Government Executive

Winning the Three-Legged Race to Financial Security

By Tammy Flanagan

March 24, 2016

Financial planners have long used the term "three-legged stool" to characterize retirement income, which traditionally has been based on a pension, Social Security benefits and personal savings. For many private-sector employees, the first leg of that stool is a thing of the past. But many current and future federal retirees have a genuine three-legged stool based on:

- A retirement benefit under the Federal Employees Retirement System or the old Civil Service Retirement System
- Social Security benefits
- Thrift Savings Plan retirement savings

The percentage of replacement income from each of these three sources depends on such factors as length of federal service, wages, coverage under CSRS or FERS and the ability to invest in and manage a TSP account.

Leg One: Annuity

According to the Office of Personnel Management, the average monthly annuity for the more than 100,000 annuitants added to the federal retirement rolls in fiscal 2014 was $1,639 for FERS and $4,634 for CSRS. The benefit is calculated based on highest three years of average salary, length of federal service (including unused sick leave) and a formula that depends on retirement coverage under CSRS or FERS.

For those who retire with the minimum of five years of civilian service, the benefit might replace just 5 percent of pre-retirement income. But for others -- those who retire with lengthy federal careers under CSRS, for example -- it could replace more than 80 percent of high-three average salary. (Remember, for longtime federal employees, CSRS was designed essentially as a single-stool retirement plan, without a significant Social Security benefit or a large amount of personal savings.)

FERS retirees with lengthy federal careers could receive an annuity bigger than their Social Security benefit. But the system is not designed to provide full retirement security without Social Security and investment income from the TSP.

Leg Two: Social Security

In a recent blog post, Virginia P. Reno, the Social Security Administration's deputy commissioner for retirement and disability policy, wrote, "today, Social Security's insurance protection is the foundation of retirement security for almost all American workers and families. The average Social Security benefit is modest -- about $1,340 a month -- yet this benefit is the main income for most seniors. For two in three seniors who receive it, Social Security is more than half of their total income."

The size of a Social Security retirement benefit is influenced by the following factors:

- Your age at the time you claim your benefit
- Your lifetime earnings history
- Other family members who may be entitled to benefits based on your work record
- The benefit formula, which is tilted toward lower wage earners

Consider this hypothetical case of a person who always worked at the maximum taxable wage limit or higher throughout her career. In 2015, her last year of employment, her income was greater than $118,500 (the maximum taxable wage amount). If she begins receiving her benefit in 2016 at age 66, it will be $2,639.40 per month. That's about twice as much as the average monthly Social Security benefit. But it would only replace 26 percent of a $118,500 salary.

CSRS retirees may not qualify for Social Security retirement if they didn't work long enough in Social Security-covered employment outside government. CSRS retirees who do qualify for Social Security are usually affected by the Windfall Elimination Provision -- a modified formula for computing Social Security for those who receive pensions from work not covered by Social Security. There was some interesting news this week about possible legislative action to reduce the impact of the WEP.

Leg Three: The TSP

The TSP can provide a valuable source of recurring retirement income. For example, suppose a 62 year old TSP participant who is separated from federal service has an account balance of $300,000 earning a 5 percent rate of return. He could withdraw $1,200 a month until age 99 and still leave his beneficiary an inheritance of more than $130,000. Even at a 3 percent return rate, the money would last until age 94.

The retiree also could opt to receive a monthly payout based on life expectancy that would be recomputed every year based on his age and account balance. For example, with a $300,000 account and a 3 percent return rate, he could start getting $1,062 a month at age 62. By age 99, the payment would be $835 a month and the remaining balance in the account would be more than $59,000.

TSP participants also have the option to purchase a life annuity. The 62-year-old retiree with the $300,000 account balance could get $1,325 a month under a life annuity. But there would be no inheritance for a beneficiary after the retiree had received $300,000 worth of payments. (It would take about 19 years to receive $300,000 at the rate of $1,325 a month).

There are 18 different options for life annuities from the TSP. They include adding increasing payments to offset inflation and a survivor benefit protection. But remember, under such an annuity, you will no longer control how your money is invested, and the interest rate used at the time your annuity doesn't change for the life of the annuity. The interest rate index as of this week was 1.875 percent.

Retirees can choose to receive a monthly payment, a life annuity, or a single payment from their TSP account after leaving federal service -- or a combination of all three. To estimate the income you can receive from your TSP account, you might want to try using the TSP Retirement Income Calculator.

On Monday, March 28 at 10 am ET, Bob Leins and I will host an edition of the radio program For Your Benefit (sponsored by the National Institute of Transition Planning and WAEPA) featuring Greg Long, executive director of the TSP, and Kim Weaver, the TSP's director of external affairs. In the hour-long discussion, they'll provide TSP updates and answers to listeners' questions.

Photo: Flickr user WIK

By Tammy Flanagan

March 24, 2016

http://www.govexec.com/pay-benefits/retirement-planning/2016/03/winning-three-legged-race-financial-security/126956/