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WHAT'S WRONG WITH THE SURVIVOR BENEFIT PLAN?

MAJOR RALPH A. BLAKELOCK 86-0285

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AUTHOR(S) MAJOR RALPH A. BLAKELOCK, USAF

FACULTY ADVISOR MAJOR MACK FOSTER, ACSC/EDCM

SPONSOR LT COLONEL MICHAEL GAFFNEY, HQ USAF/DPXE

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PREFACE

Since its inception in 1972, the Survivor Benefit Plan (SBP) has been one of the most controversial pieces of military personnel legislation ever enacted by the Congress. While the Department of Defense has supported it as a valuable military benefit, it has been characterized by others as a plan primarily benefiting officers or even a gimmick using retired pay to reduce the national deficit.

Regardless of one's opinion, the facts speak clearly. Only about one-half of all retirees elect to participate; among enlisted personnel the percentage is even lower. Using these statistics as a starting point, this article explains why participation has lagged.

The author's interest in the subject stems from his previous assignment at the Air Staff where he worked closely with Congressional staffers and representatives of the Services and the Office of the Secretary of Defense on various aspects of the SBP. From this experience, it was obvious that many individuals had little or no understanding of the real value of the plan. Hence, the author seeks to enhance service member understanding of the plan and provide some comparisons with private sector plans so that an informed decision on participation is made by future retirees.

The author wishes to thank Ms Mary Holter, Mr Charlie Hamilton, and Maj Debby Baker for their thoughtful inputs and especially Mr Bradley Snyder without whose generous analytical and data support this article would not have been possible.

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ABOUT THE AUTHOR

Major R. A. Blakelock graduated from the U.S. Air Force Academy in 1971 with a B.S. in History. After serving two tours as an Air Intelligence officer, he attended the Air Force Institute of Technology, graduating in 1976 with a M.S. in Systems Management. Subsequently, he has served in various Personnel-related assignments. Most recently, he was assigned as Chief, Military Retirement Estate and Special Projects Section at the Air Staff. In this assignment, he worked with Congressional staffers and other Service representatives on a variety of military benefits legislation.

Major Blakelock previously has completed Squadron Officer School in residence and Air Command and Staff College by seminar. He is married to the former Joanna [REDACTED] of San Antonio, Texas. They have two children, Alyssa, 18, and Benjamin, 3.

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WHAT'S WRONG WITH THE SURVIVOR BENEFIT PLAN?

INTRODUCTION

The Survivor Benefit Plan (SBP) was enacted by Congress as Public Law 92-425 on September 21, 1972. The law was the culmination of years of vigorous efforts by veterans' groups, members of Congress, and others to provide a reasonable level of income replacement for survivors of deceased, retired service members. Prior to passage of this law, many of these survivors were left without any government benefits.

Originally, the SBP was hailed by both the Congress and the Department of Defense (DOD) as a valuable estate asset that the vast majority of retiring service members would gladly accept. More recently, Defense Secretary Weinberger reaffirmed DOD's support for the program and urged each military member "to give every consideration to making SBP part of your survivor estate."

However, unlike its Civil Service cousin, the military SBP has never enjoyed widespread acceptance. While the Civil Service plan has better than a 90 percent participation rate, the military plan enrolls only about 55 percent of all eligibles and only 45 percent of enlisted retirees. What are the reasons for this rather low rate of acceptance? To gain some perspectives on this question,

this paper discusses the SBP structure, presents the findings of an Air Force survey on SBP, advances reasons for those perceptions, summarizes some insurance experts' views on the comparative value of SBP and private sector alternatives, and then concludes with recommendations to enhance service member understanding of the program.

SBP BACKGROUND

The SBP is patterned after the highly successful Civil Service survivor benefit program. Its purpose is to establish a system of income replacement for survivors of military personnel on a cost-sharing basis between the Federal government and the individual service member. In return for giving up a portion of retired pay, a participant guarantees that up to 55 percent of the elected base amount (a minimum of \$300 up to full retired pay) will be provided monthly to the named beneficiary for life. For this annuity, the participant pays 2.5 percent of the first \$300 of the base amount and 10 percent of the remainder. For example, a Master Sergeant retiring with 20 years of service under the current pay table and electing full retired pay as his base amount, initially pays \$60.10 per month in order to permit his surviving beneficiary to receive a benefit of \$454 per month. Once enrolled, both benefits and premiums are adjusted for inflation. In addition, premiums deducted from retired pay are excluded from Federal income tax.

For Air Force members, the focal point for information about the SBP is the Personal Affairs unit of the Consolidated Base Personnel Office. Here, the SBP counselors provide individual and group counseling about the SBP, answer questions, and prepare enrollment forms. Most counselors are active duty airmen in the grades of Technical or Master Sergeant and have at least three years of experience in their duties.

SURVEY RESULTS

Last Spring the Air Force surveyed two groups of individuals familiar with the program to determine why individuals joined or declined participation in the program. The first group consisted of 141 SBP counselors--the individuals charged with administering the program. The other group contained 815 personnel within 6 months of retirement.

The counselor survey focused on experience, training, program information, and perceptions regarding the value of SBP. The results indicate that counselors feel well equipped to perform their duties. In fact, 96 percent of the counselors felt confident in the performance of their duties. Information exchange between the counselors and headquarters points-of-contact appeared satisfactory. Forty percent had contacted or been contacted by the Air Force Military Personnel Center; another 30 percent had been in contact with command counterparts within the previous 6 months. The counselors also commended the quality of written materials.

Eighty-four percent rated Air Force Pamphlet (AFP) 35-23, Air Force Regulation (AFR) 211-12, AFR 211-14, and The Retired Officers Association pamphlet SBP Made Easy as good references.

Counselor perceptions regarding the value of SBP, however, varied widely. When asked to identify positive and negative aspects of the plan, negative factors were mentioned more frequently. The top three factors in each category are shown in Table 1.

<u>Positive Factors</u>	<u>(%)</u>	<u>Negative Factors</u>	<u>(%)</u>
Annuity Amount	27	Cost	35
Tax advantage	22	Other offsets	34
Benefit adjustments	22	Enrollment decision irrevocable	22

TABLE 1. COUNSELOR PERCEPTIONS

Adding to these perceptions, nearly half of the counselors found aspects of the program confusing. Most often mentioned were the benefit adjustment mechanism and the special tax advantage features. Not surprisingly, 75 percent of the counselors believed more training would be desirable.

Perhaps the most revealing statistics of the counselor survey are these: (1) Only 61 percent said they would recommend the SBP to most retirees. (2) Only 44 percent said the SBP was better than commercially offered insurance plans, while an almost equal number, 42 percent, believed commercial insurance plans were better.

The retiree survey concentrated on the quality of counseling and written materials as well as perceptions regarding the plan.

More than 60 percent of the respondents felt both the quality of counseling and the written information to be good or excellent. Therefore, the statistics indicate that most retirees believe they understand the basic elements of the SBP. Yet, when asked if they had enrolled or intended to enroll, about two-thirds either replied negatively or did not know. In fact, retirees had a strikingly similar view to that of the SBP counselors. Table 2 summarizes the top positive and negative perceptions of retirees expressed in the survey. Significantly, almost 45 percent of the respondents did not identify a positive feature.

<u>Positive Factors</u>	<u>(%)</u>	<u>Negative Factors</u>	<u>(%)</u>
Lifetime annuity	15	Cost	32
Tax advantage	13	Other offsets	22
Flexible annuity amt	9	Enrollment decision irrevocable	22

TABLE 2. RETIREE PERCEPTIONS

The statistics for those not intending to enroll demonstrate an even sharper contrast. Fifty-seven percent of this group did not identify a positive feature, and cost was rated as the primary negative factor by 46 percent.

Thus, the SBP, touted as a significant government benefit when it was introduced, is now perceived negatively by about one-half of retiring service members. There are two primary causes that have contributed to these negative perceptions. First, several flaws were present in the original plan. These were exacerbated by the

lack of a concerted effort by the DOD to press Congress for corrective action. Even more importantly, however, the belief has persisted, as exemplified by the SBP counselor results, that private insurance is a less costly alternative. The next 2 sections of this paper discuss these factors.

HISTORICAL PROBLEMS

A continuing irritant of the plan has always been social security integration. In the original legislation, the SBP benefit was offset by the amount of the social security entitlement earned as a result of military service. The significance of this feature became increasingly important in the mid-1970s when sustained high inflation had boosted social security payments dramatically from 1972 levels. While recognizing that the SBP still bridged the gap in the years between military retirement and the beginning of social security entitlements, the offset could, nonetheless, be devastating. This was particularly true for enlisted retirees. For example, a Technical Sergeant retiring in 1978 would have had his widow's SBP annuity reduced from about \$231 to \$43 because of the offset. In fact, the offset feature eliminated the SBP annuity altogether for some retirees.

The offset also had a direct bearing on the overall cost-share relationship between the individual and the government. In the original legislation, Congress expressed its intent that 60 percent of the cost be borne by the member and the remaining 40 percent be

contributed by the government. As the magnitude of the social security offsets grew throughout this period, the government share of the program declined correspondingly. For officers, the member share grew to about 76 percent by 1979. The proportion for enlisted personnel, meanwhile, had risen to 110 percent. In effect, enlisted personnel were having more retired pay withheld than they could ever expect their beneficiaries to receive in benefits.

Other problems plagued the original plan as well. Differences in calculating the annual premium adjustments for military participants compared to their Civil Service counterparts resulted in as much as a \$17 per month difference in the amount paid by military participants for identical coverage. Finally, the irrevocability of the enrollment decision deterred some from joining. Even when a marriage was terminated or the beneficiary predeceased the participant, the participant was required to continue paying premiums.

Solutions to these ills were not readily implemented. Some relief was provided in 1976 when Congress passed Public Law 94-496 and discontinued the requirement for the member to pay into the plan when the marriage was terminated or the beneficiary died prior to the participant. For the remainder of the decade, however, no other major legislation was enacted. Moreover, the DOD, because of budget considerations, declined to support efforts in the Congress to cap the social security offset. In fact, in 1979, the DOD

Actuary estimated that adoption of an offset cap equal to 50 percent of the social security value would have brought the program back into its originally intended cost-share relationship. But the DOD publicly challenged whether a government subsidy to the SBP should exist at all. This position was summarized in a letter from the Department's General Counsel to the Senate Armed Services Committee, "the present socio-economic situation in the United States, the evolution of the social security system, and the modernization of military compensation militate against the extension of the government subsidization of the Plan to future participants."

From the preceding, it was apparent that a poor environment existed for encouraging higher levels of participation. As one might expect, participation declined from about 60 percent in 1972 to about 53 percent by 1979.

Finally, in 1980, significant reforms in the SBP were made. Over the objections of the DOD, Congress passed Public Law 96-402. The "Civil Service" premium methodology was adopted, and the social security offset was limited to a maximum of 40 percent of the SBP value. In the report accompanying the legislation, Congress admitted that the increases in social security offsets during the 1970s had the effect of virtually eliminating costs to the government for most enlisted participants. Thus, by imposing the offset limit, Congress anticipated that payments to survivors of lower grade enlisted personnel would be increased immediately with

the corollary effect that virtually all participants would benefit from the change eventually.

At this point, the presumed obstacles to enrollment had either been eliminated or reduced. However, statistics show that participation did not increase appreciably. Table 3 shows Air Force and DOD participation levels since 1980.

	80	81	82	83	84
Air Force					
Officer	68	75	72	73	73
Enlisted	39	40	40	43	44
DOD					
Officer	69	73	73	74	73
Enlisted	38	41	43	45	45

TABLE 3. PARTICIPATION LEVELS

Moreover, among active duty non-disabled retirees, participation remained significantly lower. During Fiscal Year 1984, only 66 percent of officers and 40 percent of enlisted service members enrolled. Obviously, any predictions of increased participation resulting from the 1980 SBP amendments were unrealistic. What continues to cause this lack of response? The Air Force Sergeants Association (AFSA) lists the following areas as continuing irritants and sources of confusion.

(1) Many members still do not understand the social security offset. It is viewed as paying for two benefits, but having one reduced by the other.

(2) Forfeit of premiums should beneficiary die before the service member.

(3) No cancellation provision--once enrolled, always enrolled.

(4) Automatic reinstatement in the program if the member remarries.

(5) Massive negative perceptions surrounding the program.

Congress also was not satisfied with the status of the program. In the report accompanying the FY85 DOD Authorization Act, the Congress expressed its intent to study the plan during the year and make appropriate recommendations. This led to the changes to the SBP contained in the FY86 DOD Authorization Act--the most comprehensive yet enacted. The guiding principle of these changes was to make the plan simpler, hence, easier to understand. Major reforms taking effect on March 1, 1986 include:

(1) Eliminating the social security offset and establishing a two-tiered system under which survivors receive 55 percent of elected base amount prior to age 62; 35 percent thereafter. (For those who would receive greater benefits under the old formula, a grandfathering clause protects them).

(2) Indexing the minimum base amount for calculating premiums to increases in basic pay. (The 3 percent increase effective October 1, 1985 increases the minimum base to \$309).

(3) Mandatory spouse concurrence if member elects less than full SBP coverage or no coverage at all.

(4) Option for member not to continue enrollment upon

remarriage or to increase the level of participation.

Thus, 13 years after the original plan was enacted, and responding to most of the major criticisms leveled at it, Congress has substantially improved the structure. It is premature to assess the effect these modifications will have on participation, but a dramatic increase in enrollment is not likely. The reason: as inferred in the Air Force survey, many individuals do not consider the SBP a favorable alternative to private insurance. The next section discusses the value of SBP compared to private alternatives.

COST COMPARISONS

In the example depicted in Table 4, SBP is compared to a typical private sector term insurance policy for a Master Sergeant retiring with 20 years of service.

DEATH YR	GROSS SBP COST	NET SBP COST	CUM SBP COST	REPLACEMENT VALUE	TERM COST	CUM TERM COST
1985	\$ 721	\$ 541	\$ 559	\$139,994	\$ 437	\$ 452
1987	795	596	1,876	147,484	532	1,588
1989	877	657	3,501	154,963	705	3,202
1991	966	725	5,487	162,177	925	5,489
1995	1,175	881	10,810	174,902	1,587	12,944
2000	1,499	1,124	20,868	185,774	2,742	31,240
2005	1,914	1,435	36,368	187,645	4,050	63,245
2010	2,442	1,832	59,815	181,994	6,040	117,261
2015	3,117	2,338	94,786	195,439	10,240	209,871

TABLE 4. COMPARATIVE VALUES*
MASTER SERGEANT - 20 YOS - RETIRES IN 1985

*Assumes 5% inflation; real interest rate of 1.6%; member retires at age 41, spouse 3 years younger than member; member in 25% tax bracket. Data courtesy of Army Mutual Aid Association.

There are several advantages that distinguish SBP from the term plan. First, the favorable tax treatment of SBP is apparent. While the gross cost of SBP is about 7 percent of retired pay in this example, the net cost is only about 5 percent. Within the first 5 years of participation, this saves this individual over \$1000 in costs.

Another important feature of SBP is that it is designed to provide greater benefits when death is most likely--20, 30 or more years after retirement. This is reflected in the increasing replacement values for SBP shown in the chart above. Notice that even after the social security offset is applied (or the new 35 percent benefit as of March), the value dips slightly in 2010 but rebounds immediately. The reasons for this increasing value are the inflation protection provided retired pay, the straight 55 percent upon which SBP is based, and the inflation protection provided the SBP benefit. Private insurance policies have no such indefinite inflation protection. To the contrary, they are basically designed to offer high benefit-to-cost ratios when the insured is young and less likely to die. As he/she ages, the benefits decline or premiums increase dramatically. This results in the crossover effect illustrated in the example. For the first few years, the term policy is cheaper; but after 4 years the annual costs for the term policy exceed the SBP costs. By 1991 (7 years after enrolling), cumulative costs for the term policy equivalent to the value of the SBP at that point are greater. Since the

average retiree lives about 33 years after retirement, cumulative term costs would be about double the SBP costs.

Similar results are obtained when SBP is compared to other forms of insurance. Another popular form of private insurance is universal life insurance. This type of policy combines the savings asset feature of whole life insurance with the insurance protection of term insurance. Recently, Lieutenant Commander Forrest Ruck, USNR, and an executive with a major life insurance company, provided an analysis of SBP versus a typical universal life policy for the DOD Actuary. He concluded that a universal life policy with benefits comparable to SBP would lapse about the 17th year; therefore, the SBP is a better product on a cost-to-benefit basis.

Reinforcing these conclusions, Lieutenant Colonel Michael Cathey and Major Donald Clemmer, while completing their Doctoral Degrees in Business Administration, performed a cost-benefit analysis comparing the SBP with specific private insurance alternatives. They concluded that the minimum-option SBP (benefit based on the \$300 minimum base) was superior to any private sector plan for an equivalent benefit. Substantiating that, DOD estimates participants subsidize only about 25 percent of the minimum-option benefit. Furthermore, Cathey and Clemmer compared maximum-option SBP (electing full retired pay as a base) with 4 private sector plans COMBINED with the minimum-option SBP. The 4 plans were (1) a decreasing term and whole life combination, (2) a whole life policy, (3) a term policy with premium differences invested, and

(4) a universal life policy. Their analysis indicated that in some circumstances the private insurance combined with minimum-option SBP may be a better value than maximum-option SBP. However, this finding is dependent upon assumptions concerning life expectancies, rates of return on investments, and inflation. They cautioned that if a private sector plan is chosen, the retiree must accept some uncertainty about the outcome of events. In their words, "SBP is an excellent buy for protection of a surviving spouse."

Based on the foregoing, it is not surprising that reputable insurance experts such as the Army Mutual Aid Association (AMAA) and the United Services Automobile Association rate the SBP as a good value. The Fifth Quadrennial Review of Military Compensation (QRMC) completed an exhaustive analysis in 1983 and concluded that SBP "is at worst equal to and in most cases better than any alternative plan."

Yet, apparently, these observations are not well understood by many retirees. To some degree private insurers bear some responsibility for this lack of understanding. In many cases, they attempt to sell their policies by downplaying the SBP. Recent literature from a major insurer advertising an "SBP alternative" listed several "disadvantages of the SBP." Among these were (1) prohibitive cost if inflation rises, (2) severe reduction in pay at retirement, and (3) possible future program underfunding that may lead to a greater individual cost-sharing burden.

While it is not the intent of this article to refute private

insurance sales techniques, these statements are clearly misleading. Participants do not pay an ever increasing proportion of retired pay. Both retired pay and premiums are indexed by the same percentage increase since the 1980 amendment to the law was enacted. The gross premium for SBP ranges from about 2.5-9.0 percent of retired pay, the net premium, as already discussed, is considerably less. It is competitive with private insurance rates. The program is not underfunded. As part of the military retirement estate, the SBP is funded on an accrual basis--the Services must deposit appropriate funds into the retirement trust fund as determined by the DOD Board of Actuaries, an independent body appointed by the President. Moreover, in terms of reductions in retired pay collected versus benefit outlays, the program has actually been overfunded. DOD estimates that the member participants currently fund about 72 percent of the program--not the 60 percent originally intended.

Another factor hurting enrollment is negative publicity in some military journals and news magazines. Recently, a headline entitled "SBP Comes Up Short" appeared in a magazine with a large military readership. This article could have left the reader with the impression that SBP is not a good insurance value. Unfortunately, often overlooked in such articles is the fact that SBP is partially government subsidized--private insurance is not. In fact, premiums paid for private insurance must not only cover all benefits paid, but also provide a profit margin for the

company.

Finally, the DOD must shoulder part of the blame for the disappointing enrollment figures. As recounted above, the Department did not support needed changes in the program during the 1970s that could have produced a more favorable climate. In addition, no real effort was made to insure that the counselors truly understood the SBP. Fortunately, with the backing of the Secretary of Defense, some belated attention is being paid to this vital area. Within the past year, the Air Force has initiated several enhancements to its counseling program. Among these are new training aids for counselors, individual annuity and cost data reports, and a short film.

Most importantly, counselors are attending regional workshops where they discuss technical aspects of the SBP and private insurance policies so that they can be thoroughly prepared to discuss SBP.

CONCLUSIONS AND RECOMMENDATIONS

From the preceding discussion, there is little doubt that the SBP has suffered from "massive negative publicity." Almost from the beginning, the plan has been attacked for containing anomalies that provided a less generous benefit than some believed justified. To be certain, some inequities did exist in the original legislation. These have, for the most part, been addressed. In comparison to private insurance, the SBP is a favorable

alternative.

Therefore, the problem remaining is how to convince future retirees of the real value of the program--and that it is not a government rip-off. In the author's view, the following actions are essential.

(1) An extensive publicity campaign must continue. The program initiated by the DOD is a step in the right direction. This should be supplemented by a total revision of written materials. AFP 35-23 should be revised to provide actual comparisons between typical private sector insurance policies and the SBP.

(2) SBP counselor workshops should be held throughout the DOD. Initial feedback from Air Force workshops indicates that counselors enthusiastically endorse the concept and believe they are more knowledgeable about SBP after attending. An integral part of these workshops must be participation from outside insurance experts such as the AMAA. These individuals provide objective and detailed understanding of the real value of the SBP and have the expertise to discuss technical aspects. The desired outcome of these sessions should be to convince the counselor that SBP is, indeed, a good insurance value. Counselors who have misimpressions or are not adequately trained are not going to represent the program fairly or adequately.

(3) SBP counseling should begin sooner than the current 3 months before retirement. Ideally, the individual should have

several months, at a minimum, to make a decision. As it is done now, the retiree has many other important decisions to make in the critical months immediately preceding retirement. This makes it more difficult to devote adequate time to understand the various aspects of the program. One possibility is to provide mandatory counseling around the 19 year point with follow-up counseling as soon as the retiree submits his retirement request.

(4) The major military organizations such as the Air Force Association, the Air Force Sergeants Association, The Retired Officers Association, and others should endorse the program. The Congress has responded to these associations' past pleas for program improvements. Now, it is time for these organizations to publicly back the SBP. Perhaps, more than any other action, this could result in increased participation.

If these recommendations are followed, higher participation rates are possible. Counselors committed to the program will have a positive influence on future retirees. Military organizations committed to the program will have a positive influence on future retirees. And service members (active duty and retired) committed to the program will have a positive influence on future retirees.

Of course the SBP is not for everyone. Personal circumstances could dictate that an individual decline participation. However, for most retiring service members SBP provides a reasonable level of replacement income for the remainder of the spouse's life virtually without risk. Isn't it worth considering seriously?

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