

FEDERAL EMPLOYEES



HOW TO MAXIMIZE YOUR BENEFITS

Gigi Bodwin, FRC, CFEI
President
Bodwin Financial Solutions



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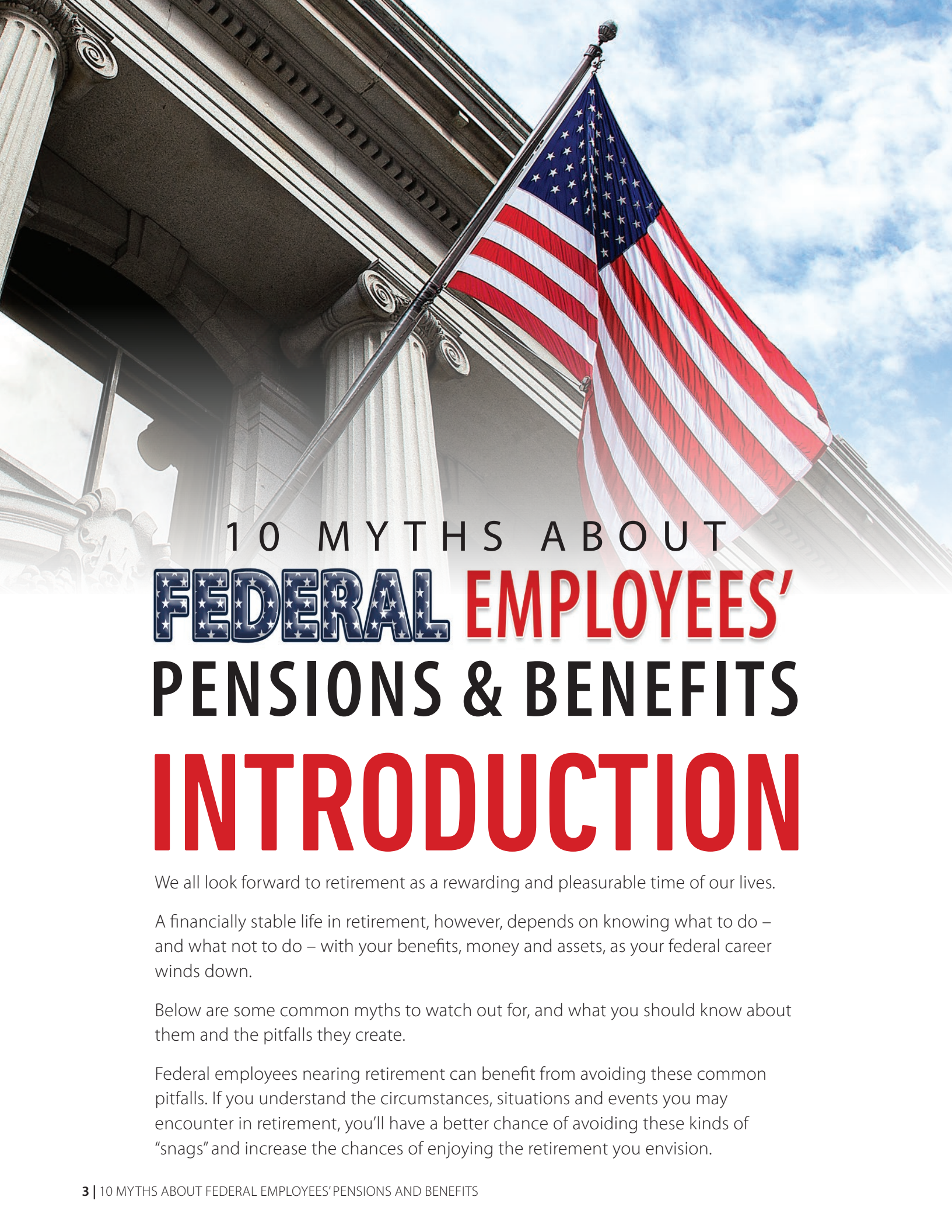


www.bodwinfinancialsolutions.com



9325 Lyonswood Drive
Owings Mills, MD 21117

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10 MYTHS ABOUT **FEDERAL EMPLOYEES'** **PENSIONS & BENEFITS** **INTRODUCTION**

We all look forward to retirement as a rewarding and pleasurable time of our lives.

A financially stable life in retirement, however, depends on knowing what to do – and what not to do – with your benefits, money and assets, as your federal career winds down.

Below are some common myths to watch out for, and what you should know about them and the pitfalls they create.

Federal employees nearing retirement can benefit from avoiding these common pitfalls. If you understand the circumstances, situations and events you may encounter in retirement, you'll have a better chance of avoiding these kinds of “snags” and increase the chances of enjoying the retirement you envision.



MYTH #1: I'LL BE IN A LOWER TAX BRACKET SO MY TAX BURDEN WILL BE LESS AFTER I RETIRE.

This is a myth most federal employees fall for – most believe that they will be in a lower tax bracket in retirement than they are right now. In reality, what actually happens is that most people end up in the exact same tax bracket that they are in right before they retire from federal service.

How could this happen? Didn't you just take a big pay cut to retire?

It's easy to see why this confusion occurs. In retirement, instead of pulling your full salary, you're going to be pulling in a pension that is typically much less than the salary you have today. However, the idea of being in a lower tax bracket assumes that you're not pulling money from any other places. Plus, as a federal retiree, you'll now be taxed on the money you use to pay the premiums for your Federal Employees Health Benefits (FEHB) – something you didn't have to do while you were working.

Imagine a scenario where you're at a certain level of salary and you take an obvious pay cut to receive your pension in retirement. However, because you still want the same standard of living in retirement, you need to fill in the income gap. If you do so with money from accounts like the Thrift Savings Plan (TSP) and Social Security — the vast majority of which are taxable — you will be right back in the same tax bracket as you were before retirement.

Remember, there are only two reasons people end up in a significantly lower tax bracket when they retire. (1) They have significantly less money to live on in retirement (but who wants that?). (2) They PLANNED to be in a lower tax bracket by implementing smart tax strategies when they were younger. That's one reason this myth can be detrimental. Falling for it might keep you from some beneficial planning.



MYTH #2: I ONLY HAVE TO PAY TAXES ON THE MONEY I PUT IN THE THRIFT SAVINGS PLAN.

Most federal employees know that there are taxes due on the back end of their traditional Thrift Savings Plan (TSP). Of course, this happens because no tax was paid on the money that was put into the TSP (called “tax deferred”). However, what many federal employees don’t understand is that they don’t just owe tax on the principal – they also owe tax on all of the growth.

For example, let’s say you contribute \$100,000 to the traditional TSP (over a long period of time),

and that \$100,000 grows to \$200,000. Then the principal that you originally contributed (\$100,000) was not taxed at the time and the growth (\$100,000) has not been taxed yet – but don’t worry; the IRS won’t forget!

Therefore, if you were to withdraw this \$200,000 (either all at once or over a long period of time), you owe the tax on the entire \$200,000 — not just the money you put in, but all the growth, too!



MYTH 3: I CAN RELY ON MY FEDERAL HEALTH INSURANCE BENEFITS (FEHB) FOR ALL MY MEDICAL NEEDS.

Good health is often key to a great retirement. Unfortunately, the cost of healthcare is rising at an incredibly fast rate. Sure, your federal health insurance will continue to cover you for the rest of your life without adding Medicare Part B and paying the additional Part B premium.

Many federal employees think that if their FEHB coverage has served them well throughout their federal careers, it should be enough to see them through retirement. However, you shouldn't decline Medicare without at least looking further

at all your options. In some cases, it makes sense to have both FEHB and Medicare part B to fill in some of the gaps.

For example, Medicare can provide additional benefits beyond your FEHB coverage for medical equipment, treatment for chronic conditions, home health care during recovery from an illness or injury, and more. Whatever plan or combination you choose, it's essential that you make sure you have the coverage you need if anything serious should happen.



MYTH 4: I DON'T NEED LONG-TERM CARE INSURANCE.

One concern that retirees commonly have is the loss of independence – and with the cost of nursing homes rising, retirees will want to make sure they have a plan to pay for this coverage, if needed.

According to a recent U.S. government report, 70% of adults over the age of 65 will need some kind of long-term care.¹ As a federal employee, you have the Federal Long Term Care Insurance Program (FLTCIP), as well as several private insurance options available to you to help you address this very startling statistic. But you must qualify for both, so don't wait to explore these options!

When it comes to long-term care insurance, most people are afraid of paying too much for a program they may never use. However, remember that statistically, we know that 70% of us will end up needing some sort of long-term care. Be sure to explore the different functions of FLTCIP and other private products to determine which is best suited for your family's needs.

No matter where you are in your career, you should at least consider the prospect of needing long-term care insurance. The right coverage can help protect your retirement savings and assets in the event you or your loved ones ever need long-term care.

How much does long-term care cost? One factor in the cost is time: for what length of time will care be required? According to the U.S. government, one-third of today's 65 year-olds may never need long-term care support, but 20 percent will need it for longer than 5 years. On average, women need 3.7 years of care while men need 2.2 years.¹

The ultimate cost of long-term care also varies based on care setting, geographic location of care and level of care required, among other things. According to long-term care insurer Genworth, national median costs for long-term care range from \$4,481 per month for in-home homemaker services to \$8,821 per month for a private room in a nursing home.²

With costs like these, it's easy to see why long-term care can be devastating to your retirement savings and assets.

1. "How Much Care Will You Need?" – LongTermCare.gov, Feb 2020: <https://acl.gov/ltc/basic-needs/how-much-care-will-you-need>

2. Monthly Median Costs: National (2020): <https://www.genworth.com/aging-and-you/finances/cost-of-care.html>





MYTH 5: TO SAVE MONEY, I SHOULD DROP MY BASIC LIFE INSURANCE COVERAGE WHEN I RETIRE.

At retirement, federal employees are required to consider how much Federal Employees Group Life Insurance (FEGLI) they want to carry into retirement and how much they want to maintain past 65. As you get closer to retirement, make sure that your life insurance still fits your needs.

For example, when your kids are grown and the house is paid off, your overall need for life insurance may go down – so, if it's no longer needed, you may be able to discontinue Option B and save yourself some money. On the other hand, you may have a new desire to have life insurance if you wish to leave a legacy to your grandchildren.

The cost of life insurance is based on two simple factors:

- How much insurance you are applying for
- Your age and health.

It's important to consider that life insurance becomes more expensive to obtain and maintain as you get older. For this reason, you should at least consider the value of Basic FEGLI. Based on cost, it's generally worth keeping, regardless of your need for other life insurance.

For some people, keeping Basic is a no-brainer. If you're 65 or older, retired, and held the coverage for at least 5 years, you can keep 25% of FEGLI coverage in place at no cost. That's right: there is no further money due and you keep some life insurance. Why get rid of it completely when you can keep 25% at no cost?

For those retiring prior to reaching age 65, paying for FEGLI until you get there is the only foreseeable deterrent when it comes to keeping "Basic." As for the additional coverage choices, there are other things to keep an eye out for, but none as obvious as holding on to at least 25% of your Basic FEGLI in retirement if you can keep it at no cost.



MYTH 6: I CAN EXPECT MY PENSION PAYMENT RIGHT AWAY.

Yes, it's tempting to expect full pension payments shortly after retiring. But, in most cases, it could be anywhere between 2 to 6 months, and in some cases, it could be even more.

The reason for this delay is that the U.S. Office of Personnel Management (OPM) is adjudicating your retirement benefits during that time. Your basic annuity is computed based on your length of service and "high-3" average salary.

- To determine your length of service for computation, they add all your periods of creditable service, then eliminate any fractional part of a month from the total.

- Your "high-3" average pay is the highest average basic pay you earned during any 3 consecutive years of service. These three years are usually your final three years, but can be an earlier period, if your basic pay was higher during that period.

Unfortunately, processing delays in retirement applications have become worse in recent years due to the increasing number of retiring employees. You should therefore play it safe and plan on not receiving your full pension payments until 9 to 12 months after you retire. That means, to avoid hardship, you should make sure that you have a sufficient amount of liquid assets or cash to help pay your everyday bills during those months.



MYTH 7: I DON'T NEED TO HAVE AN EMERGENCY FUND.

We've already covered one reason to have an "emergency fund": because you can expect a delay in receiving your full pension payments and will need money to pay for everyday expenses during the interim. But there are also unexpected events or expenses that can be crucial when protecting your assets. Having an emergency fund can be the difference between a minor inconvenience in your financial life and complete disaster in your entire life. You don't want to face dire consequences such as foreclosure or bankruptcy.

According to most financial experts, it's recommended you save at least 3 to 6 months of net living expenses in an emergency fund. Calculate your 3- to 6-month number by including only

necessary expenses like rent or mortgage, food, health insurance, life insurance, utilities, car payments, car insurance and gas. So, if your family requires \$3,000 a month to pay all of its basic expenses, then you should strive to accumulate \$9,000 to \$18,000.

This sounds like a lot of money, but you don't have to accumulate it all at once. Start small. Shoot for a starter emergency fund of \$500 to cover little emergencies. Once you're on track, focus on building up your savings and then set a reasonable timeframe to get to the 6-month number. But don't give yourself too much time – growing your emergency fund should be a priority.



MYTH 8: I SHOULD MONITOR MY TSP CLOSELY AND QUICKLY REACT TO CHANGES IN THE MARKET.

During volatile market swings, it can be easy to see your Thrift Savings Plan (TSP) take a hit and panic. But remember, your TSP is a retirement account, which means it's a long-term investment. Try to stay put and ride out the swings. The market is very likely going to come back up in the months ahead.

Knee-jerk reactions – in a good or a bad market – rarely favor the investor. Most often when people are scrambling to make a fast move in a down

market, they end up regretting it because it wasn't something that was rational for them to do. When it comes to the stock market, it pays to be patient.

Try to remember, during market downturns, that the world is not ending, the U.S. stock market is not ending, and so as long as you don't need the money right now, you've suffered a paper loss, and if we look at it historically, the market will rebound. It always has.



MYTH 9: I DON'T NEED A FINANCIAL PLAN BECAUSE MY FINANCIAL SITUATION IS SIMPLE.

Regardless of your situation, it's important to have a plan – starting right now – because the decisions you make today can have a long-term impact on your and your family's overall financial health. Failure to have a financial plan in retirement is one of the most common reasons why retirees encounter financial problems early in their retirement years.

Having a financial plan for retirement includes such items as setting up a budget for retirement, paying off one's mortgage or other debts, a timetable to start tapping into retirement accounts such as the Thrift Savings Plan (TSP) and IRAs, when to start receiving Social Security retirement benefits, and reviewing insurance coverages.

Proper retirement planning involves three distinct phases. All of them require decisions that affect your retirement. Some of the decisions are irreversible.

First, Pre-Retirement

This takes place during your working years or the accumulation years. The decisions that are made during this stage will largely determine how much income you have available when you retire.

Second Is Retirement Itself

This takes place in a relatively short period of time. The decisions made here could easily mean the difference between success and hardship during your post-retirement years.

Third Is Post-Retirement

This is when you get to enjoy the rewards of the previous phases. But the decisions here will affect your ability to continue the lifestyle you've worked and planned so carefully to establish.

No matter where you are on the retirement timeline, you have some idea of what you'd like to do when you retire. You need a well-defined financial strategy to turn your retirement goals into reality and make the golden years just that, truly golden.





MYTH 10: I CAN PLAN FOR RETIREMENT MYSELF - I DON'T NEED HELP.

It should be obvious from the myths outlined here that a sound retirement plan must take into consideration many different factors. Unless you're well versed in these factors, you could end up making serious mistakes that will sabotage your retirement years, making them far less pleasant than you'd like.

For instance, many federal employees fail to understand the effects of their elections of benefits at retirement and how one can affect another. As a federal employee, you're responsible for all of the elections that you make. So, be sure that you have the information you need regarding how your benefits will change in retirement before making any important decisions.

When it comes to investing, it can be tempting to go it alone. But when you go it alone, emotions can get the best of you and cause you to jump in and out of the market when it goes up or down. Trying to time the market in that way only costs you in the end. A professional can help you focus on the long term.

The long term is definitely what you need to focus on when you're facing a retirement that might last 20, 30 or more years. That's why you'll want to think about working with a professional planner who is well versed in the intricacies of retirement.

Professionals are trained to take into consideration your age, health, financial needs, tolerance for risk, goals, pre- and post-retirement lifestyles, and other factors when developing a comprehensive plan to guide you through your golden years. Once your plan is implemented, a dedicated planner will work with you over the years to help keep your plan on track with your changing needs and the ever-shifting economic and financial environment.

Are you certain you can do all that is required to achieve the retirement you envision? If not, then you should seriously think about sitting down with a professional. There are many excellent ones throughout the country, including some who specialize in working with federal employees. Most offer no-cost, no-obligation consultations, so sit down with a few and see what they say.

You'll be amazed at how much better you'll feel if you can find a professional planner you feel comfortable with and start planning for retirement now. You'll know where you're headed, and you'll be able to make adjustments now to improve your financial condition later on. Laying a solid foundation for your retirement can be among the most valuable time you'll ever spend on your finances.



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