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Income strategies: Enhancing your benefits with pension maximization

The strategy

Retirement is a time for you to reap the benefits of a lifetime of planning and saving. But what if your preparations aren't enough? What if the pension you primarily counted on to maintain your lifestyle for you and your spouse isn't as much as you thought it would be?

Consider this: At, or prior to retirement, you may be required by your employer to make an irrevocable choice of either a "maximum pension benefit with no survivor benefits," or a "reduced pension benefit with survivor benefits."

Decisions, decisions!

The first option maximizes the retirement income from your pension or profit-sharing plan while you're alive, but benefits cease upon your death. Should you elect this option at retirement and die shortly thereafter, your spouse may be left with no source of continuing income.

The second option provides a smaller retirement benefit while you are both living, but ensures that your spouse receives an income in case you die first. But in many instances, if your spouse dies before you, you will continue to receive the lower pension benefit for the rest of your life, even though your spouse never received any income.

Neither choice sounds very appealing, does it? Fortunately, there may be an additional choice called Pension Maximization.

Pension Maximization: What you need to know

The Pension Maximization technique combines purchasing a life insurance policy with electing the "maximum pension benefit with no survivor benefit" option for your pension. With this technique, you may be able to:

- Maximize your pension benefits during your lifetime.
- Help provide for your spouse's financial independence through the life insurance coverage.
- Use existing savings to help supplement your retirement income with a tax-deferred product.

This concept can work if the insurance is purchased before retirement (ideally, the premiums are lower than the pension gained by taking a "single life" option), but you should note, it may not work if there are any health problems at that time. Therefore, it is generally better to ensure the proper insurance is in place to help provide a secure retirement income for your spouse.

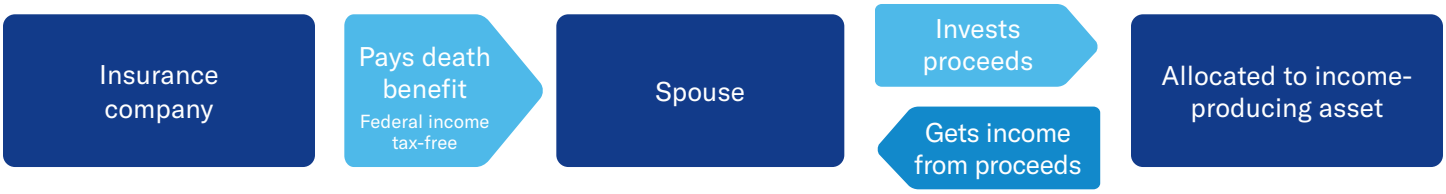
How Pension Maximization works

This graph illustrates how Pension Maximization works while both you and your spouse are living, or when only one of you is living.[1]

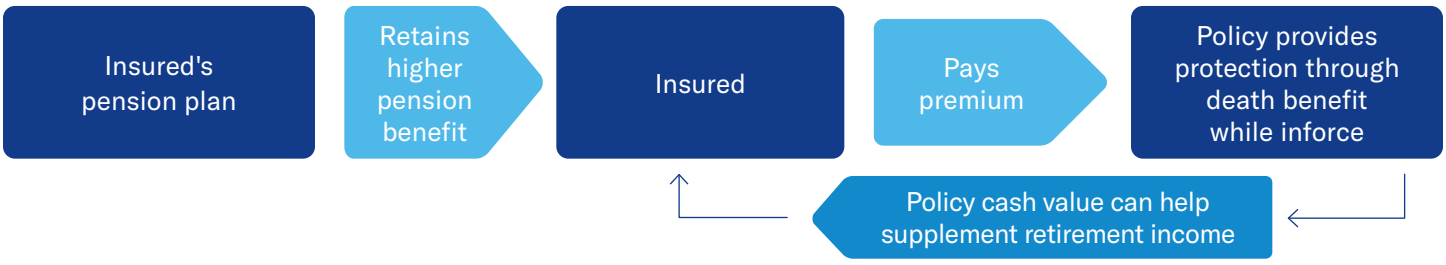
While both of you are living



If you die first



If spouse dies first



Meet Carl



- **Age 52**
- **Successful businessman**
- **Married**

Pension Maximization in action

Carl Robinson, age 52, married to Catherine, age 50, has been working for Company XYZ for the past 25 years and is planning to retire at age 65. Recently, Carl received an estimate from his representative in Human Resources who told him that at age 65, he would receive $2,500/month from his pension plan, provided he doesn't elect a survivorship benefit. Carl is concerned that if he dies first, Catherine will not see any of his remaining pension benefit. Without survivor benefits, Carl's early death would mean that most of his pension will be wasted.

If Carl elects the survivorship benefit, his payments will be reduced to $2,100/month, but Catherine will receive a predictable income of $1,050/month (based on a 50% survivorship benefit) after his death. The problem with choosing a survivorship benefit is that if Catherine lives for a short period of time and dies before Carl, Carl will face a lifetime of reduced pension income, even though Catherine and he never received any financial benefit from electing this option. If they both live full lives and die within a year or so of each other, little benefit is ever realized after years of a reduced pension.

Alternatively, Carl can choose to take the maximum pension benefit ($2,500) with no survivor benefit and purchase a life insurance policy prior to his retirement. It is recommended that Carl select an amount that would provide Catherine with a similar income benefit to what it would have been if he had chosen the survivorship benefit ($1,050/month).

As previously mentioned, it is better for Carl to purchase the life insurance policy sooner than later to reduce the cost of insurance and to take advantage of his current good health. If Carl continues to work and accrue benefits, he needs to consider whether the life insurance policy will be large enough to provide the higher survivor benefit.

In this scenario, the advantages are:

- Carl and Catherine receive larger pension benefits while Carl is alive.
- If Catherine dies first, Carl can surrender the policy for cash surrender or leave a death benefit to his children.
- If Carl dies prior to retirement, Catherine gets the face amount of the insurance policy.
- Catherine controls how the death benefit is invested if Carl dies first.
- A portion of the death benefit proceeds (payable in monthly installments) will be income tax-free if the death benefit is used to buy an annuity. Typically, pension income is fully taxable.
- Loan capability may be available on the life insurance policy, but, if outstanding, will reduce the net death benefit payable.
- Flexibility to change the beneficiary under the life insurance policy that you may not have under the pension benefit.

Important note

At retirement, the spouse must sign a waiver to make it clear that a single life pension is acceptable.

Carl's monthly income at retirement (age 65)	
With no survivorship benefit	With 50% survivorship benefit
$2,500	Carl — $2,100 Catherine — $1,050

Points to consider about Pension Maximization:

- If your pension annuity payments have a cost-of-living adjustment, you will need to factor the cost to purchase a much larger amount of insurance in order to provide your spouse with a comparable retirement income.
- By not electing the reduced pension survivorship benefit, in some cases your spouse may lose all rights to any retiree medical coverage if your employer sponsors the coverage. Sometimes this coverage is linked to receiving pension benefits, which would terminate when Carl died if he selects the maximum pension benefit.
- The person on whom the insurance would be issued must be able to qualify for the purchase of life insurance before any further analysis is done.
- You may want the spouse who signs the waiver to elect the life-only pension benefit to own the life insurance in order to ensure the insurance policy remains in effect.
- Failure to keep the life insurance inforce up to the insured's death will result in no death benefit proceeds for the spouse.
- Life insurance premiums on policies taken out before pension payments begin would be paid out-of-pocket. Once pension payments begin, the higher life-only pension payments could be used to offset life insurance premiums.

Is Pension Maximization right for you?

It depends on a number of factors, such as your financial situation, health, objectives and the options and benefits you have under your employer's retirement plan. Your financial, legal and tax advisors can assist you with your decisions and in developing the strategy that is most appropriate for you.

1 Under the current federal tax rules, you generally may take federal income tax-free withdrawals up to your basis (total premiums paid) in the policy or loans from a life insurance policy that is not a Modified Endowment Contract (MEC). Certain exceptions may apply for partial withdrawals during the policy's first 15 years. If the policy is a MEC, all distributions (withdrawals or loans) are taxed as ordinary income to the extent of gain in the policy, and may also be subject to an additional 10% premature distribution penalty prior to age 59½, unless certain exceptions are applicable. Loans and partial withdrawals will decrease the death benefit and cash value of your life insurance benefits or riders to become unavailable and may increase the chance your policy may lapse. If the policy lapses, is surrendered or becomes a MEC, the loan balance at such time would generally be viewed as distributed and taxable under the general rules for distribution of policy cash values.

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