I'm Worried Social Security Will Run Out Before I Die. What Can I Do?

by

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“Social Security is broken; it’s bankrupt; I’ll never see a dime of what I put into it.”

Chances are if you’re a millennial, a Gen-Xer, and dare I say, even a Baby Boomer, you’ve likely uttered these words, or at the very least you’ve thought about it in passing. These days it’s pretty easy to be a little skeptical about the idea of getting any type of benefit from the Social Security system. What makes it even worse is that if you look at your pay stub, you’ll notice that 6.2% of your income (up to the $118k wage base for 2015) is getting gobbled up by Social Security taxes… and if you’re really observant you’ll notice the 1.45% Medicare tax that you pay on EVERY dollar you make (there currently isn’t a cap for this tax). Talk about pouring salt on a wound.

Unfortunately, it gets worse. If you happen to be one of those entrepreneurial types and run your own business, then you’ll need to pony up the employer half of the taxes, as well. This brings the combined payment to both Social Security and Medicare to 15.3% of your income. YIKES. With current forecasts estimating that the Social Security Trust Fund will be bone dry by 2033, it’s no wonder most people roll their eyes when we bring up the idea of Social Security planning. I mean — who cares, right? We’ll never see a dime of that money.

Despite all of the doom and gloom, I’m here to tell you to take heart, my friends. The death of Social Security has been greatly exaggerated. Though don’t start planning how you are going to spend your money just yet. There are a few things that you Boomers, Gen-Xers and even… gasp… millennials need to know about Social Security.

If the Well Runs Dry

If and/or when the Trust Fund is “exhausted,” it really just means that every dollar that gets put into the Social Security system via payroll taxes will be paid out to claimants. What that means is that there aren’t excess dollars for growth, so it’s basically $1 in and $1 out. Crossing this threshold will trigger a reduction in benefits for those already drawing on the system. The reduction in benefits means that a Social Security participant will likely only receive 77% of their expected payments at that time, but here’s the interesting part. Just by triggering the benefit reduction the Social Security Administration estimates that they would be able to pay out around 70% of promised benefits to future retirees through the rest of the 21st century.

While I’m certain that current retirees aren’t exactly thrilled about the idea of taking a 23% pay cut just so future generations get to participate in Social Security, I’m hopeful getting a heads-up 18 years in advance will give those consumers enough time to plan to make up for the shortfall. For those of you who are still working and saving, the good news is that even though your benefits may be a little bit less than estimated today, it appears the system will still be around for some time to come, so you should probably learn a little about it.

Getting the Most Out of Your Payout

First, and this one is an absolute must, be sure to maximize your Social Security payout. For every year beyond the full retirement age that you delay drawing on your own work history, you can earn 8% in delayed retirement credits. This means that just by delaying your benefit from age 66 to age 70, you get an increase of 32%. This alone can help make up for the haircut you’ll take when the fund is exhausted.

While getting a guaranteed 8% a year seems like a no-brainer, it's important to realize that maximizing your benefits isn't always about waiting as long as you can to take them. It is almost always about how you and your spouse coordinate your filings so as to get the biggest bang for your buck. Unfortunately, the odds of the average retiree getting this right aren't very good. MassMutual recently conducted a survey where it asked 1,500 adults 10 simple true/false questions about Social Security benefits. Only 28% received a passing grade and only one person answered all questions correctly – not very encouraging.

Now I know what you're thinking: "Who cares? How much of a difference can the way I file really make?" Here is a quick real-world example:

A few months ago, I was working with a client who had spent the prior three months talking to representatives at the local Social Security administration office in addition to doing some Internet research. (This first point usually makes us financial planning types laugh a little since we know that Social Security reps are told not to provide guidance on claiming strategies, but I digress.) Because of this, he felt that he had figured out the best way for him and his wife to file, so we put it to the test. We compared his claiming strategy with an approach that our firm felt would be just a little more optimal. The result surprised even me. Using our approach, we were able to get them an estimated $187K in additional income over the course of their lifetimes. I think we can all agree that $187K isn't exactly chump change, so the way you file truly does matter.

Delay Your Benefits Responsibly

Second, and this is a pretty big one, Mind the Gap. Many of the retirees who want to postpone drawing benefits to earn delayed retirement credits just can't afford to. They fail to plan for the income gap that results from the delay of benefits. Because of this, they may be forced to go ahead and draw Social Security early, thus permanently forgoing a much larger benefit amount (remember the $187K). Some go ahead and try to fill the gap by distributing assets from other accounts in a less than ideal way. Both of these scenarios could easily set you up for failure in retirement.

Fortunately, like so many personal financial decisions, a little planning and some minor attention to detail can go a long way. One simple way to do this is to open a separate bank account or brokerage account into which you put a little extra money every month. Someone who puts an extra $100 a month into a brokerage account that grows at a 3% rate for 40 years would have around $90K. (Did you hear that, millennials?) This would give you $22,500 a year, or $1,875/month, for the four-year period (age 66-70) that you are able to earn delayed retirement credits. That's likely pretty close to what your Social Security benefit would be, so it fills the gap nicely. Also, if you can add a little bit more money as you get older, achieve a little higher rate of return, or leverage some type of income vehicle that maximizes the distributions for you, then you could end up with a much larger balance resulting in larger monthly distributions.

Social Security claiming is definitely a tricky subject, but since we know that the system will likely survive for decades to come, it's important to try and learn what you can. For those who want to absolutely make sure that they get it right, consider working with a Certified Financial Planner with expertise in Social Security optimization. After all, it's pretty much a one-shot deal. With few exceptions, once you file you are locked in forever and that's a mighty long time. So make sure that you do it right.

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