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Kotlikoff: Social Security's Rules Ripping Off Recipients

The Social Security expert on why high-income clients fail to plan at their peril, and why to never ask the SSA for advice

By Jane Wollman Rusoff Contributing Editor Research Magazine

Kotlikoff says Social Security is a complicated, at times unfair system designed with "old white guys" in mind.

Social Security's labyrinth of 1,728 rules written in gobbledygook and riddled with nasty traps is duping Americans out of retirement benefits that they've earned — in some cases, amounting to hundreds of thousands of dollars.

So says Social Security expert Laurence J. Kotlikoff, Boston University economics professor and president of financial planning software company Economic Security Planning. He has served as consultant to the U.S. Department of Labor, Merrill Lynch and Fidelity Investments, among other institutions globally.

Kotlikoff's newest book, "Get What's Yours: The Secrets to Maxing Out Your Social Security" (Simon & Schuster), is an often humorous — that's right, humorous — guide on how to triumph over Social Security's gotchas and what the professor calls a deeply flawed system, which has thousands of other rules stemming from those basic 1,728. "Danger lurks," Kotlikoff writes.

Financial advisors should find the detail-packed volume a godsend to help clients navigate the confusing maze.

In an interview with ThinkAdvisor, Kotlikoff stresses that it’s higher income earners, with millions of dollars in benefits at stake, who stand to be the biggest winners from getting Social Security-savvy and avoiding serious mistakes, like when to start benefits and what benefits to take.

Gadfly economist and Social Security expert Laurence Kotlikoff says service will enable divorcing couples to maximize their financial outcomes and...

Co-authors Philip Moeller, who writes about retirement for Money magazine, and Paul Solman, a PBS NewsHour business and economics correspondent, helped Kotlikoff to elucidate the system’s “windfalls and pitfalls.”

The three also quote verbatim several truly bizarre Social Security rules, like this one: “If you are a minor convicted of intentionally causing your parent’s death, you may be denied survivor benefits on the earnings of your parent.”

Kotlikoff pulls back the obfuscating Social Security curtain by also explaining auxiliary benefits, such as those based on the work records of an ex-spouse. He hammers home the key concept that an individual is entitled to receive only one benefit at a time: If you apply for two at once, he writes, one “effectively vanishes.”

Kotlikoff, who has provided expert testimony to congressional committees, insists that Social Security has concealed penalties, “devious rules,” hidden benefits for the disabled and on top of all that, employs personnel who all too often supply earners with the wrong information.

ThinkAdvisor recently caught up by phone with Kotlikoff, who has consulted to The International Monetary Fund and The World Bank. He believes that to a degree the U.S. government has deliberately made Social Security rules excessively opaque and complicated as a way to save money and reduce benefits. Here are highlights of our conversation:

ThinkAdvisor: You write that Social Security is a maddening system with perverse and seemingly crazy rules. That’s some gift you’re giving Social Security on its 80th birthday this year!

Laurence Kotlikoff: I’m coming from outrage. The way it treats people is disgraceful. Most people aren’t getting the right answers. Very few are doing the right things.

And most folks probably have no idea that they can suspend or withdraw benefits. Can’t the Administration help them make the right decisions?
About 40% of the time, Social Security people are giving the wrong answers. They’re very, very poorly trained and aren’t supposed to give advice. But they *are* routinely giving advice and telling people they can’t do things when in fact they can.

Should wealthy investors care about receiving Social Security benefits?
Higher earners have the most to gain from getting this right. But a lot of them think that Social Security is a poor person’s program.

You write that Social Security should be viewed as an insurance policy rather than as an investment. That's an enlightening notion.
A lot of people, especially those in the financial industry, think Social Security is like investing in stocks and bonds. But it's not at all, because you can't think about it on a break-even basis, like, if I take benefits early vs. later, maybe it's a break-even. Nobody evaluates homeowner's insurance that way. First and foremost, Social Security is longevity insurance, and you have to evaluate it the correct way.

You point out that an individual may have to pay federal taxes on up to half their benefits. Wow.
The government gives and takes. There's a lot of nasty stuff. For most people, Social Security is their key financial asset, so they need to manage it properly. It's certainly worth it.

You mention 25 Social Security gotchas. What's the worst?
The biggest trap is the deeming provision [penalty for filing before full retirement age if eligible for both retirement and spousal benefits]. Your benefit is permanently reduced because you took it early, never realizing that you were being forced to do this.

What's Gotcha No. 2?
The minute you file for retirement benefits, you're thrown into Excess Benefit Hell, because once you do that, you can never take an auxiliary benefit by itself.

What are some auxiliary benefits?
Spousal benefits, divorced spousal benefits, widow's benefits, divorced widow's benefits, survivor benefits, divorced survivor benefits.

I'm sure most people don't know much about those. What's your advice?
The thing is not to wait and take everything at the last minute because one benefit will wipe out the other since you can get only the larger of the two. So take one benefit early, and let the other grow.

One thing most people probably do know is that if they wait to take Social Security until the maximum-benefit age of 70 instead of at 62, they'll get more money each month. Is that worth doing?
If you wait till you're 70, your benefits will be 76% higher — and the money is inflation adjusted. So, by not taking benefits for eight years, the loss of those benefits is, in effect, a premium payment for a higher annuity from Social Security. You can't buy such an annuity on the market. If you've never been married and Social Security is the only retirement benefit you have available, then [typically] you'd want to wait till you're 70.

This one isn't widely known, I bet: If you remarry, you lose spousal benefits from your ex — who actually could be a higher earner than your second spouse, who could have little money. Devil is in the details.
There are all kinds of inferences in the decision to get married or not, or to get divorced. The other day a couple, age 64, called me. They figured out that they can make an extra $50,000 by getting divorced. So they can still live together and then get remarried at 70, when they won't be penalized. They'll only be getting retirement benefits and won't have a problem.

If you're married a few times, you can flip from one ex-spouse to the next to get the largest benefit. Interesting rule…
Yes, if you had four exes, you'd get the largest of possibly five numbers.

Another rule is that you can't access a former spouse's earnings record, and neither can a widow or widower. That makes it hard to plan when to retire.
The system was constructed by older white guys in the 1950s, '60s and early '70s. They didn't want their wives finding out what they were earning.

Here's a positive — I think: You can replace one of your previous 35 high-earning years — on which your benefit amount is based — with a higher earning year, such as the most recent one, and thereby raise your monthly benefit. Can that be done even if you're collecting Social Security and continuing to work?
Yes, even if you're working at 100, if you earn enough, your benefit will automatically rise. But here's another example of older white guys probably knowing higher income people. Other earners will not necessarily automatically get a benefit hike. So that isn't fair.

The Windfall Elimination Provision stipulates that if you've earned a government-agency pension at a job not covered by Social Security, the Social Security benefits you may have earned at other jobs, where you paid into Social Security, may be reduced. However, you write that upon death, that provision doesn't affect the family survivor benefit. Is this as good as it sounds?
When someone dies, their spouse or ex-spouse will be able to collect a widow's benefit based on the [decedent's] earnings history, and the government-pension offset will not affect it — but it will affect their spousal benefit. When Social Security says you can get a benefit, there are always strings attached.

Your book states that "Despite women's steady entry into the work force, there has been a slow and steady counter-effect on what surviving female spouses can expect from Social Security." Please explain.
If you get a larger retirement benefit because you've worked more and also [stand] to get a widow's benefit, the system will just give you the larger of the two. Say your own benefit is $1,000 a month and your widow's benefit is $1,500. Your check will be $1,500. But suppose your benefit is $1,200, Social Security will say, we'll give you $1,200 as your retirement benefit, but we'll give you a widow's benefit of $300 and call it the "excess widow's benefit." This is a form of lying to the public.

But Social Security gets away with it.
They intentionally made the language highly misleading to pretend that if people contribute more to the system, they'll get more out. They're pretending they'll get their own retirement benefit. But even if they earn more, they don't [in fact] get anything more.

Unfair.
A lot of secondary earners contribute to Social Security their entire lives and get not a penny more from the system than they would if they hadn't worked a minute.

That's really unfair!
Yes. If someone works his or her whole life at McDonald's and pays taxes every week, they will essentially get

far less than someone who spent their life on the golf course and never contributed a penny. Social Security has systemic inequities that are outrageous. And then it also has the capricious nature of redistribution because people don't know what to do [coupled with] getting bad advice from Social Security itself.

Anything else wrong with the system?
The benefit statements they send out to potential recipients don't include any future inflation or economic wage growth in their assumptions [even though] we've had inflation and wage growth in this country every year since World War II.

So what's the best way to "get what's yours"?
You can't rely on Social Security. They're the last place I'd go. You need to know exactly what you want to do before you talk to them and then insist on doing it, and make sure they do it right.

What's the status with your own Social Security benefits?
I'm 63 and haven't filed. When I remarry, my ex-wife and my new wife will both be able to collect on my earnings history. Somehow that doesn't seem right. Social Security should divide the contributions in half and put half in each [spouse's] account. [That way], when one spouse is home watching the kids and a divorce occurs, they don't end up with a zero benefit. But the system was set up so that males would get more and if the wife didn't work [outside the home], she wouldn't be penalized. They were like, "Let's keep the wife at home watching the kids." Another older white guys' provision.

Well, there's certainly a good opportunity here for FAs to be valuable in counseling clients about Social Security.
Right because the first obligation for the financial advisor is to find safe money for their clients. Before you put them into risky assets, you should do everything you can to increase their living standard safely.