PENSION MAXIMIZATION STRATEGY

Pension plans were developed to provide a lifetime retirement income for covered workers. Gradually, these retirement plans adopted provisions for spousal benefits. While the details vary with each plan, every spousal benefit is based on the same premise: spousal benefits are produced by pension reductions.

The worker is frequently given a choice of options. The full pension (standard option) may be continued, but with no survivor benefit. This normally requires the acquiescence of the spouse who is, in effect, forfeiting his or her security. The modified pension provides a survivor benefit that comes from a significant decrease in benefit for the retiree.

TYPICAL CHOICES PRESENTED TO RETIREES

The Plan's Pension Option	Monthly Benefit	At Death the Spouse Receives
The Standard Option	2,000	0
100% Survivor Option	1,500	1,500
Pension Difference	500	

This retiree would receive $6,000 less per year. If the retiree lives 15 years, the total reduction of income would be $90,000. If the spouse does not survive the retiree, then the result is that there was no benefit!

Once the survivor option has been irrevocably elected, the income reduction is permanent. Even if the retiree's spouse dies the year after benefits have commenced, the reduction stays in effect. Many plans offer several choices, including 50% income for the survivor that is a compromise solution.

JOINT AND 50% OPTION

The Plan's Pension Option	Monthly Benefit	At Death the Spouse Receives
Standard Option	2,000	0
Survivor Option	1,700	850
Pension Difference	300	

In the above case, the retiree suffers an annual reduction of $3,600. If there were a survivor, that person would receive $10,200 per year.

In the second case, if the retired worker lives fifteen years, the loss in income would be $54,000 ($3,600 X 15), and the surviving spouse would need to live for more than five years to receive what they had both lost in the earlier period. When the interest is considered, the survivor must live more than seven years beyond the retired worker.

In both cases the retiree is, in effect, purchasing a policy that pays a benefit to the survivor. If there is a survivor, the premium is $300 per month or $500 per month payable for life.

AN ALTERNATIVE OPTION – PENSION MAXIMATION

The concept of Pension Maximization is for the worker to select the highest pension option and use a high interest earning insurance plan to insure the survivor benefit.

1. In most cases, the monthly insurance premium is lower than the alternative pension reduction.
2. Premiums may end in 10 to 15 years providing a lifetime paid-up policy.
3. If the spouse dies first, the policy may be cashed in to further increase the full retirement benefit being received by the retired worker.
4. In later years of retirement, the insurance cash values may be converted to supplement income for both retirees.
5. The surviving spouse has the flexibility to accept a lump sum or to elect a life income option from the life insurance company, commonly referred to as an annuity.
6. The insured survivor benefit also provides for children, whereas the pension plan would not. This would be critical for a disabled dependent child.

WHEN TO ELECT PENSION MAXIMIZATION

While one could wait until retirement to deal with the pension maximization issue, there are several reasons for not delaying this step:

1. As a person ages, the initial premium for life insurance increases sharply.
2. By waiting to purchase the insurance, there is the possibility that health changes will cause the insurance to be highly rated or even unobtainable.
3. Cash accumulated in the insurance may be available for any emergency.
4. The structure of variable universal life functions as a tax shield for the investment elements in addition to the protection features that provide the pension replacement.

WHEN NOT TO ELECT PENSION MAXIMIZATION

1. If the employer is subsidizing the survivor benefit options. This is likely to be the case in a state-funded pension, such as for teachers or state employees.
2. If the retirement plan has a cost of living feature allowing post-retirement benefits to escalate. However, most plans provide no escalation of the spouse's benefit.

3. When the worker is not insurable. However, many people are not aware of their insurability status. A professional advisor can do a preliminary underwriting at no obligation.

Source: Financial Planning Consultants, Inc. (9/10/14)