

# Family Retirement Benefits

*While different methods are used by retirement plans to compute spouse benefits, ultimately it is the amount of the basic retiree benefit that has the largest effect on the amount of spouse benefits.*

BY WILLIAM J. WIATROWSKI

This publication and others have long debated the worth of retirement plans and ways to compare benefits coming from widely different plans. Past articles have explored plan provisions, replacement rates, and employer contributions. The question of how much retirement plans pay has usually been examined from the perspective of benefits for the individual employee. Consider an alternative: what does the method by which a plan provides spouse and family benefits — generally thought of as an ancillary provision to the basic pension formula — reveal about the worth of the plan? In fact, widely varying treatments of these ancillary benefits has a large effect on the total payment available to the retiree and family.

The first objective of public and private retirement plans is to provide income to workers during retirement. But often retirement income comes in the form of an individual benefit, a spouse benefit, and a child benefit. Perhaps it is the sum of these benefits, and the change in benefits that occurs when one spouse dies, that must be used in comparing the worth of one plan with another.

What is a family benefit? In essence, it is the total amount of pen-

sion received by a retired worker, a spouse, and possibly dependent children. This benefit is typically different than that available to a single retiree. Family benefits are typically greater while both spouses are alive; upon the death of one spouse, total benefits are usually reduced — although this reduction may differ based on which spouse dies first. This article explores the methods that public and private pension plans use to provide family benefits and works through some benefit calculations.

## Major types of family retirement benefits

*Social Security.* This Nation's largest retirement program is Social Security, with just over 40 million beneficiaries currently receiving payments and nearly 150 million workers currently paying into the system.<sup>1</sup> Social Security provides a direct family benefit, in the form of spouse and dependent children pensions paid in addition to the worker's pension.<sup>2</sup>

Under Social Security, the employee's Primary Insurance Amount — the basic benefit a worker receives if retirement occurs at normal retirement age<sup>3</sup> — is determined by earn-

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**Table 1. Social Security payment factors for various beneficiaries**

Beneficiary	Payment factor
Single individual .....	100
Married individual .....	100
Spouse .....	50
Children .....	50
Family maximum .....	175
Surviving Retiree .....	100
Spouse .....	100
Children .....	75
Family maximum .....	175

**Table 2. Employer-provided pension plan payment factors for various beneficiaries**

Beneficiary	Payment factor
Single individual .....	100
Married individual who selects a joint and survivor benefit .....	90
Surviving Retiree .....	90
Spouse .....	45

ings history. A spouse receives 50 percent of the employee’s benefit and dependent children each receive 50 percent of the employee’s benefit. (The 50 percent spouse benefit assumes the spouse is not eligible for Social Security benefits from his or her own earnings. In a case where a spouse is eligible for their own Social Security, they receive the greater of their own benefit or the spouse benefit.) Total family benefits are subject to a maximum of about 175 percent of the employee’s Primary Insurance Amount.<sup>4</sup> Variations in the amounts occur if the retiree or spouse is younger or older than age 65. Dependent children benefits are only available for children up to age 18, or up to age 19 if the child is still in elementary or secondary school.

Upon the death of either spouse, the Social Security benefit for the surviving spouse is 100 percent of the Primary Insurance Amount – equal to the basic benefit of the retiree. (Again, this assumes only one spouse is eli-

gible for benefits from earnings.) Regardless of which spouse dies first, the surviving spouse receives the full benefit. Benefits for dependent children increase to 75 percent of the deceased’s Primary Insurance Amount, and continue to be subject to the maximum age restrictions. Total surviving spouse and children benefits also continue to be subject to the maximum family benefit.

There is no additional cost to the employee for family protection under Social Security. That is, employee contributions to Social Security do not differ based on the expectation that spouse and child benefits will be paid. The benefit is automatic.

Throughout this article, the percent of the basic benefit received by retirement income recipients will be referred to as the “payment factor.” In all cases the basic benefit as calculated by the retirement plan, before accounting for survivor protection, would have a payment factor equal to 100. Table 1 shows the Social Security payment factors for various beneficiaries.

*Private pension plans.* While Social Security coverage is nearly universal, slightly more than half of all workers are covered by an employer-provided retirement plan.<sup>5</sup> In general, these plans have two alternative designs, one providing individual accounts that are typically paid in a lump sum at retirement and one providing periodic payments during retirement.<sup>6</sup> It is these latter plans that are relevant to this comparison of family benefits.

Employer-provided pension plans, whether through private employers, labor organizations, or Federal, State, or local governments, typically use the “joint and survivor annuity” approach to providing family and survivor benefits. In general, this approach is similar to the Social Security approach — a larger benefit is paid while both the retiree and spouse are living, with a lower benefit paid for the surviving spouse. But in fact, these benefits are quite different.<sup>7</sup>

A joint and survivor benefit, as the name implies, consists of two parts –

a joint benefit for both spouses and a survivor benefit for the remaining spouse. Unlike the added family benefits found in Social Security, however, no additional benefits are paid to the spouse while the retiree is alive. Under a joint and survivor arrangement the joint benefit for both spouses is equal to the basic benefit (or often less than the basic benefit), and the surviving spouse benefit is equal to some portion (commonly 50 percent) of that joint benefit.<sup>8</sup>

Under most employer-provided plans, the employee essentially must “pay” for the survivor benefit through a reduction in his or her basic benefit; this reduction typically amounts to 10 percent or less. Thus, the retiree and spouse might receive joint pension benefits equal to about 90 percent of the basic benefit; following the death of the retiree, the typical surviving spouse’s benefit, 50 percent of the joint benefit, would be about 45 percent of the basic benefit. An advantage, perhaps, under the employer-provided plan, comes if the spouse should die first. In this case, the employee continues to receive, for the rest of his or her life, the joint benefit that both spouses had been receiving (and not the lower survivor benefit). The retired employee continues to receive about 90 percent of the basic benefit. The benefit typically does not “pop-up” to the 100 percent mark, however, even though the survivor benefit will never be paid. Table 2 shows payment factors under employer-provided pension plans.

*Railroad Retirement System.* The Railroad Retirement System, which predates Social Security, provides pension benefits for employees in railroad and related industries. By design, Railroad Retirement contains features of both Social Security and a private pension plan. It consists of two portions known as Tier I and Tier II. Covered employees and employers do not pay into Social Security. Instead, Tier I provides identical benefits to those provided by Social Security, including the spouse and children ben-

**Table 3. Railroad Retirement payment factors for various beneficiaries**

Beneficiary	Payment factor	
	Tier I	Tier II
Single individual .....	100	100
Married individual .....	100	100
Spouse .....	50	45
Children (max.) .....	50	
Family maximum .....	175	145
Surviving		
Retiree .....	100	100
Spouse .....	100	50
Children (max.) .....	75	15
Family maximum .....	175	80

efits described above.<sup>9</sup> Tier II functions as a private pension plan, but provides both a spouse and child add-on to the basic benefit (like Social Security) and a joint and survivor provision (like a private pension plan).

Under Tier I, a spouse receives 50 percent of the retiree's Tier I basic benefit. Dependent children also receive 50 percent of this basic benefit, with total family benefits subject to the family maximum. These benefits are in addition to the retiree's Tier I benefit, just like under Social Security.

In addition, under Tier II, the spouse receives 45 percent of the employee's tier II basic benefit. Again, this is in addition to the retiree's Tier II basic benefit. There is no children's benefit under Tier II while the retiree is alive.

Upon the death of the retiree, the surviving spouse receives 100 percent of the retiree's Tier I benefits — just like Social Security — plus a percent of the deceased employee's Tier II amount — just like a private pension. Tier I benefits for surviving children are the same as under Social Security. Under Tier II, should the retiree predecease the spouse, the spouse's add-on benefit is dropped in favor of a survivor benefit. This surviving spouse benefit is 50 percent of the employee's Tier II amount; each eligible child receives 15 percent of the employee's Tier II amount. There is a family maximum of 80 percent. However, the total survivor benefit to the widow or widower cannot be less than the

amount he or she received prior to the retiree's death. If the spouse predeceases the retiree, the retiree's benefit is unchanged.

There is no cost for family protection under Railroad Retirement. That is, employees are not required to contribute toward the cost of providing family benefits from these plans nor is there a reduction in the employee's benefit to account for the spouse and survivor payments. Table 3 shows benefits under Railroad Retirement for various beneficiaries, based on a payment factor of 100 for each tier for single individuals.

*Are there two retirement systems?* From the vantage point of family benefits, there appear to be two systems: One increases total family benefits at no cost while the other reduces family benefits at a cost. Is this fair? Is it fair for unmarried retirees to receive a lower benefit under Social Security or Railroad Retirement than their married counterparts, with no difference in contributions? Is it fair for workers under an employer-provided pension plan to have to take a reduction in benefits to fund protection for their spouse, while those under Social Security and Railroad Retirement have no such reduction and in fact get a "free" spouse benefit?

While there may be *prima facie* evidence that Social Security and Railroad Retirement are a better "deal" for families than employer-provided plans, there are other factors to consider. Two important variables are the amount of basic benefit each plan provides and any combinations of benefits beneficiaries receive. By design, each plan provides a different level of basic benefit. In addition, these plans are typically received in conjunction with one another. Considering combinations of benefits, there are, in essence, three benefit possibilities: Social Security only, Social Security plus a private pension, and Railroad Retirement (Tier I plus Tier II).

### Comparison of benefit amounts

Neither Social Security (and Railroad Retirement Tier I) nor employer-

provided retirement plans provide a single benefit level for all beneficiaries. That is what makes comparisons so difficult. Social Security benefits are designed to provide a greater percentage of prior earnings for lower income than for higher income workers. Employer-provided retirement plans vary in how benefits are provided, although many provide a fixed percent of final earnings.<sup>10</sup> Only Railroad Retirement Tier II has a fixed benefit amount — 0.7 percent of earnings times years of service (or 21 percent of earnings after 30 years).

To make comparisons, therefore, typical basic benefits will be used. For Social Security and Railroad Retirement Tier I, a benefit of 1.1 percent of earnings times years of service, or 33 percent after 30 years, is used. While Social Security benefits vary with earnings, this amount is typical. Employer-provided retirement plans provide an average of about 30 percent of final earnings after 30 years (1.0 percent per year), while plans providing benefits based on a percentage of earnings average about 45 percent of final earnings after 30 years (1.5 percent per year).<sup>11</sup> Calculations of family benefits include private retirement plans paying both 30 and 45 percent of final earnings. These different basic benefits — ranging from 21 to 45 percent of final earnings after 30 years of service — may help to explain the difference in family benefit approaches.

Table 4 shows the percent of earnings per year and after 30 years from Social Security (and Railroad Retirement Tier I), employer-provided pensions (1.0 and 1.5 percent), and Railroad Retirement Tier II. The table also shows the dollar amount of the benefit received by an employee retiring after 30 years of service based on final earnings of \$30,000. Also shown is a "payment factor," which indicates the percent of the retiree's benefit that will be received by various beneficiaries.

These data indicate that the payment factor does not correspond with the amount of benefit received, because of differences in the basic benefits. For example, the employee and spouse

**Table 4. Yearly percent of earnings, 30-year percent of earnings, 30-year benefit, and payment factor for typical basic retirement benefit plans**

Plan and plan beneficiary	Percent of final earnings <sup>1</sup> per year of service	Percent of final earnings for 30 years of service	30-year benefit with final earnings of \$30,000	Payment factor
<b>Social Security</b> (or Railroad Retirement Tier I)				
Employee .....	1.100	33.00	9,900	100
Employee and spouse .....	1.650	49.50	14,850	150
Surviving retiree .....	1.100	33.00	9,900	100
Surviving spouse .....	1.100	33.00	9,900	100
<b>Employer-provided pension (1 percent per year)</b>				
Employee .....	1.000	30.00	9,000	100
Employee and spouse .....	.900	27.00	8,100	90
Surviving retiree .....	.900	27.00	8,100	90
Surviving spouse .....	.450	13.50	4,050	45
<b>Employer-provided pension (1.5 percent per year)</b>				
Employee .....	1.500	45.00	13,500	100
Employee and spouse .....	1.350	40.50	12,150	90
Surviving retiree .....	1.350	40.50	12,150	90
Surviving spouse .....	.675	20.25	6,075	45
<b>Railroad Retirement Tier II</b>				
Employee .....	.700	21.00	6,300	100
Employee and spouse .....	1.015	30.45	9,135	145
Surviving retiree .....	.700	21.00	6,300	100
Surviving spouse .....	.350	10.50	3,150	50

<sup>1</sup> Most retirement plans specify a definition of earnings that does not equate exactly to final year earnings, such as an average of the last 3 years' earnings. The examples presented here are simplified for comparison purposes.

**Table 5. Yearly percent of earnings, 30-year percent of earnings, 30-year benefit, and payment factor for combinations of retirement plans**

Plan and plan beneficiary	Percent of final earnings <sup>1</sup> per year of service	Percent of final earnings for 30 years of service	30-year benefit with final earnings of \$30,000	Payment factor
<b>Social Security only</b>				
Employee .....	1.100	33.00	9,900	100
Employee and spouse .....	1.650	49.50	14,850	150
Surviving retiree .....	1.100	33.00	9,900	100
Surviving spouse .....	1.100	33.00	9,900	100
<b>Social Security and employer-provided pension</b> (1.0 percent per year)				
Employee .....	2.100	63.00	18,900	100
Employee and spouse .....	2.550	76.50	22,950	121
Surviving retiree .....	2.000	60.00	18,000	95
Surviving spouse .....	1.550	46.50	13,950	74
<b>Social Security and employer-provided pension</b> (1.5 percent per year)				
Employee .....	2.600	78.00	23,400	100
Employee and spouse .....	3.000	90.00	27,000	115
Surviving retiree .....	2.450	73.50	22,050	94
Surviving spouse .....	1.775	53.25	15,975	68
<b>Railroad Retirement Tier I and Tier II</b>				
Employee .....	1.800	54.00	16,200	100
Employee and spouse .....	2.665	79.95	23,985	148
Surviving retiree .....	1.800	54.00	16,200	100
Surviving spouse .....	1.450	43.50	13,050	81

<sup>1</sup> Most retirement plans specify a definition of earnings that does not equate exactly to final year earnings, such as an average of the last 3 years' earnings. The examples presented here are simplified for comparison purposes.

have a higher payment factor under Railroad Retirement Tier II (145) than under the 1.5-percent employer-provided pension plan (90), but the employer-provided plan provides a higher dollar amount than Railroad Retirement Tier II plan. Similarly, the lowest payment factor for surviving retirees—90 under the 1.5-percent employer-provided plan—corresponds with the largest benefit: 1.35 percent per year, or \$12,150 after 30 years. Thus, the effect of the payment factors, which are determined by the plan provisions (that is, family add-on benefits versus joint-and-survivor protection), is outweighed by differences in basic benefits among the retirement systems. The more generous the basic benefit, the more generous the family benefits. For this reason, payment factors do not correspond with the monetary value of the benefits.

## Benefit combinations

The inconsistency between the payment factor — the percent of the basic benefit received -- and the actual dollar amount is also evident when the possible combinations of benefits are considered. (See table 5.) For example, the employee and spouse receiving an employer-provided retirement plan (1.5 percent of earnings) plus Social Security have a payment factor of 115 percent of the basic benefit, compared with 148 percent for those under Railroad Retirement Tiers I and II. Yet, the former couple receives a greater benefit — \$27,000 — compared with \$23,985 for the latter couple. Even under the less-generous 1.0-percent of earnings employer-provided retirement plan, similar results can be found. While the lower payment factor for a retiree and spouse (121) compared with that for Railroad

Retirement Tiers I and II (148) would suggest larger Railroad Retirement benefits, in fact the payments are about the same (\$23,985 for Railroad Retirement and \$22,950 for the employer-provided pension). Likewise for surviving spouse benefits, the payment factor would suggest the Railroad Retirement recipient would have greater benefits yet in actuality the employer-provided retirement plan recipient has the greater benefits.

What do these comparisons suggest? Once again, the ability to compare pension plans by focusing on one or a few key plan provisions must be questioned. What may on the surface appear more generous in reality may not be so. Ultimately, dollar amounts of pensions, whether for retirees alone or for spouses and families, may be the best measure of one plan against another.

## —ENDNOTES—

<sup>1</sup> Current statistics on Social Security beneficiaries and covered workers are available monthly in the *Social Security Bulletin*. More detailed data are available in the *Annual Statistical Supplement to the Social Security Bulletin*.

<sup>2</sup> For a detailed account of Social Security provisions, see Robert J. Myers, *Social Security*, McCahan Foundation, 1985.

<sup>3</sup> The normal retirement age under Social Security, the age at which full, unreduced benefits may be received, was traditionally age 65. Following enactment of the Social Security Reform Act of 1983, the normal retirement age was increased to age 67, to be implemented over several years. Beginning with those individuals who turn age 62 in 2000, the normal retirement age increases gradually. The normal retirement age will be age 67 for those who turn age 62 in 2022 or later.

<sup>4</sup> This is known as the Maximum Family Benefit. It is actually determined by a formula that varies with earnings. In 1997, the maximum was equal to 150 percent of the first \$544 of Primary Insurance Amount, 272 percent of the next \$241, 134 percent of the next \$239, and 175 percent of any additional amount. Under the Maximum Family Benefit, all benefits other than those of the retiree are proportionally reduced. Some benefits,

such as those of divorced spouses, are excluded from the Maximum Family Benefit.

<sup>5</sup> Data from the Bureau of Labor Statistics, Employee Benefits Survey, indicate that 56 percent of full- and part-time employees in private industry and State and local government participated in a retirement plan in 1993-94. See Ann C. Foster, "Employee Benefits in the United States, 1993-94," *Compensation and Working Conditions*, Spring 1997, pp. 46-50.

<sup>6</sup> A *defined benefit pension plan* specifies a formula for providing periodic payments to a beneficiary beginning at retirement age for the remainder of his or her life, and often for the life of a spouse. A *defined contribution plan* specifies employer and employee contributions to an individual account. Benefits at retirement are not specified; they are determined by the value of the account. Defined contribution plans are often paid to retirees in a lump sum, although some plans offer the option to purchase an annuity that will pay periodic payments, and may include an option to maintain those periodic payments for a surviving spouse. The discussion of survivor benefits from employer-provided retirement plans in this article is limited to defined benefit pension plans only.

<sup>7</sup> Employer-provided retirement plans typi-

cally do not include specific benefits for children, although a plan may specify that survivor benefits are available to any beneficiary named by the retiree, not necessarily a spouse.

<sup>8</sup> Detailed information on joint and survivor provisions of defined benefit pension plans may be found in Donald Bell and Avy Graham, "Surviving spouse's benefits in private pension plans," *Monthly Labor Review*, April 1984, pp. 23-31. Calculations of joint and survivor benefit payments may be found in William J. Wiatrowski, "New survey data on pension benefits," *Monthly Labor Review*, August 1991, pp. 8-22.

<sup>9</sup> Railroad employees and employers pay the same earnings-based contribution to Railroad Retirement Tier I that others pay to Social Security.

<sup>10</sup> Note that most retirement plans specify a definition of earnings that does not equate exactly to final year earnings, such as an average of the last 3 years' earnings. The examples presented here are simplified for comparison purposes.

<sup>11</sup> See *Employee Benefits in Medium and Large Private Establishments, 1993*, Bureau of Labor Statistics, Bulletin 2456, November 1994. The average multiplier in terminal earnings formulas that calculate benefits using a flat percent times years of service is 1.5.