SURVIVOR BENEFIT PLAN

WELCOME AND INTRODUCTION 1

One of the most important aspects of financial planning is the ability to provide for a survivor or survivors in the event of a wage-earner's death. People rely on several different types of tools to help insure continuing income for their survivors ranging from personal assets to life insurance to social security. Some service members also think that their retirement pay will continue to be paid to their survivors, unaware that this is true ONLY IF they have elected at retirement to participate in the Survivor Benefit Plan (SBP). The SBP is a government-subsidized program which guarantees that a portion of a member's monthly retirement pay will continue to be paid to a spouse or other designated beneficiary after the member's death. Unlike any other resource available, the SBP monthly payment is guaranteed by the government and protected from inflation.

All active duty military members are covered by SBP automatically at no cost. The government bears the total cost of that coverage while you are on active duty. Should you die on active duty in the line of duty, your retired pay entitlement is calculated as of that date, and the SBP annuity flows to your surviving spouse from that amount.

Your decision at retirement, then, is whether you wish to afford your family the same survivor benefits that were in place for you on your last active duty day. If so, you begin to share SBP's cost with the government by electing to receive reduced retired pay during your lifetime. When a member maintains SBP coverage, their portion of the cost will be deducted from their retired pay on a pre-tax basis. The government cost-sharing and pre-tax treatment of the member's cost make SBP an attractive way to provide long-term financial security for a beneficiary.

The SBP decision, however, is complicated by the fact that military retirement often occurs at a young age. Retiring servicemembers in their late thirties or early forties will likely have many forces competing for their income. They are frequently still raising young children, buying houses, and preparing for new careers. Any reduction in retirement pay at an uncertain time in their lifecycle can understandably be viewed as a sacrifice. However, it must also be understood that due to the transient nature of military life, many military spouses have put careers on hold. If they have held jobs, they may not have worked long enough in one place to accrue long-term retirement benefits from their employer. Since military retirement pay stops when the retiree dies, it is critical to consider the long term income needs of the surviving spouse.

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SBP and Financial Planning

Financial planners look at six key areas of a person's financial life:

- Basic financial statements, like a cash flow or budget that tracks regular income and expenses, and a net worth statement that measures the amount of assets you own and the amount of liabilities you owe.
- Insurance planning, which includes all aspects of risk management, especially life insurance needs.
- Investment planning, which typically includes personal assets like stocks, bonds and mutual funds, but also includes real estate, businesses owned, etc.
- Retirement planning, which includes planning retirement dates, estimating longevity, exploring employer-provided pensions and personal investment plans to ensure cash flow continues when you decide to stop earning income.
- Tax planning, which involves looking at all areas of a person's financial life and ensuring you are paying the minimum amount of tax possible.
- Estate planning, which is concerned with preserving and passing on any assets you have accrued over your lifetime, and also includes planning for survivors through the use of wills, medical power of attorneys, etc.

The Survivor Benefit Plan is a unique financial planning tool that impacts every single area of a person's financial plan:

- The decision involves consideration of a retiree's cash flow and determining the affordability of the SBP premium.
- Often insurance is sold as a "replacement" for SBP (which it is not), so your insurance planning can be affected by SBP.
- Your personal investments will impact the decision to take SBP, because if you have sufficient personal investments your survivors may not need to have a portion of your retired pay continue.

- SBP is a key component of your retirement planning and a unique benefit when it comes to compensation plans. When exploring the options for employment outside of the military, you will want to be familiar with the characteristics of SBP so you can compare it to the benefits offered by a potential employer. SBP also broadens the worth of your retirement benefit, so it should be taken into consideration when evaluating all retirement plans you may have in effect.
- Taxes come into play in several ways when considering SBP, the biggest factor being the pre-tax nature of the premium payment.
- Finally, the SBP can be a big piece of estate planning, especially if you have a special needs child that will need continued income in the event of your death. This invaluable option allows for mentally or physically incapacitated children to continue to receive the benefit as long as they continue to be incapacitated.

So, whether you are about to retire and need to make the SBP decision, or are just interested in what the program is about, you can see that it is worth your time to learn about this important (and virtually unmatched) benefit.

This program will explain how SBP works, the costs and coverage amounts, your election options (who you can designate to receive the SBP benefit), and additional considerations to help you make this important decision.

COVERAGE AND COST

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The Survivor Benefit Plan: Basic Questions Answered

Retired Members

The decision that's been made by someone who participates in SBP is fairly straight-forward; they choose to receive reduced retired pay during THEIR lifetime in order to continue a portion of their pay after their death. Conversely, one can say that retirees who do not participate have elected to receive full retired pay during their lifetime, knowing that their full retired pay will die with them.

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Benefit Amount

The SBP benefit, called an "annuity", is the regular, continuing payment of a portion of retired pay to a designated beneficiary (sometimes referred to as the "annuitant") after the member dies. The portion is 55% of a base amount chosen by the member. The base amount is the dollar amount of retired pay selected by the member, upon which both the cost and benefit are based. It can be any dollar amount between a minimum of $300/month up to full retired pay.

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Cost

SBP was designed with the military spouse in mind (former spouse costs and benefits follow the same rules.) Spouse coverage costs 6.5% of the base amount selected. No similar private survivor program matches SBP's 6.5% tax-free cost and other features.

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Example

If a member's retired pay will be $3,000 per month, the member can choose any amount from $300 to $3,000 as the base amount. If the member chooses the full base amount and desires spouse only coverage, the cost will be:

Cost: $3,000 x 6.5% = $195/month

This payment, or premium, will be deducted from retirement pay each month BEFORE taxes are calculated, resulting in an additional benefit.

Having chosen $3,000 as a base amount, the benefit would be 55% of the monthly base amount, in this case $1,650 will be paid monthly and is taxable to the surviving spouse.

Annuity: $3,000 × 55% = $1,650/month

Each year when retired pay receives a cost of living adjustment (COLA), the base amount increases accordingly. For example, if the $3,000 base amount receives a 3% COLA, the base amount is now $3,090 and the spouse's potential survivor annuity has increased to $1,699.50.

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Active Duty Members

As mentioned above, active duty members of the armed services are automatically covered by the Survivor Benefit Plan at no cost to the member.

Death in Line-of-Duty. If the member was on active duty at the time of death and the death is in line-of-duty, then the death qualifies for SBP benefits. The SBP base amount is equal to the retired pay as if the member retired with total (100 percent) disability or 75 percent of the appropriate retired pay base. (Those electing CSB/Redux get the reduced cost-of-living-adjustment.)

Death is Not in Line-of-Duty. If the member is retirement eligible at the time of death while on active duty, then the SBP base amount is equal to the retired pay as if the member were retired for length of service under applicable law of the respective service of the deceased member. However, in the case of a death of a member who is not on active duty, or was on active duty but the death is determined to be not in the line-of-duty and the member is not eligible for retired pay, then the member's death does not qualify for SBP benefits. The SBP base amount will be computed as if the member retired for length of service based on the final basic pay or high-3 average applicable. (Those electing CSB/Redux get the reduced cost of living adjustment.)

Beneficiaries. For deaths while on active duty, the beneficiaries, in order of priority, are:

- Former Spouse based on a court order
- Current Spouse
- Children

THE ELECTION OPTIONS

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There are Six SBP election options. An election enrolls eligible beneficiaries within a category. The most important feature of electing by category is that the decision you make for each category available to you at decision time is binding. In other words, if you have an eligible spouse or child who you do not enroll, then later gain a spouse or child, or simply wish you would have enrolled – you have closed these categories forever! Your only ability to change this decision might be through a future "Open Season", of which there have been only five since 1972. Conversely, if you DO enroll your eligible beneficiaries at election time, all future eligible persons in those categories will be automatically covered.

Federal law requires that SBP elections be made prior to midnight of the last active duty day. If the election is NOT made before retirement, federal law directs the Finance Center to default the election to full spouse coverage. If that happens, the election can be changed only if the member proves that the government erred in the election process. This is a safeguard which protects a spouse's expected benefit. In fact, Congress added more "meat" to the process in 1986, when they began to require married members to provide their spouse's written concurrence in order to make certain elections.

Generally speaking, the SBP process is:

- the Sailor and spouse receive SBP counseling;
- the Sailor makes an SBP election;
- if the election requires spouse concurrence, the spouse is notified of the decision and given the opportunity to concur;
- if concurrence is provided before retirement, the election is valid;
- if it is not, the election is invalid and full spouse coverage is established, in accordance with federal law.
- Certified mail is used to obtain concurrence when the spouse cannot be present for counseling.

Spouse

The spouse option is one of the elections that require written spousal approval if a member elects a reduced base amount or declines SBP entirely. If $300 is chosen, the survivor's benefit would be 55% of $300 or $165. The cost would be 6.5% of $300, or $19.50/month. A reduced benefit amount may be appropriate if there are other substantial sources of funds available to replace the retiree's lost income. If no election is made, the retiree's full retirement pay will automatically be the base amount.

The annuity is paid for the surviving spouse's lifetime – it cannot be outlived! Your spouse may remarry after age 55 and continue to receive SBP benefits. If remarried prior to age 55, the benefits stop. If the marriage ends due to death or divorce, payments can resume. Former spouses are covered under a separate category – under the same cost and benefit rules as spouses (see below).

It is important to note that with spouse coverage, only the spouse is covered, no one else, including children. If the spouse dies and there are surviving children, they will not receive a benefit under the spouse only election. If a member would like the benefit to continue for children, the spouse and child election may be a better choice.

Spouse and Child

The spouse is the primary beneficiary and children are secondary beneficiaries under this option. The annuity is not paid to the children unless the spouse first loses eligibility through remarriage before age 55, or by death. Even then, the children must be under age 18 (or 22 if in school) to be eligible.

The cost for this election is based on the cost for spouse coverage AND an additional cost based on the age of the child and both spouses. One important reason to elect child coverage is because SBP is paid forever to an incapacitated child, providing the incapacitation occurred when the child was in the eligibility age range. Note that if an election is made for a former spouse and children, only the children who resulted from that marriage are eligible beneficiaries. This means that if you gain children in the future, they could not be added to a "Former Spouse and Child" election. However, if you elect "spouse and child" – all your children, of any unions, are eligible.

Children

Children are eligible for coverage if they are unmarried and under the age of 18. If they are still full-time students, they can be covered until age 22. Marriage at any age renders a child ineligible for coverage. Children may be covered with or without spouse or former spouse coverage.

If covered without a spouse or former spouse, the children will divide 55% of the retiree's base amount. Using the earlier example: If the base amount is $3,000, the monthly payout would be $1,650. If there are three children, each one would receive $550. As the children become ineligible for coverage due to age or marriage, the remaining children will divide the annuity payment. Cost for coverage is based on the ages of the member and the youngest child. All eligible children are covered at one cost, and the cost stops when children are no longer eligible. The cost for the child-only benefit is cheaper than the spouse benefit because the benefit ends when the child(ren) is 18 or 22. However, this election is costlier than the spouse and child election since the child is the primary beneficiary.

Insurable Interest

If a member is unmarried, they may cover another family member or even a business associate. Covered family members must be more closely related than a cousin. Parents, stepparents, siblings, aunts, uncles and grandparents all qualify. An individual child or stepchild can be covered regardless of dependency status. Business associates can also be protected if they would suffer financially due to the death of the retiree.

Costs for this option are 10% of the retiree's full base amount plus 5% for every full 5 years the beneficiary is younger than the retiree. If the beneficiary is 12 years younger than the retiree an additional 10% would be charged. The maximum premium is 40%. The cost of insurable interest coverage continues to be subtracted from the beneficiary's monthly annuity.

The benefit for the insurable interest option is also 55% of the base amount. Under this option, the member is required to elect the maximum base amount. Unlike the other options, premiums continue to be paid after the death of the retiree. They are also based on a more complex formula which is a percentage of retired pay plus an additional charge based on the beneficiary's age.

Former Spouse

Benefits for a former spouse are identical to spousal benefits. If a former spouse is covered by SBP, a current spouse and/or children of the current spouse cannot be covered. When electing former spouse coverage the member must file a written statement with the Finance Center indicating the reason for the election. The current spouse must also be informed of the election. The rules regarding a spouse's remarriage apply to the former spouse.

No Beneficiary at Retirement

Members without a spouse or children on their date of retirement have future options. Since they have no eligible beneficiaries now, they have not closed the door on future enrollment. If a member gains an eligible family member after retirement, contact DFAS. Members have a ONE YEAR time limit on making all SBP changes. If you gain a child, the coverage is effective upon your request. If you gain a spouse, while you MUST take the action BEFORE your one-year anniversary (i.e., make a written request and provide a marriage certificate) – a spouse gained after retirement is NOT eligible until completing one year of marriage, or earlier, if a child is borne of the marriage.

IMPORTANT CONSIDERATIONS

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Social Security Offset

In the past, a surviving spouse would experience a reduction in their monthly annuity when they became eligible to receive Social Security at age 62. This reduction is gradually being phased out and will be completely eliminated effective 1 April 2008.

Paid-Up Status

Starting 1 October 2008, when a member has paid SBP premiums for 30 years and has attained age 70, he or she is considered fully paid-up and coverage continues without any further premium payments.

One Year Termination Option

Between the 24th and 36th month of SBP participation, you may terminate SBP coverage. Spouses and former spouses must give their consent for this termination. There is no refund for past protection and future enrollment is barred.

It will be helpful if, two years into retirement, you ask these two questions:

1) is my retired pay still a major part of our household income?

2) have I adjusted my lifestyle to incorporate the cost of SBP into it?

If you answer yes, then stay enrolled in the SBP. If you answer no, discuss termination with your spouse (whose concurrence you need) and take action to disenroll.

Pre-tax Benefit

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One of the major advantages and cost savings of the SBP is that premiums are taken out of retired pay BEFORE taxes are computed, resulting in a significant tax savings, and further reducing the true cost of the SBP benefit.

For example, a member with a $3,000 monthly retirement check declines SBP and leaves the entire $3000 gross retired pay to be taxed. If the member is in the 28% tax bracket, the taxes due are $840. However, if a member covers a spouse at the full base amount, which costs $195 per month, the resulting taxable income is $2,805 (since the premium comes out BEFORE taxes are assessed), and federal taxes due are $785, $55 less each month.

You could say that in reality, including the tax savings, the premium is $195 less the $55 in tax savings, or $140. Understanding this concept allows you to make sound cost comparisons of SBP with other insurance products products. Real comparisons require the use of real figures. When a private product is being touted as one that "will provide the same benefit as SBP, for the same cost" – be sure to use only the real, after-tax SBP cost as your basis for comparison.

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SBP operates slightly differently in regard to costs and benefits when a member elects the CSB/Redux retirement option. CSB/Redux includes a re-adjustment to its retired pay amount. At age 62, retired pay is re-computed to what it would have been under High-3. Also, at age 62, a one-time COLA adjustment is made that applies the cumulative effects of High-3 COLA (CPI) to the new retirement base. Afterwards, future COLAs again are set to CPI minus 1%.

Base Level: Under CSB/Redux, full coverage means the full retired pay you would be entitled to under High-3 is your base amount. (This is the amount that would be used as a basis for your age 62 retired pay adjustment).

SBP Costs (Premiums): If you elect full coverage, your base amount is higher than what you are actually paid until the age 62 readjustment. Also, remember that the base amount is adjusted annually by CPI minus 1%.

COLA under CSB/Redux: Members choosing the CSB/Redux plan have a COLA increase of CPI minus 1%. This reduced COLA impacts the retirement benefit under SBP. If in a given year the CPI was 3%, the increase in survivor pay would be 2%. In the year the member would have been age 62, survivor's benefits are adjusted to what they would have been if full CPI increases had been applied from the beginning. After this one time restoration, survivor annuities are once again subject to annual increases of CPI minus 1%.

Summary: As a result of this modification to the standard premium and benefit calculations, you will pay a higher proportion of your retired pay to obtain coverage. This amount, however, is the same as what an individual who opted for High-3 would pay for the same amount of coverage. Your beneficiary will be better protected against inflation than they would be if SBP benefits received the same COLA as under CSB/Redux. In effect, you are paying the same price as a High-3 individual for the same coverage.

Premiums Stop If You Lose Your Spouse

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If your marriage ends due to the death of your spouse or divorce, premiums for SBP protection stop once you provide appropriate documentation to DFAS. If you remarry, you can cover your new spouse.

Open Season

Some people think they can join SBP years after they retire, during a so-called "open season." In the 25-plus-year history of SBP, only five times have retirees had a second chance at SBP. Each time was after major plan improvements. The second time, premiums were raised for new joiners to help make up for the missed premiums. The third time, new joiners were required to pay all missed premiums with interest, plus an additional amount to protect the solvency of the plan. Open enrollment elections have typically required a period of time (two years) before the election is actually effective. This prevents too much adverse election (people joining with short life expectations).

Don't count on an open season. Although an open season may be enacted by special law, they are not part of the regular plan. No more are expected and it won't give your survivors peace of mind.

Annuities vs. Premiums

The annuity your spouse receives will typically quickly exceed the amount you paid in SBP premiums. If the retiree paid premiums for 5 years, the spouse beneficiary will receive the equivalent of the total SBP premiums paid in just eight months of collecting the annuity.

If the retiree paid premiums for 15 years, the SBP beneficiary will receive the equivalent of the total SBP premiums paid in one year six months.

If the retiree paid premiums for 30 years, the spouse will receive the equivalent of the total SBP premiums paid in two years five months. Remember, on the average, 70 percent of female spouses will outlive the retiree by 8 years, 40 percent by 15 years, 20 percent by 22 years, and 10 percent by 28 years.

THE DECISION

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When considering whether or not to elect SBP, the surviving spouse's need for long-term income is paramount. 2005 Census Bureau figures tell us that 57.5% of married couples are dual income. Recent reports indicate that the percentage of income saved by American workers is about .5% (June 2007). It is reasonable to assume that the majority of household income is being consumed by current needs.

In the event of a retiree's death, even if both spouses were working, it must be asked, how much income can the surviving spouse afford to lose? Some expenses such as housing and children's education and activities will likely remain the same. Food, insurance and car expense may decrease. Costs for childcare, home maintenance and professional services may increase. It will likely be determined that some measure of income replacement will be necessary to preserve the family's economic security.

For military members with a desire to provide ongoing retirement income for their spouse, it is logical to consider the cost of SBP relative to other personal or commercial alternatives.

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Personal Assets

If a couple has other assets that could be used to generate income, it is necessary to determine if those assets are sufficient on a long-term basis. Using a 6% rate of return on investments with an annual inflation rate of 3%, $476,273 would have to be available at retirement to provide a monthly annuity of $1,650 to the surviving spouse based on average life expectancy.

Although many military members are very successful financially, few have $476,273 available at their military retirement to set aside for this purpose. In addition, the investment and economic environments are ever changing. There is no guarantee that 6% can be earned consistently or that inflation will remain at 3%.

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Life Insurance

Life insurance is another possibility. Since SBP is guaranteed, permanent (whole life) insurance is the only legitimate alternative since it is also designed to provide lifelong protection. A policy providing a face amount of $476,273 would cost a non-smoking 40 year old male approximately $709 monthly. Rates vary by company and other factors relating to the applicant such as gender, health history, avocations and smoking status. These factors will impact premium cost. If SBP premiums increase annually by 3% they will never get as high as the whole life premium. So the actual lifetime cash outlay will be higher using the insurance approach. However, insurance will pay benefits to the beneficiary even if they have remarried.

Any program earmarked as security for your survivors deserves serious consideration – not the average 8-10 minute telephone insurance sales pitch reported as typical. Personalized SBP valuation printouts, prepared by the DOD Actuary, are available on-line or through your RAO. To access this program go to DOD Actuary homepage, www.dod.mil/actuary/, click on "SBP Programs," and select the program, "Insurance".

SBP vs. Life Insurance: If you are considering passing on SBP and replacing it with a commercial insurance product, remember these five main points:

1. Use the valuation program to see exactly how much insurance you need in place to provide the same benefit as SBP.

2. Since you don't know how many years your spouse might outlive you, determining what is adequate regarding insurance is impossible. A crystal ball is not needed with SBP - it simply cannot be outlived.

3. SBP's inflation-fighter is its guaranteed cost-of-living adjustments (COLAs). Increasing life insurance is needed as one ages, due to inflation's eroding effect on the dollar's purchasing power.

4. Try to adjust your thinking from short to long-term. When you limit your view, life insurance may appear more attractive (i.e., cheaper) than SBP. But, if you compare SBP costs and benefits with life insurance costs and benefits for each year in the future, you'll see that insurance costs must increase dramatically based on the insurer's increased risk of paying a policy. Since SBP simply protects your ever-increasing retired pay, its value rises at the same rate – even after it begins to be paid as an annuity.

5. The SBP premium is government subsidized and pre-tax. No commercial product has these features.

In a well-designed retirement plan, it is probable that some combination of personal investments, life insurance, government benefits and retirement benefit plans from post-military employers will all be at work. When one factors in the government's subsidization of SBP costs, the COLAs, and the before-tax treatment of premiums, the Survivor Benefit Plan can be a cost-effective way to deliver an ongoing measure of financial security to spouses and families.

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Advantages and Disadvantages

To summarize the advantages of the SBP:

- The impact of a government subsidy speaks volumes. Only a non-profit concern like the U.S. government can offer this feature.
- Any time you have the opportunity to take advantage of tax-avoidance you should! SBP does - and, you can even use the tax savings to make other riskier investments.
- Unlike insurance values which are eroded by inflation, SBP's value increases at the same rate as retired pay.
- If you balk at the finality of "SBP elections are forever" - the termination feature permits you to rethink your participation after you've settled into retirement for two years. And, don't forget SBP's recent "paid-up" provision.
- The annuity is paid for however long it is needed – one year to 50 years or more.
- SBP costs don't consider any factor except covered retired pay.
- A level benefit of 55% without regard to age of spouse or former spouse!
- There are no extra fees, agent commissions or risks to the retiree.
- It's a plus that only Congress can change SBP's features. They make changes on matters affecting survivors very cautiously.
- While less quantifiable, peace of mind rises in value with age.
- Every active duty Sailor is enrolled at no cost. At retirement, you must decide to continue participation and share cost.

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The disadvantages of SBP actually all have a positive side:

- All income is typically taxed either at the front or back end. Obviously, it is smartest to take a tax break when it's of most value to you – when you're in a higher tax bracket as a couple. That's when tax-free SBP premiums are paid. It is not a viable "counter" to pose that insurance proceeds are tax-free – when they are used, they are taxed, and when they are gone, they are gone.
- SBP's goal is to protect military retired pay…period. If it is protection of a spouse's life you seek, you might want to buy a life

insurance policy on your spouse. In fact, you can use the monthly tax savings SBP provides to fund that policy.

- Choosing to receive reduced retired pay during your lifetime is the only way to continue a portion of it after you die. And it couldn't be a simpler process. The Finance Center simply deducts the premium before paying you. Such automatic deductions result in coverage that can't lapse because of a missed payment. Worth thinking about is this….if you find living on 93.5% of your retired pay (retired pay minus 6.5% spouse costs) painful – how will your family survive on 0% after your death?
- The 6.5% spouse cost does not increase. However with each retired pay COLA received, your cost becomes 6.5% of a new, higher amount - which produces a higher annuity.
- SBP is not intended to be an "inheritance" vehicle. But, consider the notion that the best inheritance you can give your kids is a financially-independent parent. If they aren't burdened with supporting your spouse, that's a substantial "inheritance." Also, when SBP is used to pay monthly living expenses, perhaps other monies can be tucked away or invested to meet your inheritance goals. But without SBP as the work horse, the intended "inheritance" could easily be depleted.
- SBP does not have insurance-like features, but that's a plus as it keeps the plan affordable.
- SBP is far easier to understand than insurance. Like any such plan, there are exceptions to its general rules. However, basic rules and principles apply to most participants, and are what need to be understood. When you have a more complicated question, help is only a phone call away.

SOURCES OF HELP

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Assistance in evaluating your personal financial needs may be obtained from a variety of civilian and military sources. Financial planners, financial counselors or accountants can be helpful; however, make sure they possess knowledge on military retirement plans and ask them how they expect to be compensated. Look for designations such as CFP® (Certified Financial Planner®), AFC (Accredited Financial Counselor), and/or CPA (Certified Public Accountant).

Financial counselors at Fleet and Family Support Centers and Career Counselors can also lend assistance. Once again, make sure they are comfortable with all aspects of military retirement plans and SBP.

The following websites provide in-depth information on SBP and online calculators.

www.defenselink.mil/militarypay/survivor/sbp

www.navymutual.org

www.afpc.randolph.af.mil

www.dod.mil/dfas