

MILITARY PENSION: SELECTING THE APPROPRIATE SPOUSAL BENEFIT

Pensions, or employer-based retirement benefit funds, used to be common. Today they are all but unheard of, replaced by personal retirement funds like IRA and 401(k) funds. One place where they still exist, however, is for military service members.

In this article, we will discuss a provision of military pensions known as the Survivor Benefit Plan (SBP) — a plan to confer pension benefits to a surviving spouse and/or dependents if the primary pensioner predeceases the spouse and dependents.

Military Pension Overview

Before we discuss the SBP, let's familiarize ourselves with the basics of military pensions.

Who is Eligible for a Military Pension?

Military pensions are available for military personnel with 20 years of service.

How Much is the Pension?

Most military personnel are eligible for "High-36" pension calculation. An eligible service member, upon retirement from service, will receive a pension in the amount of **50% of the average of his/her highest 36 months of base pay.**

Military personnel who entered service before September 8, 1980 may be eligible for a "Final Pay" pension calculation, based on the service member's final base pay.

For military personnel who entered service before January 1, 2018, the pension benefit increases 2.5% for each additional year of service after 20 years.

For military personnel who entered service after January 1, 2018, the pension benefit increases 2% for each additional year of service after 20 years.

Military pensions may also be eligible for increase due to a "cost-of-living adjustment" (COLA) to protect the pension benefit against inflation. A COLA is triggered by an increase in the average third-quarter consumer price index compared to the previous year.

Survivor Benefit Plan (SBP) Overview

The Survivor Benefit Plan (SBP) within military pensions provides for a portion of the pension to transfer to a surviving spouse or dependents.

How Much is the SBP Benefit?

The maximum SBP benefit is 55% of the service member's military pension benefit.

Is the SBP Included in Military Pensions?

No, and this is important to understand. Not only is the SBP not automatic, **it is not free.** It is more like insurance, and the service member must pay a premium to activate it.

The premium is a portion of the service member's pension benefit. How much depends on the size of the benefit. The SBP benefit can be up to 55% of the pension benefit, but it's actually 55% of the selected "base amount." The service member can set the base amount at lower than his/her full benefit.

The premium can either be set at:

1. 6.5% of the chosen base amount, or...
2. 2.5% of the first \$725 of the base amount, then 10% of the remaining base amount.

Fortunately, the premium comes out of the retired service member's gross retirement pay, meaning the premium reduces his/her taxable income. SBP benefits are also eligible for COLAs to protect the benefit from inflation.

Alternatives to SBP

While the SBP can be a valuable benefit, it is not the only option available to military personnel to provide for their spouses and dependents after their passing. Service personnel who prefer not to claim SBP, supplement the SBP benefit, or forgo their pension altogether may want to consider the following alternatives:

Purchasing Term Life Insurance

Compared to the SBP premium, term life insurance premiums can be much more affordable, especially if purchased early in life. If a service member joined before the age of 20, she may claim her pension in her late 30s or early 40s. If she is in good health, she may be eligible for the lowest available term life insurance premium.

If the value of her pension plan is \$1 million, she may be able to purchase a 20-, 30-, or 40-year term life insurance policy with a value of \$1 million for an overall premium significantly less than the SBP premium.

Term life insurance has some disadvantages compared to SBP. As the name implies, term life insurance policies are limited according to their term. For a 20-year term policy, the death benefit expires at the end of the 20-year term. The SBP, by contrast, has no limiting term.

SBP benefits are also protected from inflation by COLA. Term life insurance benefits are not eligible for COLA.

Hybrid Approach — SBP and Term Life Insurance

Some military families may elect a “best-of-both-worlds” scenario—enroll in SBP and also purchase term life insurance. Families who take this “hybrid” approach often choose a lower “base amount” than the maximum for their SBP to keep their premiums low. They would then offset the neglected SBP with term life insurance.

This approach may result in a lower overall cost of insurance, while still offering the family exposure to some of the benefits of SBP, like COLA and no term limits.

No SBP or Insurance

This is the riskiest strategy, but believe it or not, some military families may come out ahead by declining both SBP and life insurance.

This may sound reckless, but consider—if both spouses live long lives, they will come out far ahead financially than if they pay SBP or life insurance premiums. After all, if the retired service member passes away at an old age, the life insurance term may expire. If the spouse passes away only a few years later, (s)he will miss out on only a few years of SBP benefits—possibly a lower dollar value than the retired spouse paid in SBP premiums.

Under a limited set of circumstances, this can make financial sense—but remember that risk management is all about preparing for the unexpected. No one is guaranteed a long life. If the retired service member passes away unexpectedly due to an accident or illness, this strategy could leave the decedent’s heirs in a precarious financial situation.

Conclusion

While they may not be enough on their own, military pension Survivor Benefit Plans can be a tremendous asset in retirement.

Selecting the right SBP benefit, with a premium that makes sense and possibly with term life insurance as a supplement, is a decision of enormous importance. It could make all the difference in the comfort and security of the service member’s loved ones in the event of an untimely passing.

As important as this decision is, it can also be complicated. We strongly recommend consulting a trusted financial advisor to strategize for this crucial judgment call.

To those who have served and who serve currently, we are extremely grateful. Thank you for your service!