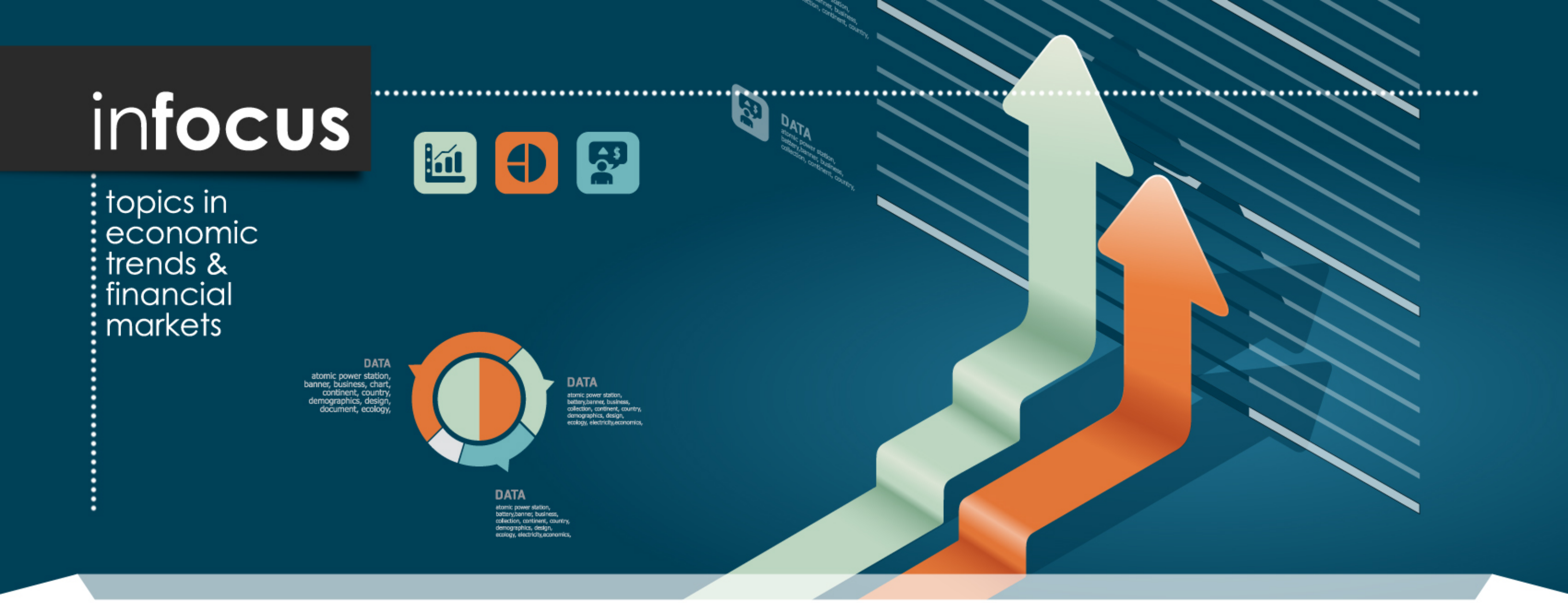


A Closer Look at Social Security

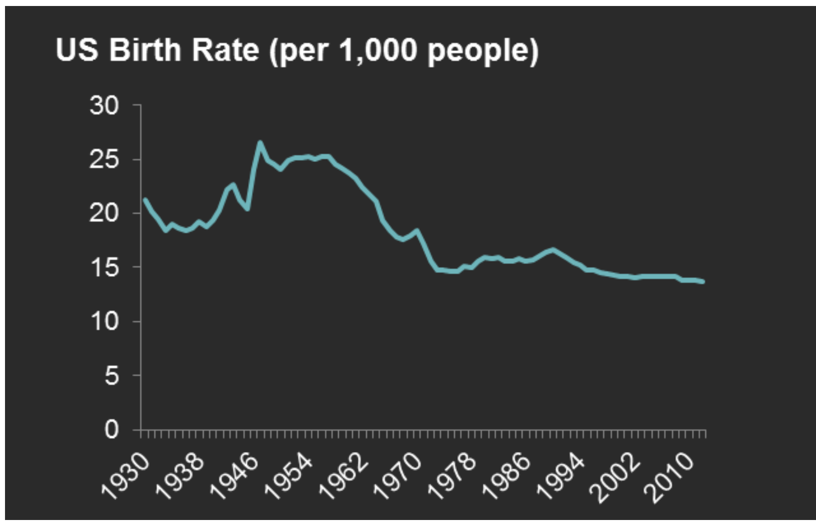
In 1935, Social Security (the Old-Age, Survivors and Disability Insurance program) was introduced through the Social Security Act. Since then, retirees have used this as a reliable source of income to supplement retirement savings. The retirement age in which full social security benefits are payable is currently 67, while those who have reached age 62 are eligible for partial benefits. While the program has changed significantly since it was introduced, its goal has always been to provide a more stable income outlook for those that are retired or affected by disability.

Baby Boomers

The generation of Americans born from 1946 to 1964 has historically been called Baby Boomers. This generation will have a tremendous impact on the economy, strategy for investments and the future of social security. Beginning on Jan. 1, 2011, and every day for the next 19 years, it is projected that 10,000 baby boomers will reach the age of 65. In addition to the sheer number of baby boomers, the increase in life expectancy over the past few decades has caused the projected benefit obligations of the social security system to substantially increase.

Revenue and Expenses

While Social Security is not a business, the same concepts apply. For the system to continue operating functionally, it must generate a sufficient amount of income to cover the benefits that are paid out. In 2010 and 2011, Social Security expenditures exceeded non-interest income for the first time since 1983. This is expected to continue for at least the next 75 years under current circumstances. Thus, to continue the ability to fully pay all scheduled benefits, congress will have to either increase the revenues generated by social security taxes, decrease projected expenses or both. To generate income for Social Security funding, Congress enacted the FICA tax. Until recently, the income has been greater than payments, generating a surplus. This surplus has then been held in a trust fund, earning interest income. Any future funding shortfalls will be drawn from this trust fund.



Each year, the Trustees of the Social Security trust fund report on the financial status of the program. In 2012, the actuarial deficits were made worse because of updated economic data and assumptions. The Trustees determined that legislative modifications will be necessary in order to avoid disruptive consequences for beneficiaries and taxpayers. The primary goal of the report was to warn lawmakers not only about the extent of the issue of long-term projected shortfalls, but also

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that changes should not be delayed. Any additional delay will only make the problem worse and will reduce options available to lawmakers. One of the biggest issues with the program is that growth in program expenses is forecast to be substantially larger than GDP growth due to the aging population of baby boomers. Additionally, social security will be strained by the increasing life expectancy of its participants and growing health care costs in excess of GDP, and Social Security costs as a percentage of GDP are projected to increase from 4.2 percent in 2007 to 6.4 percent in 2035. With projected future shortfalls, the trust fund is projected to run out in 2033 (three years earlier than in 2011). While this is alarming, FICA tax is still projected to cover roughly 75 percent of schedule benefits after the fund is depleted.

Future

Changes to Social Security that would help solve future funding shortfalls (increasing income, decreasing expenses or both) are difficult, but necessary. Further complicating this issue is political matters. Neither political party would like to be seen as responsible for raising FICA taxes or extending the retirement age. However, changes to the system are necessary in order to extend the availability of fully funded benefits and therefore appear inevitable. While no material discussions are ongoing regarding changes to the system, the simplest change to help combat future shortfalls would likely be an increase in retirement age. The main reason for this is that changes have not been made to the Social Security retirement age since the early 1980s. Life expectancies have continually increased, rising above 78 years in 2011. Additional possible changes could include raising the FICA tax to higher levels, raising/eliminating the income limit for FICA taxes, introducing means testing and many more.

Effect on Financial Planning

The effect of the uncertain future of Social Security on financial and retirement planning is tremendous and should be taken into account by everyone, regardless of age. Based on the projections outlined by the Social Security Board of Trustees, there is a marked difference in the effect this uncertainty will have on different generations.

For those already in retirement, while it is possible that benefits could be changed to reduce expenditures, it is highly unlikely that changes would be made for anyone already retired. With benefits still projected to be fully provided through 2033, any potential benefit shortfalls are relatively unlikely to affect individuals that are already retired. With a high likelihood that Social Security will be changed to solve funding shortfall problems, it is reasonable to rely on this income source for the rest of your life.

Individuals near retirement have less certainty about the future of social security, as the projected future shortfall in the Social Security trust fund in 2033 will likely be within your planning time frame. The high likelihood that some Social Security regulations will change in the near future will make it extremely likely that this projection will change for the better. If you are near retirement, most of your investment decisions related to retirement have already been made. As a result, future changes in social security may have little impact on your retirement plan. However, it may be beneficial to analyze the potential scenario (however unlikely) that no changes are made and only 75 percent of projected income is realized from this source after 2033.

For people who are far from retirement, any future changes to the structure of social security will alter the projections for the viability of future payouts. This uncertainty means that a contingency plan to cover cash flow shortfalls should be in place, just in case Social Security benefits are reduced. It is important to remember that even if no changes are made and the Social Security trust fund is entirely depleted, 75 percent of benefits are still projected to be paid from ongoing taxes. Projecting cash flow under the assumption that only 75 percent of benefits are paid would be helpful to determine whether your savings will be enough, even in this scenario. An increased focus on saving personal funds would decrease the risk of not having enough resources to achieve retirement goals.