Why Dismissing Social Security in Your Retirement Plan Is a Mistake

Jarrett Simpson, CFP®
Wealth Advisor

When the subject of Social Security comes up during retirement planning conversations, both younger and older investors often greet it with a healthy dose of cynicism. Such discussions tend to include comments like, "Oh yeah, sure. If there's even anything left for me" or "Isn't Social Security going bankrupt?" Sometimes I hear a more draconian stance, like, "I just plan on it not being around when I'm retired." This last viewpoint actually is quite common. According to a study by AARP, 65% of adults are not confident about Social Security's future.

And really, who can blame people for feeling this way? Headlines regularly stoke fears of Social Security's bankruptcy and insolvency (fear-mongering makes for great click-bait). Unfortunately, the underlying facts tend to be drowned out by the noise such headlines create. It is true that, beginning in 2020, Social Security is set to pay out more in benefits than it will receive in tax revenue. The strain of baby boomers leaving the workforce has created a looming shortfall, not bankruptcy. If it isn't resolved, that shortfall will manifest itself in reduced benefits, estimated to begin in 2035.

But common misperceptions surrounding this reality highlight much of the confusion over how Social Security works and the key role it plays in people's financial lives. And I am not just talking about people who in retirement will rely heavily on Social Security just to survive. With very few exceptions, Social Security impacts us all, no matter our age or financial situation. Its importance in retirement planning should not be sold short.

Most Americans no longer have access to traditional pension plans offering the promise of monthly income for life. Thus, for many, Social Security provides the only "guaranteed" annuity income stream in retirement, and it does so without any of the fees charged by companies that sell annuity products in the marketplace.

KEY POINTS:

- Social Security is not slated to go "bankrupt" as many people erroneously believe.
- People who are cynical about Social Security are likely selling the program short.
- Even for those who have substantial resources outside of Social Security, the guaranteed income stream it provides makes a meaningful difference in retirement projections.
- Ignoring Social Security could have unintended consequences. For instance, it may lead people to save much more than they need for spending in retirement (thus foregoing current spending and any associated life experiences). It also could lead investors to take more risk in their investment portfolios than may actually be necessary to support the retirement they envision.
- For most people, Social Security represents the only guaranteed income stream they will have in retirement, as traditional pensions have fallen by the wayside. The program acts as an annuity stream without all the fees associated with typical annuities.

An income source you will not outlive is a tremendous asset if your goal is to not run out of money. This is especially true when that source is designed to replace on average about 40% of wage income in retirement. That is why removing Social Security from the equation when projecting retirement outcomes may feel like a safer, conservative approach, but can also unnecessarily handicap your financial plan. This holds even for those who have significant assets and savings available to support their retirement lifestyle. Therefore, if out of skepticism you dismiss Social Security as a resource altogether, its impact on your retirement plan must be made up for in other ways.

One way to compensate is to put more money than you would anyway into personal savings throughout your working years. Even if you have the ability to do so (many do not), that may come at its own price, specifically, the opportunity cost of not using and enjoying those extra dollars along the way. Dollars that, in reality, may not actually be required for retirement. Some savers may be fine with that, but others may regret the opportunities and experiences they forgo through such a conservative approach. You should take into account the present as well as the future impact of this decision.

Another option is to be more aggressive with your investment portfolio in the hope that higher expected returns will make up for the funding hole Social Security would otherwise fill. Even if you are comfortable taking on extra risk with your nest egg (again, many are not), why introduce unneeded uncertainty into your life? What's more, adding investment risk, by its very definition, does not promise to work out as expected.

So, if ignoring Social Security may be tied to additional costs and risks, what about the uncertainty associated with Social Security itself? If no changes are made to the current system, the Social Security Administration projects that beginning in 2035 there will only be enough funding available to pay about 75% of promised benefits moving forward.

While that outlook presents a problem that no doubt needs to be addressed, 75% of promised benefits is a far cry from 0%. Fixing the system will require political willpower that all-too-often seems in short supply. But it is worth noting that recent proposals put forth in Congress could potentially *increase* benefits for both current and future retirees while solidifying the system for another 75 years.

Those proposals may be a long way from being put into law, but their existence underscores the significant gap between what some skeptics believe about Social Security and what is likely to occur. Regardless of one's optimism or pessimism about the future of the system, it remains an integral part of nearly every American's financial future.

Despite the obvious and widespread concern regarding this topic, less than half of adults are confident in their knowledge of Social Security and only 16% claim to have received advice in this area from a financial professional. This illuminates a need that advisors who understand how to integrate this vital benefit, and its many claiming strategies, into an individual's overall financial plan can help to fill. The goal, of course, is to build a solid strategy that prepares current and future retirees for whatever Social Security may look like down the road.