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Buying extra time for your pension

By Stef Donev • Bankrate.com

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When we plan for retirement, there is one crucial question that none of us can answer: How long will I live?

Obviously that's important to everyone, but it has particular financial ramifications if you work in the public sector -- a governmental agency or organization -- that lets you "buy" additional time for your pension plan.

Let's say you are going to retire from your government job or someplace else that lets you buy what is formally referred to as "service time."

You have a defined-benefits pension plan, been there 25 years and you know that your monthly retirement check -- based on your salary and 25 years of service -- will be X, and it will arrive in your mailbox every month for the rest of your life, even if you live to be 100.

But if you were to invest some money and buy an additional five years, your monthly retirement check -- based on your salary and 30 years of service -- will be X+Y, and it will arrive in your mailbox every month for the rest of your life.

Should you buy more time?

The question is, do you buy the additional years?

A defined benefit plan is one that pays according to a formula, usually a combination of years of service and your pay, says Dr. Mark Johnson, of ERISA Benefits Consulting, of Colleyville, Texas.

"While defined-benefit plans were once fairly common," Johnson says, "over the last 20 years they have been going away at a very rapid rate. Today it's most common in the public sector. The private sector avoids it. Companies don't want to do anything that will increase their defined benefit liability. Companies prefer defined contribution or individual account plans."

With those, the company and/or you put a certain amount of money into the account on a regular basis for as long as the plan is active. As soon as you leave the company, the company is done adding money to it.

"It's cheaper for them," Johnson says. "In these types of plans, your pension consists of whatever is in your personal pension fund when you retire."

If you live to be 100, with a defined payment plan you keep getting a pension check every month. If you live to be 100 with a defined contribution plan, you better hope you that you have saved enough to last you.

When you do die, any money you have left from a defined contribution plan -- 401(k), IRA and so on -- goes to your heirs. But money in your defined benefits pension fund stays there. If you do "buy" extra time, that money becomes the plan's money. It is no longer yours or your family's, even if you die before you hit retirement age.

Edward Fong, a spokesman in Sacramento for CalPERS, the California Public Employees' Retirement System, says that as far as defined benefit plans are concerned, the key point about "buying time is that it be cost-neutral to the employer. It cannot cost the employer anything extra.

"Our actuaries calculate what you make, what it will cost to pay you a pension and how long you can expect to live. I believe the general assumption today is that most people will live to be about 80."

Next: "There are other factors to consider. ..."

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