Retirement Daily

Social Security/Medicare

Roosevelt signs Social Security Act, 1935. Photo: Library of Congress

Will Social Security Be There When I Retire?

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By Timothy Kenney

On a winter's day in early 1940, a 65-year-old woman opened the front door of her house in Ludlow, Vt., and went to her mailbox. Her mailbox was just outside the door, and she reached up to open the lid to retrieve the delivered mail. She'd done it many times, but this was no ordinary trip. The minute she opened that mailbox and picked up its contents, she automatically became a part of American history and lore (though she would not have realized it at the time).

When the retired schoolteacher and legal secretary opened the envelope, she became the recipient of a check issued to her by the U. S. government. Numbered 00-000-01, it was the very first Social Security check. It wasn't a big check -- certainly not by today's standards -- but it was made out for the amount of $22.54, and it was welcome.

That woman's name was Ida May Fuller. She had only been retired three years by the time she went to the mailbox that day.

The check she held in her hand was the result of an act approved by Congress and signed into law by Franklin D. Roosevelt on Aug. 14, 1935. As members of the press and photographers recorded this monumental event of the New Deal, the president took note of the significance of this moment to applaud Congress for approving this legislation, and to remark that what they did was a "patriotic act."

One of the great parts about my job is getting to hear how different everyone's life story is. From their upbringing, to their goals and personal situations, everybody is different. But if there's one part of the financial planning process where virtually everyone has the same outlook, it's Social Security. When it comes time to discuss potential sources of retirement income and I mention Social Security, clients usually say something to the effect of, "Well, we're out of luck there aren't we?"

It's a reasonable reaction. According to the 2019 Social Security trustees report, assuming no further action, the Social Security trust fund reserves will be depleted in 2035. For those of us planning for retirement in the next 10+ years that is troubling. After a lifetime of paying into the system, some of us may find ourselves retiring right as the well runs dry. Let's take a quick look at the system today, focus on what changes can be implemented to prolong the program, and how you should plan for the future.

Social Security Today

When the Social Security system was created in the 1930s, it was meant to help older Americans avoid poverty in old age, provide income for disabled workers, and assist survivors of deceased breadwinners. It was never intended to be a full retirement plan. Yet, Social Security has become the major source of income for most of the elderly. Here are some stats from the Social Security Administration:

- In 2019, roughly 64 million Americans will have received over $1 trillion in benefits
- Nearly nine out of 10 people age 65 and older receive Social Security benefits
- Social Security benefits represent about 33% of the income of the elderly
- Among elderly Social Security beneficiaries, 48% of married couples and 69% of unmarried persons receive 50% or more of their income from Social Security
- Among elderly Social Security beneficiaries, 21% of married couples and about 44% of unmarried persons rely on Social Security for 90% or more of their income

Coming right on their heels, roughly 10,000 baby boomers are reaching the age of 65 every day for the next 10 years and will start collecting their benefits. Add those up, and the almost $3 trillion in the Social Security trust fund is estimated to be depleted sometime around 2034. So, does that mean all of us paying in for all these years are out of luck?

Not as Bad as You Think

Not exactly. When most Americans hear that Social Security is going to run out, they assume the funds are just going to go away. Remember, Social Security is funded by payroll taxes which are collected through withholdings every time you receive a paycheck. Even if the Social Security trust fund is exhausted in 2034, the payroll tax should still be able to cover about 3/4 of the Social Security benefits meant to be paid out each year. While it would be terrible for some retirees to see a big cut in their monthly Social Security check, the benefits do not completely disappear when the trust runs out.

In recent years, numerous proposals have been talked about or proposed in Washington, D.C., that would extend the solvency of the trust. Some of them include:

- Slowly raising the full retirement age up from 67
- Raising Social Security payroll tax
- Eliminating cost-of-living increases at a certain income level
- Lowering benefits through means testing of higher-income beneficiaries
- A combination of all of these

For those of you too young to remember, Congress has already made changes to Social Security before by raising the retirement age slowly back in the 1980s. Even with the current political gridlock in Washington, hopefully they can come together and make changes that can extend the program which can benefit all Americans.

So, what should you do?

Even though there are ways for the system to be fixed, we are ultimately dealing with something that is beyond our control. As with all aspects of financial planning, it's best to take a more conservative approach to estimating how much we can depend on for our Social Security benefits. Let's cover some of the ways to think about this depending on where you are in your life:

Already Retired and Receiving Benefits

There's unfortunately not a whole lot you can do but hope that Congress can come up with a solution to fix the program and continue to pay full benefits. In any case, you may want to run some projections on what a 30% cut to your benefits might look like in 15 years just to be safe. If you would be in danger of running out of money with this kind of reduction, having a discussion with a financial advisor would be prudent to see if a change in your investment strategy would be appropriate.

Age 50 to Social Security Eligible

A couple things to consider here. Just as in the example above, running a scenario to consider what a 30% cut to your benefits might look would be worthwhile. Also, for those of you that are closer to retirement and have a good idea of what your income might look like through things like investment income, pensions, required minimum distributions, and rental income, you may be affected by a means test. The idea has been floated before and should at least be taken somewhat seriously when planning for the future. It's hard to say what the actual number might be, but a proposal was put out in 2015 to start to phase out benefits at $80,000 and eliminate them completely for incomes over $200,000. If you think you'll be in the upper part of the income range, you should at least have a plan in place in case your benefits are reduced or eliminated completely.

Younger Than 50

For those of you younger than 50, I'd be very conservative with your estimates for the future. Not only might the above examples apply to you with a potential reduction in benefits and/or means testing, you will probably be the group that will be subject to the raising of your full retirement ages. The last time Congress made changes to the system they slowly raised the full retirement age from 65 to 67. I'd be surprised if this doesn't happen again. To deal with all the uncertainty, I run scenarios with a 50% reduction in benefits for all younger clients. I would be focusing on saving and investing as much as you can and not worrying too much about Social Security.

Be Safe, Be Conservative

Even if there are solutions to fix the system and we give the benefit of the doubt to Congress to implement them, it's still a good idea to stress-test your retirement plan when looking to the future. Just like you might look at what your reduced benefits might be at 62, delaying benefits until 70, etc., you should look at what a 30% cut in benefits does to your overall plan. If you really want to be aggressive, assume no benefits at all. Would this derail your retirement plan? If so, should you plan to adjust your spending? Work longer? Save more? It's good to play it safe when planning for retirement. Focus on what you can control - your spending, savings, asset allocation, tax savings, and your behavior. Doing this can only set you up to have a more successful retirement, regardless of how the system ends up looking in the coming decades.

About the author: Timothy Kenney is the founder of TK Pacific Wealth, Inc., a fee-only financial planning and investment management firm located in Cardiff by the Sea, Calif. Tim is a former fixed income trader with LPL Financial and currently helps clients navigate the transition from work to retirement. Tim specializes in working with stock option recipients and ex-military both locally and across the country.