I didn't choose this title! - Dan

# Elder Law

# Help elderly clients pay for pension survivor benefits

By Dan Gallagher

Before 1985, when the Retirement Equity Act of 1984 (REA '84) took effect, millions of pre-retirees participating in pension plans and participants in most defined contribution plans funded with annuities were unaware until retirement that they had to make an irrevocable decision when retiring. The decision was whether or not to have their pensions or annuity payment continue to their spouses in the event that the retiree died before the spouse. This continued payment was call the Survivor Benefit Payment, or SBP. If the retiree did not opt to have any pension continued to the spouse, the retiree received the pension which was promised (and illustrated on annual statements) but payments stopped upon the retiree's death. The retiree could not change that decision during retirement. If the retiree opted to have the SBP continue to the surviving spouse, the pension was greatly and irrevocably reduced but the potential widow(er) would have the security of whichever payment level the retiree had selected. The reduction is about 12% for half pay or 24% for full continuation and this cost increases for every year of age which the retiree is older than the spouse. The reason why the retirement pay was reduced is because the pension plan might have to pay out over the longer of two lives, rather than just the retiree's life. Since the pension plan administrator never knew that a worker would be married at retirement, annual pension projection statements showed an unreduced pension and did not mention the reduction at all.

### What SBP represents

Retirees made this decision alone and without any professional financial planning help. Hence, many thousands of widows and widowers became surprised when the pension just stopped after the retiree died. Even if the retiree opted to buy the SBP, it too stopped upon the spouse's death, leaving nothing for heirs or children. If the spouse for whom the SBP was provided died before the retiree, none of the money which had already been debited from retirement pay over those many years could be recovered. SBP is a benefit contingent upon a death and it must be paid for (through a lower pension). So the SBP was, and still is, a guaranteed-issue permanent life insurance policy. It is one which gathers no cash value and which can only be settled as a monthly benefit. The SBP is the largest and most expensive life policy that most people ever buy.

### Survivorship under new law

So what is different, now that REA '84 has taken effect? On the surface, not much: most spouses of employees still incorrectly assume that the retirement years will be great; that the pension projected on annual statements is actually what they will receive (without any reductions) and that there will be no surprises in event of the retiree's death. Most couples lose or plan to drop their term insurance at retirement when, they assume, pension and accumulated wealth will protect them. But yet something has indeed changed. Something very subtle, yet absolutely critical has come about with REA '84: it is no longer the retiree's decision as to whether or not to permit the spouse to have any continued pension (SBP). Hence, retirees now automatically experience roughly a 12% retirement pay or annuity payout cut to provide a continuation of half pay to the potential widow(er) unless that spouse signs an irrevocable waiver of the right to this minimum level of SBP. SBP is more costly when a spouse is younger than the retiree. Lump sum distributions, if permitted, also require spousal waiver since the spouse's interest is potentially endangered. Unfortunately, details of retirement benefits and rights are rarely communicated effectively when employees and spouses are young enough to wisely plan ahead.

### When does the right exist?

The spouse has the right to a future SBP if married to the employee at least one year before retirement and if the employee has a right (is vested) to any benefit in pension form. This right exists even if the couple divorces during working years. For the military, the spouse has this right if married to the service member for any ten year period prior to retirement, or if married at all within two years of retirement. In the case of divorce, property settlements must contain an SBP provision or else it is deemed to have been waived by the spouse.

### The importance of survivorship

Despite its drawbacks, SBP does represent a very valuable legal right to at least 50% pension continuation. It is also the bulk of most survivor income. So why would a spouse surrender such a valuable legal right, anyway? Well, the retiree might have accumulated vast wealth and feel that the spouse would thereby be left well off. Yet the spouse would ask, just as the pen were meeting the irrevocable waiver document, "What am I receiving in return for the surrender of this legal right to pension continuation, that I don't already own?" It should be emphasized that this question is not one which sets a spouse at odds with an employee, for most relationships are based upon love and caring which lead the retiree to opt for even more protection for the spouse than the 50% minimum. It is, however, a critical question which REA '84 raises in the mind of a well-informed spouse. The spouse could opt to keep SBP or give up the right to SBP in return for the ownership and control (not just being the beneficiary) of a life policy on the retiree. The death benefit would have to be large enough to pay the same amount per month as the SBP would. Alternately, both spouses could mutually surrender rights to the SBP from each other's pensions. This is a smart move only if the SBPs of each pension were about the same value and the couple was very well off. But a spouse would not and should not surrender a valuable right in return for wealth which that spouse already owns or has access to. Your retirement planning should not be left to generic advice found in magazines or even to well-intentioned agents or stockbrokers. Professional advice is in order.

### Caring and logical decisions

What decision should you and your spouse make? That depends upon factors such as health, existing permanent life insurance, wealth, ownership designations, specific retirement plan provisions, retiree/spouse age differences and many other factors. It should also be emphasized that the correct calculations are essential to assure the spouse has both equitable and adequate survivor income. Even though the decision on SBP is not made until 90 days before retirement, you should plan for it and other retirement needs at least 15 years before retirement. You may wonder whether private coverage is a superior substitute for SBP, since SBP is insurance. You would be wise to choose survivors who are trained in this particular area (most are not) and who are full-time professionals with good reputations and strong professional credentials. It's your money, your right and your financial well-being.

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