Pension Maximization

Using Life Insurance

Concept Detail and Design...

INSURANCE - BANKING - ASSET MANAGEMENT

Concept Overview

Pension Maximization Using Life Insurance provides a method of illustrating the potential maximization of retirement income available to a client from their pension plan.

The Problem

For married individuals, the default option for taking pension income from a qualified pension plan at retirement is to take the *Joint & Survivor Option*. This option provides a reduced income during the client's lifetime in order to ensure that the spouse receives survivor benefits at the death of the retiree. The reduction can be as much as 20% – 25%, depending upon the age of the client and spouse at retirement.

The *Life Income Option* provides a higher income during the retiree's lifetime, but provides no surviving income to the spouse. In order to take this option, the spouse must consent in writing to forfeit survivor benefits.

Concept Overview

Pension Maximization Using Life Insurance provides a potentially attractive alternative for clients who can afford to use assets otherwise available for retirement income to pay premiums on life insurance.

By purchasing life insurance to provide the survivor income needed, the client and spouse can take the *Life Only Income Option* and receive a higher monthly income from the pension plan.

At the death of the client, the life insurance proceeds are used to provide an ongoing income to the spouse.

The concept pages produced by *ING Presents* can help your clients understand how Pension Maximization Using Life Insurance provides the potential for additional income and flexibility at retirement.

You should review with your clients whether Pension Max is right for them. Pension Max works most effectively for married individuals who are currently participants in a defined benefit pension plan and are 10 – 15 years from retirement.

There are certain risks associated with the Pension Maximization strategy. First, the life insurance policy may lapse before the insured's death. Second, the surviving spouse may consume both the policy death benefits and the earnings they generate. Finally, it is possible that after the retiree's death, the spouse could lose eligibility for survivor health benefits.

Pension Maximization – A Case Study

Meet Cliff and Pat Reeves…

Cliff is age 55 and Pat is 54. They are planning to retire when Cliff reaches age 65. They want to make sure they will have enough to retire comfortably in 10 years.

Cliff is a school teacher at Carver School District and has a pension plan that he expects will contribute significantly to their retirement years. You ask if they would be interested in looking at a method of potentially maximizing the benefits from Cliff's pension.

- The latest report from Cliff's pension plan shows an annual life income for him of $2,800 per month during his life, beginning at age 65.
- If he elects the Joint & Survivor Option to ensure an income to Pat, their income will be reduced to $2,100 per month.

Let's review the Pension Maximization presentation for Cliff and Pat…

Pension Income Options

This page describes the options available from Cliff's pension plan and the problem with the typical pension options.

Pension Income Options From Carver School District

At retirement, you typically have two basic alternatives from which to choose when selecting how to receive your pension income benefits: The Life Only Option or a Joint and Survivor Option. Following is a comparison of the monthly retirement income available under these options, based on information provided by you about your current pension plan.

Prepared for: Cliff Reeves and Pat Reeves
Assumed Age at Retirement: 65

	Cliff's Monthly Income Options at Retirement Age	Monthly Survivor Income to Pat if Cliff Dies
Life Only Option	$2,800	$0
Joint and Survivor Option (100.00% to Survivor)	$2,100	$2,100
Cost of Providing Survivor Income		
Monthly Cost	$700	
Annual Cost	$8,400	
Total Cost From Retirement To Age 83 - (18 years)	$151,200	

Cost to Cliff and Pat for the Joint & Survivor Option (to provide an ongoing income to Pat) is $700 per month, or $8,400 per year.

The Pension Maximization Alternative

This page describes the alternative of taking the Life Income Option from the pension plan and purchasing life insurance to provide the survivor income to Cliff's spouse.

An Alternative

The Pension Maximization Alternative using Life Insurance

Pension Maximization is an alternative that allows you to take the maximum pension income while still providing a survivor death benefit to Pat through the use of life insurance. Following are the steps involved:

Prepared for: Cliff Reeves and Pat Reeves
Assumed Age at Retirement: 65

Step 1:
Purchase life insurance of $351,481 on Cliff's life

Step 2:
At retirement, maximize your pension with life income option $2,800

Step 3:
At the death of Cliff, use $351,481 of life insurance death benefit proceeds to provide benefits to Pat $2,100 monthly income

The following page describes how life insurance can provide the monthly income shown.

How Life Insurance Proceeds Can Provide an Income to Pat

Whether Cliff dies before or after retirement, the life insurance death benefit proceeds become payable in cash to Pat, the policy beneficiary.

The life insurance death benefit is the amount needed to provide $2,100 monthly income to Pat, assuming Cliff dies at retirement age. This calculation assumes that all of the death benefit proceeds are invested in an investment vehicle earning an annual rate of 7.00%. If this rate of return is achieved the fund will provide Pat with $2,100 monthly to age 100.

If a 7.00% rate of return is not achieved, the Pension Maximization survivor income may not equal the survivor income which would be paid under the joint and survivor option of the retirement plan. It may be more or less than illustrated. In order to obtain survivor benefits, premiums must be paid to keep the life insurance policy in force. Therefore, you should consult your professional advisors before making a final decision.

Advantages of Pension Maximization

This page describes the options available from Cliff's pension plan and the possible problem with the typical pension options.

Advantages of Pension Maximization using Life Insurance

- **Maximize pension income.** At retirement, Pension Maximization allows you and your spouse to elect the Life Only option and maximize your pension income. In the event that Pat dies first, you can continue to collect your full pension.
- **Flexibility in determining beneficiary.** You can change the beneficiary of the life insurance policy at any time if your life circumstances and objectives change.
- **Continuing benefits if spouse dies first.** If your spouse dies first, you have the option of (1) maintaining the life insurance policy and naming a new beneficiary, (2) accessing the cash surrender value on a tax free basis*, or (3) continuing to receive the maximum pension benefit for your lifetime.
- **Benefits may be passed on to heirs.** When your spouse dies, death benefits may be passed on to your children or other designated heirs.
- **Pre-retirement death benefit.** Death benefits from the life insurance policy are payable to the policy beneficiaries, whether death occurs before or after retirement.
- **Increasing cash value.** The policy may build cash value as long as you maintain the life insurance policy and continue to pay premiums if needed. If you desire, you can borrow from or withdraw portions of this cash value for other needs which might arise, subject to policy limitations. Loans and withdrawals may generate tax liability, reduce available cash value and reduce the death benefit or cause the policy to lapse.
- **Income tax deferred accumulation.** Under current federal income tax law, cash surrender values accumulate within the life insurance policy income tax deferred until withdrawn.
- **Tax free death proceeds.** Under current tax law, if you die first, your spouse receives the death benefit proceeds from the life insurance policy free of federal income tax. Joint and survivor pension income option amounts generally are fully taxable when received.

Comparison of Features

This page provides a side-by-side comparison of the Joint & Survivor Option vs. the Pension Maximization using life insurance alternative.

Comparison Of Features

	JOINT & SURVIVOR Pension Option	PENSION MAXIMIZATION Using Life Insurance
While you and your spouse are both living	A reduced pension benefit is received.	The maximum pension benefit is received.
If you die first	Your spouse continues to receive a reduced pension benefit.	Your spouse can use the income tax-free death benefit to provide a lifetime income.
If your spouse dies first	You continue to receive a a reduced pension benefit for your lifetime.	You continue to receive the maximum pension benefit for your lifetime and can continue the life insurance policy for your heirs, or you can use any cash value to provide supplemental retirement income.*
If you have a financial emergency	The pension benefit cannot be adjusted to provide emergency funds.	Any cash values from the life insurance policy can be utilized.*
Your heirs	Heirs receive nothing from the pension plan upon the death of you and your spouse.	Beneficiaries of the life insurance can be named.