CHOICES FOR FEDERAL EMPLOYEES

Pension Benefits or Life Insurance

for the Surviving Spouse

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The information in this publication is for federal employees under the Civil Service Retirement Systems (CSRS) or the Federal Employees Retirement System (FERS). This publication discusses planning for the financial needs of the retiree's spouse. It does not provide a detailed explanation of all the provisions of the retirement plans. More complete information about your retirement plan is available from the personnel officer in your agency.

The information in this publication is based on legislation enacted through September 1, 1992.

Prepared by Norma Nielson, chartered life underwriter and professor, College of Business; and Alice Mills Morrow, certified financial planner, attorney, and Extension family economics specialist, Oregon State University.

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Pension Benefits or Life Insurance
for the Surviving Spouse

N. Nielson and A.M. Morrow

When planning your retirement, you will make many decisions. One of the most important is whether to waive the pension benefit for your surviving spouse.

Often you first hear of pension benefits for survivors from a representative of a life insurance company, usually a proponent of the insurance alternative. While life insurance may be appropriate for some couples, it may not work for you.

Before making the decision about pension benefits, both you and your spouse should understand the advantages and disadvantages of the pension benefit and the insurance alternative. Consider also your family's goals and income needs, and make the decision carefully.

This publication gives a general explanation of pension benefits for survivors. Obtain detailed information from your retirement plan administrator. Don't rely solely on an insurance seller to provide this information.

Pension benefits for federal employees

Federal employees are under the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Most federal employees who transferred from CSRS to FERS will, upon retirement, have part of their pension under CSRS and part under FERS. If the pension is part CSRS and part FERS, benefits for survivors will be determined entirely under FERS rules.

Basic pension annuity

The pension benefit under both CSRS and FERS depends upon the employee's years of service and salary base. The salary base is the employee's highest 3-year average salary ("high-3"). The high-3 or salary base is figured by averaging your highest basic pay over 3 consecutive years of service. If you are close to retirement, the personnel office at your agency can estimate your high-3 or salary base. This salary base is used to determine the basic retirement annuity.

Basic retirement annuity	
CSRS	**FERS**
Take 1.50% x salary base x CSRS service up to 5 years. **Add** 1.75% x salary base x service up to 5 additional years. **Add** 2.00% x salary base x number of years of service over 10. For a quick CSRS estimate: (Number of years of CSRS service) – 2 x 2. The result is the percentage of salary base received annually as pension.	**If retiring before age 62 or with less than 20 years of service:** 1.00% of salary base x all years of FERS service **If retiring at age 62 or older with at least 20 years of service:** 1.10% x salary base x all years of FERS service

Pension benefit for surviving spouse

☐ The amount paid to the spouse after the death of the retiree is a percentage of the basic pension annuity increased for any cost-of-living adjustments received after retirement and before the retiree's death.

Pension benefit for surviving spouse	
CSRS	**FERS**
CSRS will pay the eligible spouse of a CSRS retiree 55% of the retiree's basic pension annuity. The retiree and spouse may agree to choose only a portion of the retiree's annuity as a base for figuring the surviving spouse's annuity.	FERS will pay the eligible spouse of a FERS retiree 50% of the retiree's basic annuity amount. The retiree and spouse may elect a survivor benefit of 25%.

You may choose no survivor benefit

☐ You may waive your right to a survivor benefit. The retiree and the spouse must agree to this in writing. If you don't elect the survivor benefit, it is a *single life annuity* and pension payments are paid only for the lifetime of the retiree. If you elect a survivor annuity, called a *joint and survivor annuity,* this annuity continues after the death of the retiree.

Cost of the survivor benefit

If you do choose the survivor benefit, the annuity paid during the lifetime of the retiree is reduced to provide for the spousal benefit. This benefit will be paid to the surviving spouse after the retiree's death.

Annuity reduction to provide survivor benefits	
CSRS	**FERS**
Unless waived by the retiree and spouse, a CSRS retiree's annuity will be reduced in order to provide for a survivor benefit. The first $3,600 of a retiree's annual benefit will be reduced by 2.5%. The amount of the annuity over $3,600 is reduced by 10%. For most career retirees, this amounts to a 7–8% reduction. (**Note:** The 55% spouse's benefit is based on the amount of the annuity before this reduction is taken.)	Unless waived by the retiree and spouse, a retiree's annuity will be reduced by 10% in order to provide a 50% survivor benefit. If a 25% benefit is elected, the reduction is 5%. (**Note:** The spouse's benefit is based on the amount of the annuity before this reduction is taken.)

Cost-of-living adjustments (COLAs)

Federal retirees and surviving spouses receive cost-of-living adjustments (COLAs). COLAs help pensions keep pace with inflation, that is, with increases in the prices of goods and services. Inflation is measured by the consumer price index (CPI). You cannot predict how prices will increase during your retirement years. The higher the inflation rate, the more important a COLA becomes.

Federal health benefits

Federal retirees are eligible for the Federal Employees Health Benefit Program. A surviving spouse is eligible for the Federal Employees Health Benefit Program *only if the surviving spouse is a survivor annuitant.* A survivor annuitant is a spouse who receives an annuity after the retiree's death. If the survivor annuity is not large enough to pay the health insurance premium, the survivor may pay the difference. If the spousal annuity was waived, the surviving spouse is not eligible for the Federal Employees Health Benefit Program.

Flexibility in spousal benefits

If a retiree and his or her spouse elect a survivor annuity and the spouse dies before the retiree, the annuity may be increased by the amount of the reduction made to provide the survivor annuity for the spouse. This occurs only after proper notification to the United States Office of Personnel Management.

If the retiree remarries after his or her spouse dies, upon proper and timely notification a survivor annuity may be elected for the new spouse. If a retiree and spouse elect a survivor annuity and later they divorce, the survivor annuity may continue for the former spouse or be discontinued, depending on the divorce decree. If the survivor annuity is discontinued, the retiree's annuity may be increased by the amount of the reduction made to provide the surviving spouse's annuity.

If you anticipate a change in your marital status, contact the personnel office in your agency to determine the consequences. When these changes occur, notify the personnel office in your agency or the Office of Personnel Management, Employee Service and Record Center, Boyers, PA 16017.

Now that you have information and knowledge about your federal retirement benefits, complete the Survivor Pension Benefit Checklist on page 11.

The insurance alternative

☐ A common alternative to pension benefits is life insurance. The insurance-replacing-pension proposal is as follows: The retiree and spouse waive the survivor benefit, thereby electing the single life annuity. The single life annuity pays only during the lifetime of the retiree. The retiree then purchases a life insurance policy to provide income for the spouse if the retiree dies before the spouse.

The higher monthly payment of the single life annuity is maintained as long as the retiree lives. The longer the retiree lives, the bigger this advantage. The insurance proceeds assure income for the spouse after the death of the retiree. And if the spouse dies before the retiree, the retiree/insured can either keep the policy to provide an inheritance for heirs or withdraw the cash value by terminating the policy or taking out a loan.

There is one essential requirement for any retiree considering this approach. He or she must be able to qualify for the purchase of life insurance. A prior or current medical condition may make a person uninsurable.

The principal advantages of the insured approach, sometimes called a "pension maximization" program, are:

- more income while the retiree lives;
- income from the insurance proceeds for the surviving spouse after retiree's death;
- cash value of the insurance policy for the retiree if the spouse dies first; and
- insurance proceeds not needed for support of retiree or spouse provide inheritance for heirs.

The principal disadvantages of the insured approach are:

- loss of the cost-of-living adjustment the survivor would receive under the federal pension;
- loss of federal health insurance that is available only to pension annuitants;
- the possibility that income from insurance proceeds will be less than the income from the pension survivor benefit; and
- the possibility that the net monthly income of the single life annuity (annuity, less taxes, less the cost of the insurance) is less than the net monthly income of the joint and survivor annuity (annuity, less taxes).

The Life Insurance Checklist on page 12 will help you review information about insurance costs and benefits.

Often an insurance or annuity seller will prepare an analysis of the financial aspects of your decision. As you review financial information, be certain you understand which figures are guaranteed and which figures are "illustrations" or "estimates" and aren't guaranteed. The differences between non-guaranteed illustrations and the actual results may or may not be favorable to you; you cannot know in advance what these differences will be.

When you receive the analysis, also have it explained, preferably by someone who doesn't sell insurance. A life insurance agent represents the insurance company and receives commissions from sales of life insurance, so he or she may be biased. An accountant or a financial planner may review the analysis for a fee. Remember, paying for an hour or two of advice before making this decision makes financial sense.

If you are going to choose a single life retirement annuity and purchase life insurance to replace retirement income if the retiree dies first, consider all your alternatives. You may have an existing insurance policy that the company will agree to increase. However, in most instances, there is no guaranteed right to increase an existing policy after age 45. Check the amount of a group life insurance available through employment that may be continued beyond retirement.

If you are buying a new policy, shop for insurance. There are different kinds of policies and many sellers of insurance. Prices of policies vary with the type of policy and the company offering it. Before you buy life insurance, read the insurance contract and ask your agent for an explanation of the terms. Work with an agent who takes a genuine interest in your well-being, someone who is willing and able to explain proposals and policies and answer your questions. If both you and your spouse are not convinced that the first agent you talk with will provide the service you want, look for another agent.

If you buy insurance to provide income for the surviving spouse, you must decide who should own the policy, the retiree or the spouse. If the retiree owns the policy purchased to provide for the spouse, the retiree during his or her life may cash in the policy or change the beneficiary. If the spouse is the owner of the policy, the spouse controls the policy. It's a good idea to have the spouse own the life insurance to assure that his or her future interest is as secure under the "insured" plan as it would have been under the joint and survivor pension arrangement.

Family goals and income needs

☐ Family goals and income needs are the most important factors in your retirement pension decisions. Your family is unique. The decision selected by a co-worker is not necessarily the best decision for you and your spouse. If both you and your spouse are employed and have pension plans, consider the benefits from both the husband's and the wife's pension plans as you make decisions about spousal benefits.

Think about your goals. If your most important goal is adequate income for both spouses, your decision probably will not be the same as it would be if your most important goal is leaving an inheritance for children. If you are a two-career family, your situation is different from that of the one-career family. If you've been married a long time, your situation is different from that of the recently married couple.

To clarify your goals, complete the Family Goals Rating Scale on page 13. To review income, complete the Family Retirement Income Checklist on page 14.

Think about the amount of risk you are willing to assume. It's not uncommon for couples approaching retirement to consider avoiding risk more important than maximizing income.

Remember, in life there are many unknowns, the biggest of which is the life expectancy of you and your spouse. Life expectancy tables often are used as estimates, but do not predict how long you or your spouse actually will live.

Survivor Pension Benefit Checklist

1. My pension income will be $__________ per month if there is no surviving spouse benefit.

2. My pension income will be $_________ per month if there is a surviving spouse benefit.

3. The pension income for my surviving spouse is $__________.

4. After my death, my surviving spouse:
   - ❐ would be totally dependent on income from my pension
   - ❐ would be partially dependent on income from pension
   - ❐ has adequate income from her or his own pension and/or assets

5. To my spouse, eligibility for federal health benefits is
   - ❐ important
   - ❐ unimportant

6. My pension includes a cost-of-living adjustment (COLA). The COLA is determined in the following way:

   ____

7. Federal income tax on income from this retirement plan will be paid on ______________ part of the income. The estimated tax is ______________.

8. I will pay state income tax on income from this retirement plan.
   - ❐ Yes
   - ❐ No

9. If yes, the tax is on _____________ part of the income. The estimated tax is _____________.

Life Insurance Checklist

1. The cost of the life insurance premium is $__________ per year and $ ____________ per month.

2. Number of months/years premium will be paid ___________.

3. Premium is
   - ❐ fixed
   - ❐ variable

4. Amount of death benefit is $_______.

5. Death benefit is
   - ❐ guaranteed
   - ❐ an estimate

6. If death benefit is annuitized, how much income will it provide?

   ____

7. Is the monthly income from the death benefit an estimate? If so, is the estimate based on a moderate interest rate?

   ____

8. If the death benefit is annuitized, how will annuity income be taxed?

   ____

   The estimated tax is $ _______________________.

Family Goals Rating Scale

On a scale of 1 to 5, how important are the following to you and your spouse? (Circle one number for each question.)

	Not at all important				Very important
1. Adequate retirement income for husband and wife	1	2	3	4	5
2. Inheritance for children	1	2	3	4	5
3. Money for charitable bequests	1	2	3	4	5

Family Retirement Income Checklist

1. Monthly income needed by couple:
   $_____________

2. Monthly income from all sources:
   $_____________

3. Monthly income needs of spouse after death of retiree:
   $_____________

4. Monthly income after death of retiree if there is a federal pension benefit for the surviving spouse:
   $_____________

5. Monthly income after death of retiree if there is no federal pension benefit for the surviving spouse:
   $_____________

6. Income needs of other family members, if any, who are financially dependent on retiree:
   $_____________

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