The Cost-of-Living Adjustment and What It Means For You

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Each year, the Social Security Administration (SSA) announces the cost-of-living adjustment for the next year. Whether you are retired or not, you should be aware of what the changes mean.

Last October the Social Security Administration announced that the cost-of-living adjustment (COLA) for 2019 will be 2.8%. The increase will show up in beneficiaries' January checks.

Also in October (earlier than usual), the Centers for Medicare and Medicaid Services (CMS) announced Medicare premiums for 2019. The Part B base premium will be rising slightly, to $135.50, up $1.50 from $134 in 2018. There will also be small increases in the income-related monthly adjustment amounts (IRMAA).

The hold-harmless provision that prevents Social Security checks from going down due to higher Medicare premiums is not an issue this year, with Social Security checks going up by 2.8% and Medicare premiums rising by just over 1%. About 2 million Medicare beneficiaries (3.5%) who were previously held harmless will be catching up this year. Anyone who has been paying less than the $134 base premium should now be able to pay the full amount out of their 2019 COLA. This means some people will not see the full 2.8% COLA increase in their net checks.

Nearly all Medicare patients affected by IRMAA should see their full Social Security COLA this year. Last year, CMS added a new income tier which forced those with incomes between $107,000 and $133,500 ($214,000 to $267,000 for couples) to pay a higher income-related monthly adjustment amount. The IRMAA exceeded the COLA, but too bad, because anyone subject to the IRMAA is not held harmless. The only people who may not see their full COLA are those with incomes over $500,000/$750,000, which is the new tier with an IRMAA of $325. In the prior top tier they had been paying $294.60, so their Part B premiums will be going up by $30.40, which will eat into the COLA a bit.

Maximum benefit

The national average wage index rose 3.45%. This brings the maximum wages taxable for Social Security up to $132,900, from $128,400 in 2018. Wages above that amount are not subject to Social Security taxes. (They are, however, still subject to Medicare taxes.)

On a more technical note, the increase in the national average wage index affects the indexing factors and "bend points" that will be used to determine the primary insurance amount (PIA) for individuals born in 1957 who will be turning 62 in 2019. Bend points will increase to $926 and $5,583 from $895 and $5,397, respectively.

The PIA for a person born in 1957 who had maximum earnings since age 22 is $3,030.59. So the maximum Social Security monthly benefit for someone who turns 62 in 2019 is theoretically $3,030.50.

However, this is the amount a person turning age 62 in 2019 will receive if they apply at their full retirement age (FRA) of 66 and 6 months. But starting in 2020, COLAs will be added to this amount, so by the time they get to FRA, the amount will be higher. If they apply at 62, they receive a reduced benefit of only 72.50% of the PIA. (We are starting to see the effects of the higher FRA phase-in, as the age-62 benefit is now less than 75% for anyone whose FRA is over 66—on its way down to 70% for those born in 1960 or later.)

The SSA fact sheet says that the maximum benefit for a worker retiring at full retirement age will be $2,861. This is a bit misleading, because they are applying 2019 bend points to someone who is FRA—as if their PIA is calculated at FRA and not age 62. In truth, a person who turns FRA in 2019 had their PIA calculated when they turned 62 in 2015. Using the bend points for that age cohort ($856 and $5,157), the maximum PIA worked out to be $2,788. Adding four years of COLAs (actually three, as there was no COLA in 2015: 0.3%, 2.0%, and 2.8%) would bring the benefit up to $3,010. As far as the maximum benefit is concerned, this explanation is the more accurate one. Ignore the one on the fact sheet.

Earnings test

The "earnings test" is a calculation for withholding benefits when a Social Security recipient is under FRA and still working (earning income). The thresholds for 2019 will be $17,640 ($1,470 per month) and $46,920 ($3,910 per month), up from $17,040 ($1,420 per month) and $45,360 ($3,780 per month) in 2018.

If a person under FRA applies for benefits, they will be asked how much they expect to earn during the rest of the year. If they are fully retired and expect to have no further earnings, none of their benefits will be withheld, regardless of how much they earned prior to application. If they do expect to have earnings, they will be under the monthly earnings test for the remainder of the calendar year. If they earn more than $1,470 in any month, their benefit for that month will be withheld. Then starting with January of the following year they will be under the annual earnings test. Again, they will be asked how much they expect to earn during the year. SSA will subtract the first threshold (the $17,640 adjusted for next year's COLA), divide by 2, and withhold as many checks as it takes to work off that amount. They will keep doing this every year until the year the person turns FRA. In that year, in the months leading up to the FRA month, the second threshold (the $46,920, which will be higher then due to COLAs) will be applied: SSA will subtract that threshold, divide by 3, and withhold as many checks as it takes to work off that amount. The month the person turns FRA, there will be no further withholding.

When the person turns FRA, the benefit will be adjusted to remove the actuarial reduction for those months in which a check was withheld. For example, if the PIA is $2,000 and someone files at age 62, the benefit will be $1,450 ($2,000 x .725). This represents an actuarial reduction of $550 over 4.5 years (54 months), or about $10.18 per month. For each month the check was withheld, $10.18 will be added to the benefit. So, for example, if a person had a total of 26 checks withheld, their new benefit would be $1,450 plus $265 (26 x $10.18), or $1,715. With respect to those withheld benefits, it's as if they had applied at FRA instead of age 62. Once they turn FRA, they can voluntarily suspend the benefit to build 8% annual delayed credits to age 70.

The earnings test can be a hassle for everyone, and in general we encourage everyone who's still working to wait until they stop working or turn FRA to apply for benefits. The only exception would be a widow who would be switching to a different benefit (retirement to survivor or vice versa) and would therefore not be receiving the adjusted benefit long enough to reap the full FRA-year adjustment. Of course, every situation is unique, and you should talk to an advisor to determine when your best time to claim Social Security is.

Statement estimates

Social Security statement estimates probably won't change that much because estimates are stated in today's dollars anyway. But it's worth noting that for workers under age 62, who have not had their PIA calculated yet, behind the scenes are the machinations of some nice benefits by the time they get to claiming age. Over the next ten years, the trustees estimate that the average wage index will rise by more than 4% a year. If the estimates bear this out, it means that the indexing factors and bend points that will ultimately determine their PIA will be rising by over 4% a year. Still, be cautious, as you never know what might happen to Social Security or the economy between now and then.

And, as always, if you plan to stop working at an age other than one of the Social Security claiming ages shown on the statement, your benefit will turn out to be different from the amount shown. Generally, those who work past claiming age are disappointed that their benefit won't increase by as much as they'd hoped (especially if they already have 35 years of high earnings), while those who stop working early are disappointed that their benefit will turn out to be considerably lower than the amount shown on the statement. But the 4% annual increase in the indexing factors and bend points may turn out to somewhat mitigate the years of zero earnings prior to claiming.

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