California State Social Security Administrator Program

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HOW SOCIAL SECURITY RETIREMENT BENEFITS ARE COMPUTED

The purpose of this Bulletin is to clarify the manner in which Social Security benefits are computed.

CalPERS members who have Social Security coverage should realize that benefits under the CalPERS defined benefit retirement plan are computed in a very different manner than retirement benefits under the Social Security system. CalPERS retirement benefits are based on three factors: (1) a **Benefit Factor** based on one's age at retirement [e.g., 2% @ 55; 2% @ 62]; (2) one's years of **service credit**; the product of these two factors is multiplied by (3) one's **final compensation** [full-time payrate], averaged over a three-year or one-year period.

The Social Security benefit calculation utilizes none of these factors; and thus it may seem confusing to many CalPERS members.

OVERVIEW

Social Security benefits are based on your earnings in employment that were covered by Social Security. Your actual earnings are adjusted or "indexed" to account for changes in average wages since the year the earnings were received. Then, Social Security calculates your average indexed monthly earnings during the 35 years in which you earned the most. .

They apply a three-part formula to these earnings, and thus arrive at your basic retirement benefit, or "primary insurance amount" (PIA). This is how much you would receive at your **full retirement age**—which may be between ages 65 and 67, depending on your date of birth. To calculate your full retirement age, visit http://www.socialsecurity.gov/pubs/ageincrease.htm.

These benefits, however, will be reduced if you retire before reaching your full (or "normal") retirement age; these benefits will also be increased if you retire after reaching your full retirement age, up to age 70.

Retirees usually receive annual Cost-of-Living Adjustments (COLA), as well.

DETAILED EXPLANATION

In computing your 35-year average earnings, only earnings covered by Social Security are included; and only earnings up to the Maximum Taxable Earnings[1] for the year.

[1] This is $117,000 in 2014, for example. For earlier years, see: http://www.socialsecurity.gov/planners/maxtax.htm

One's actual earnings in a given calendar year are multiplied by an **Index Factor**[2], to adjust for inflation, changes in average wages, etc.[3] After identifying the 35 (or less) years with the highest indexed earnings, the total indexed earnings are divided by the total number of months in those years (e.g., 420 months, for a 35-year period.) The resulting average is rounded down to the nearest whole dollar: this is the worker's **Average Indexed Monthly Earnings (AIME).**

For workers with less than 35 years of earnings (e.g., due to separating from work to provide care for children; unpaid leaves of absence; unemployment, etc.), any years with no earnings are considered as "zeroes," but are still included in the total averaging of the AIME.

Once the AIME is computed, a three-part computation is done. This computation is done by separating the monthly averaged AIME into three levels (based on what are sometimes called "bend points"[4]):

1. Monthly averaged earnings up to $816;
2. Monthly averaged earnings from $817 to $4917;
3. Monthly averaged earnings above $4917, but less than the Maximum Taxable Earnings for the year.

The first earnings component ($0-$816) is multiplied by a factor of 90% (0.90);
the second earnings component ($817-$4917) is multiplied by a factor of 32% (0.32);
and the third earnings component (above $4917) is multiplied by a factor of 15% (0.15).

These three earnings components are added together; the result is one's **Primary Insurance Amount (PIA),** which becomes the basis for the benefits that are paid to an individual.

The following example will illustrate this computation. For a worker with an AIME of $5000, the calculation would be done as follows:

EXAMPLE 1: AIME = $5000:

90% x $816 = $734

32% x $4101 = $1312.32 ($4101 is $4917 - $816)

15% x $83 = $12.45 ($83 is $5000 - $4917)

TOTAL/PIA: **$2058.70** (round down to the nearest dime)

Here are some further examples:

[2] See http://www.socialsecurity.gov/oact/COLA/awifactors.html
[3] These Index Factors through 2013 are shown at: http://www.socialsecurity.gov/pubs/EN-05-10070.pdf; this publication applies to persons born in 1952 and later.
[4] They are called "bend points" because a formula, when graphed, appears as a series of line segments joined at these amounts. See: http://www.socialsecurity.gov/OACT/COLA/bendpoints.html

EXAMPLE 2: AIME = $750:	**EXAMPLE 3: AIME = $4500:**
90% x $750 = $675	90% x $816 = $734
32% x $0 = $0	32% x $3684 = $1178.88 ($3684 = $4500-$816)
15% x $0 = $0	15% x $0 = $0
TOTAL/PIA: $675	**TOTAL/PIA: $1912.80** (rounded down)

It should be noted that while the percentages of this PIA formula (i.e., 90%, 32%, 15%) are fixed by law, the specific dollar amounts (i.e., the "bend points") in the formula change annually, with changes in the national average wage index.

EFFECT OF EARLY RETIREMENT; DELAYED RETIREMENT

One may choose to take an "early retirement" for Social Security, which may be as early as age 62. In the case of a person retiring at exactly age 62 in 2014, the early retirement benefit will be 25 percent less than the person's PIA[5].

One may also "delay" one's retirement past the "full" (or "normal") retirement age, to increase one's benefit. To receive full credit, you must be covered by Social Security at your normal retirement age. (No delayed retirement credit is given after age 69.)

If you retire before age 70, some of your delayed retirement credits will not be applied until the January after you start benefits.

Unlike CalPERS benefits, Social Security retirement benefits increase for each month you defer your retirement, until age 69. (No "special" or proportionately larger increase occurs after each whole year, or quarter year, however.)

SSA provides an online calculator to help workers make a better estimate of the effects of early and delayed retirement at: http://www.socialsecurity.gov/OACT/quickcalc/early_late.html

COST-OF-LIVING ADJUSTMENTS (COLA)

Social Security benefits are adjusted to reflect the increase (if any) in the cost of living as measured by the Consumer Price Index. The purpose of the cost-of-living adjustment (COLA) is to ensure that the purchasing power of Social Security benefits is not eroded by inflation.

[5] The early retirement benefit is reduced 5/9 of one percent for each month before normal retirement age, up to 36 months. If the number of months exceeds 36, then the benefit is further reduced 5/12 of one percent per month. For example, if the number of reduction months is 60 (the maximum number for retirement at 62 when normal retirement age is 67), then the benefit is reduced by 30 percent. This maximum reduction is calculated as 36 months times 5/9 of 1 percent plus 24 months times 5/12 of 1 percent. For more information, see: http://www.socialsecurity.gov/OACT/quickcalc/early_late.html

However, it is important to realize that **COLA increases are not guaranteed**[6], and may not be paid in a given year. (In 2010 and 2011, for example, no COLAs were paid to beneficiaries.)

"MAXIMUM" SOCIAL SECURITY BENEFIT?

Technically, there is no statutory "maximum" Social Security benefit; but if you were paid the Maximum Taxable Amount for your entire 35-year career, and retired at your normal retirement age in 2014, your maximum benefit would be $2,642[7].

However, relatively few workers have earned the Maximum Taxable Amount for their entire careers; thus, their AIME will not be the "maximum" (highest possible) benefit. Therefore, workers who may be highly-paid now will receive less—perhaps substantially less—than this "maximum" amount.

OTHER FACTORS TO BE AWARE OF:

It is also important to be aware of potential limitations on your Social Security benefits, such as the Windfall Elimination Provision (WEP); the Government Pension Offset (GPO); and the Dual Entitlement restriction. Go to Social Security's website at http://ssa.gov/ for more information about these potential limitations, or refer to previous editions of this Bulletin at:

http://www.calpers.ca.gov/index.jsp?bc=/employer/program-services/federal/social-security-bulletin.xml&pat=PAER

SOCIAL SECURITY CALCULATORS

SSA provides a variety of online calculators, to enable you to estimate your Social Security benefit; e.g., http://www.socialsecurity.gov/planners/benefitcalculators.htm. You are encouraged to make full use of these programs, to aid you in your future financial planning.

A special-purpose version of the Online Calculator[8] provides retirement benefit estimates under the Windfall Elimination Provision (WEP), for those who also receive a pension from work not covered by Social Security.

But the best way to estimate and monitor your future Social Security benefits is to register for **my Social Security,** at http://ssa.gov/; registration is free, and takes only a few minutes.

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[6] See http://www.socialsecurity.gov/cola/2014/factsheet.htm for more information.
[7] See http://www.socialsecurity.gov/OACT/COLA/Benefits.html
[8] http://www.ssa.gov/retire2/anyPiaWepjs04.htm

OTHER HELPFUL SSA PUBLICATIONS:

- Retirement Benefits: at http://ssa.gov/pubs/EN-05-10035.pdf
- Your Retirement Benefit: How It Is Figured: at http://www.socialsecurity.gov/pubs/EN-05-10070.pdf
- When To Start Receiving Retirement Benefits: at http://ssa.gov/pubs/EN-05-10147.pdf
- How to Use the Online Retirement Estimator: at http://ssa.gov/pubs/EN-05-10511.pdf

For more information and to find copies of other SSA publications, visit their website at **www.socialsecurity.gov** or call toll-free, **1-800-772-1213** (for the deaf or hard of hearing, call their TTY number, **1-800-325-0778)**. They can answer specific questions from 7 a.m. to 7 p.m., Monday through Friday. They also provide information by automated phone service, 24 hours a day.