted as though the participant had elected later, by the number of months during which no benefits were paid (annotated as 4 in this example). As a simpler explanation, if 12 total months of benefits were withheld due to the earnings test, and the participant filed at age 63, their benefits would be adjusted as though they had originally filed at age 64.

	Bill			Sarah			Summary
Year	Age	Retirement	Spousal	Age	Retirement	Spousal	Total
2019	66	$0	$6,143	63	$9,726	$0	$15,869[1]
2020	67	$0	$8,292	64	$13,128	$0	$21,420[2]
2021	68	$0	$8,292	65	$13,128	$0	$21,420
2022	69	$0	$10,800	66	$17,100	$0	$27,900[3]
2023	70	$33,000	$1,800	67	$17,880	$0	$52,680[4]
2024	71	$39,600	$0	68	$17,880	$0	$57,480
2025	72	$39,600	$0	69	$17,880	$0	$57,480
2026	73	$39,600	$0	70	$17,880	$0	$57,480

Example is for illustrative purposes, and individual results will vary.

Conclusion

The restricted application for spousal benefits strategy can be valuable for your married, or formerly married, clients **born on or before January 1, 1954**. Although it was essentially an unintended benefit for couples, Congress recognized the importance of preserving the strategy for those who would become eligible to use it in the near future. Thus, 2019 and the following four years will be important for financial advisors who serve clients transitioning to retirement, as they reach their FRAs and are considering Social Security options. They are the last group eligible to use this strategy before the loophole is closed. When discussing this opportunity with your clients, be sure to educate them on the implications of their filing decisions.

The Nationwide Social Security 360 Analyzer® and Retirement Institute Income Planning Team can help you identify these opportunities and run personalized client reports that compare strategies and provide filing instructions for your clients.

Contact your Nationwide wholesaler or the Retirement Institute Income Planning Team for support and resources with Social Security planning.

1-877-245-0763 **IPLNDESK@nationwide.com**

Nationwide®
is on your side

• Not a deposit • Not FDIC or NCUSIF insured • Not guaranteed by the institution • Not insured by any federal government agency • May lose value

[1] Social Security Administration: https://www.ssa.gov/policy/docs/ssb/v70n3/v70n3p89.html

[2] Social Security Administration: https://www.ssa.gov/legislation/Bipartisan%20Budget%20Act%20Closes%20Social%20Security%20Loophole.pdf

[3] Social Security Administration: https://www.ssa.gov/history/ret2.html

This material is not a recommendation to buy, sell, hold or rollover any asset, adopt an investment strategy, retain a specific investment manager or use a particular account type. It does not take into account the specific investment objectives, tax and federal condition, or particular needs of any specific person. Investors should work with their financial professional to discuss their specific situation.

Information is general in nature and is not intended to be tax, legal, accounting or other professional advice. The information provided is based on current laws, which are subject to change at any time, and has not been endorsed by any government agency.

Nationwide Investment Services Corporation (NISC), member FINRA, Columbus, OH. The Nationwide Retirement Institute is a division of NISC.

FOR ADVISOR USE ONLY — NOT FOR USE WITH CLIENTS.

NFM-17741AO.1 (01/19)