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Bridging the Retirement Gap: Crack the Nest Egg Before Taking Social Security

Hiding in plain sight is a simple, low-cost, and effective tool to meaningfully increase retirement income: newbie retirees should live off their 401(k), individual retirement account (IRA), or other savings and delay taking Social Security, ideally until age 70. Each year a person postpones Social Security from age 62 until 70, his or her benefit increases by roughly 8 percent. As an added bonus, those lifetime Social Security benefits, including the 8-percent bump, will be increased annually for inflation. In effect, the retiree is buying an annuity from Social Security.

An October 2019 paper from the Center for Retirement Research at Boston College confirms that this Social Security delaying tactic can have significant advantages for retirees. Employers should educate, and perhaps encourage, near retirees to consider this approach.

Here's how it could work. Many employers, through their 401(k) administrator, HR department, or financial wellness vendor, already educate employees about Social Security as they approach their early 60s. The message could be tweaked to highlight that each year a retiree begins Social Security before age 70 costs them an 8-percent benefit reduction. This is a reverse of the usual explanation that benefits increase 8 percent for each year payment is delayed past 62. Although the math is the same, people react more strongly to avoiding losses than forgoing gains.

Employers could provide estimates of each near retiree's Social Security benefits based on payroll data and offer to help workers get actual numbers from Social Security. Then, with the estimated or actual number in hand, employers can suggest that, upon retirement, the individual postpone his or her Social Security checks and instead begin withdrawing the same amount from his or her 401(k) account. Ideally, the retiree will have a large enough nest egg and the discipline to wait until age 70 (when the 8-percent bump ends) or at least until his or her unreduced retirement age (somewhere between 66 and 67, depending on birth year). But each month of waiting will add value. Ideally, the plan should offer the retiree using his or her 401(k) as a bridge to higher Social Security benefits a lifecycle or other fund consistent with systematic withdrawals. The investment could be limited to enough money to cover the expected withdrawals or cover the entire account. Perhaps the installment-friendly investment fund should be the default (with an opt-out) for anyone electing the bridge.

Although financial experts uniformly agree that an annuity is an ideal retirement product for most retirees—offering longevity protection, professional investment management, and budgetary certainty—virtually no one will take this advice. (*See* "Modernizing the American Private Pension System Plan for the Future of Work" in the Winter 2018 issue of *Benefits Law Journal*.) The Social Security delaying tactic offers a frictionless way for retirees to increase their guaranteed lifetime income without the emotional and economic baggage surrounding annuities. It even has some advantages over traditional annuities.

First, it is reversible. If the retiree's health, financial, or other circumstances change, he or she can simply start Social Security payments and stop or modify the 401(k) withdrawals. Second, the value of the 8-percent Social Security increase is actually higher than what an individual could buy from an insurance company. Social Security doesn't have marketing costs, a profit motive, or charge for administration or legal compliance, and has lower mortality charges than an insurance company. Third, is simplicity: the retiree only has to decide when to start collecting benefits. With annuities, the retiree has to choose which insurance company and then select from a menu of product feature such as term certain and survivor benefits. Although these options can offer added value, having to make a decision, especially one of such importance, paralyzes many people.

Delaying Social Security is not for everybody. People with known health issues who are likely to fall on the short end of the mortality curve would be better off taking benefits as early as possible. The same holds for a retiree with scant savings who should maintain a rainy day fund rather than use it to cover daily living expenses. Married couples also should consider the impact of early versus late claiming on their spousal and survivor benefits.

Then there's the risk that the Social Security Trust Fund will run dry (currently projected for 2034) causing an across-the-board benefit reduction. These funding crises, however, occur roughly every generation and each time the President and Congress have (at the last minute) adopted solutions that left current and near retirees protected.

Even though we live in politically strange times, I expect the next fix will be no different.

Employers should get involved. A Social Security bridge is as inexpensive and effective retirement benefit as they come. Most 401(k) plans already allow for installment payments, but for those that don't, adding installments would require a simple plan amendment and very likely no added recordkeeping costs. Enhancing the financial education program for near retirees to highlight the potential advantages of waiting should not take much doing as the concepts are easy to understand. Indeed, recordkeepers and financial wellness vendors should jump into the act as ideal way to add value and win business.

I've heard some concern that employers should be careful of potential fiduciary liability from promoting a Social Security bridge. As long as the decision rests with the retiree, educating folks, and facilitating Social Security-like 401(k) withdrawals should be risk-free to employers. In time, as this idea proves its worth, employers may consider making a Social Security bridge the default distribution option, although more cautious employers would want a regularity protection.

A Social Security bridge will not help people lacking a workplace savings program and/or not saving enough (or at all). It certainly will not resurrect pension plans and is not a substitute for the heavy policy lifting needed to offer a secure path for the typical worker. These types of solutions will take legal and political change. Nevertheless, to move the needle *right now*, a Social Security bridge is doable, essentially cost-free, and simple. Let's go!

The views set forth herein are the personal views of the author and do not necessarily reflect those of the law firm with which he is associated.

David E. Morse
Editor-in-Chief
K&L Gates LLP
New York, NY