Retirement Planning Shortfalls

By John K. Naland

A survey administered to 200 Foreign Service members at the start of a recent Retirement Planning Seminar at the Foreign Service Institute highlighted both strengths and weaknesses in their retirement planning.

Strengths included the fact that most of the respondents already had at least a basic understanding of many key retirement planning topics. But the survey also identified a number of shortfalls in retirement preparations and knowledge.

While only current employees were surveyed, seven of the identified shortfalls are issues that retired Foreign Service members should also pay attention to. This article lists those shortfalls, along with information to help you bridge any similar gaps in your own planning.

Gaps in Actions

Have Not Updated Beneficiary Designations: Ten percent of respondents said that they knew that their beneficiary designations were not current for accounts such as their life insurance and TSP savings. Another 17 percent of respondents were unsure if their beneficiary designations were up-to-date.

Every year, there are cases of death benefits not being paid to the immediate next-of-kin because the annuitant had not updated their beneficiary designations after marriage, divorce, or other relationship changes. So, please check your own records to make sure that your beneficiary forms reflect your current wishes. If not, submit new forms:

-- Retirement benefits designation (DS-5002): obtain from www.RNet.state.gov and submit to the Human Resources Service Center, 1999 Dyess Ave., Building E, Charleston, SC 29404.

-- Federal Employees Government Life Insurance (SF-2823): obtain from www.RNet.state.gov and submit to OPM Retirement Operations Center, P.O. Box 45, Boyers, PA 16020.

-- Thrift Savings Plan (TSP-3); obtain from www.TSP.gov and submit to Thrift Savings Plan P.O. Box 385021, Birmingham, AL 35238.

Do Not Have Estate Planning Documents: Thirty-nine percent of respondents did not have an up-to-date will and/or trust and other estate planning documents such as a power of attorney.

While all states and the District of Columbia have laws directing the division of assets of people who die without wills, those laws can vary widely. Unless you know the default inheritance laws of your state of residence and are sure they match the division of assets you would want, it is a good idea to execute a will or trust and other estate planning documents.

Gaps in Knowledge

Unclear about Impact of Divorce on Retirement Benefits: Nearly half--47 percent--of married respondents had little or no understanding of how their pension and other benefits could be impacted by divorce.

Federal law has provisions governing the division of Foreign Service retirement annuities between former spouses. Divorce decrees and property settlement agreements can also impact the division of retirement benefits. Thus, all annuitants (retirees, their survivors, and former spouses) should keep the Department informed of changes in marital status (marriage, divorce, or death of spouse). Notify the Human Resources Service Center at HRSC@state.gov or call 1-866-300-7419.

Unclear about How Retirement Benefits are Taxed: Similarly, 46 percent of survey respondents had little or no understanding of how retirement benefits are taxed and what strategies could reduce or defer those tax consequences.

The federal government taxes retirement income from pensions (excluding a portion representing your contributions), Social Security (if the recipient's income from other sources exceeds a base amount), and TSP withdrawals (excluding those from Roth TSP accounts). The only way to reduce the tax bite on pension and Social Security income is to reduce income from other sources in order to drop to a lower tax bracket.

Taxes on TSP withdrawals depend on the amount and timing of withdrawals and can be reduced or entirely deferred until age 70½ by limiting or delaying withdrawals. Roth TSP withdrawals are not subject to taxation as long as vesting requirements are met.

State and local taxation of retirement benefits varies with some jurisdictions excluding them from taxation. Consult your taxing authority or AFSA's annual tax guide for details.

Unclear about Long-Term Care Options and their Usefulness: Thirty percent of respondents had little or no understanding of long-term care insurance options and costs or of how they would cover long term care expenses absent such insurance.

Long-term care insurance pays for long-term care services at home, in a nursing home, or at another long-term care facility. According to the Department of Health and Human Services, at least 70 percent of people over age 65 will require some long term care services at some point -- expenses that most health insurance (including the Federal Employees Health Benefits Program) does not cover. Thus, annuitants who are concerned about their long-term finances should weigh the costs and benefits of long term care insurance. For information on the Federal Long-Term Care Insurance Program, go to www.ltcfeds.com. Several private insurance companies also offer policies.

Unclear about TSP Risk versus Reward: Twenty-nine percent of respondents had little or no understanding of the fact that TSP bond funds which offer the safety of capital preservation may not generate long-term gains that out-pace inflation.

Over short periods of time, stock funds can dramatically underperform bond funds. For example, in 2008 the TSP's C fund fell 36.99 percent while the TSP's G fund grew 3.75 percent. However, over long periods of time, stock funds out-perform bond funds. For example, between 2004 and 2013, the G fund had an average annual return of 3.39 percent while the C fund had an average annual return of 7.44 percent. Thus, in selecting a TSP portfolio, participants must decide how much risk they are willing to take.

A key consideration is your time horizon. If you hope to remain invested in the TSP for many more years, then you may want to take more risk now in your TSP account to increase your likelihood of generating gains over time that out-pace inflation.

Unclear about Life Insurance Needs: Twenty-one percent of respondents had little or no understanding of how much life insurance they would need in retirement.

Life insurance needs depend on how much money you wish to leave for your survivors (for example, to pay off a mortgage or leave an inheritance). Most employees carry into retirement their basic coverage under the Federal Employees Group Life Insurance program. That coverage is automatically reduced after age 65 (unless you pay a higher premium to avoid that) until it reaches 25 or 50 percent of its starting level (depending on the option you pay for). Many private insurance companies offer their own plans.

To Learn More: More information on these topics is available on the Office of Retirement's Internet site, The Retirement Network (RNet), at http://www.RNet.state.gov. RNet offers a wealth of information, including a database of 300 Frequently Asked Questions on Foreign Service retirement issues. See also the Foreign Service Annual Annuitant Newsletter which is mailed every November to each Foreign Service annuitant and is posted on RNet under "What's New?".

John K. Naland is the director of the Office of Retirement at the Department of State. A 28-year Foreign Service veteran, his overseas assignments include Colombia, Mexico and Iraq. He has twice served as AFSA president. His essay "Assistance After Retirement" appeared in AFSA's 2013 Directory of Retired Members.