Pension Maximization Strategy

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The Pension Maximization Strategy

Many people who are close to retirement are faced with decisions as to how to take various employee benefits. For those in defined benefit plans, there will be options as to how they should take such benefits. Those options often include the ability to take a straight life annuity on the employee only or a joint and survivor annuity on the employee and the spouse.

In that a married couple has a much longer joint life expectancy than a single individual, pension plan administrators must offer a significantly smaller pension if the pension is to cover two lives instead of one. How much less depends on the ages of the spouse's and is also impacted by whether an individual chooses a joint and 100% survivor benefit, a Joint and 75% benefit or Joint and 50% survivor annuity. In the case of a joint and 75% annuity benefit, at the death of the primary annuitant (employee) the surviving spouse receives 75 % of the spouse's benefit and 50% in a joint and 50% benefit. Although they may be paying out a lesser benefit, since it is paid out over two lives, it reduces the amount of the primary benefit.

The Issue

At retirement, pension plan participants who are married must make a decision:

- Choose the maximum monthly income for the life of the retiring employee
- Choose a substantially reduced pension that will cover the lives of the employee and their spouse whether it is a Joint and 100% benefit or Joint and 50% benefit
- For married individuals, the single life option isn't really viable since the death of the employee retiree will leave the surviving spouse with absolutely no benefits from the pension.
- The joint option which will provide for the survivor results in a smaller amount for both to live on.
- In addition, if the employee spouse dies shortly after receiving benefits, the surviving spouse will receive a lifetime of reduced benefits
- If they both live a long life and die a year apart, they will have wasted the sacrifice of taking a joint and survivor benefit.
- Whether they choose a single life annuity or a joint life annuity, there is nothing left to pass on to children at the second death.

The Solution may be the Pension Maximization Strategy!

How can a retiring couple use the system to their advantage? Pension Maximization is a way of using life insurance to supplement retirement options.

How does the Pension Maximization Strategy work?

With the Pension Maximization Strategy, a couple decides that when they retire, they will take the single life option to maximize the income they receive in retirement. Prior to retiring, they calculate the difference in benefits between a single life and a joint and survivor life and decide to use a portion of the excess cash flow to purchase a life insurance policy on the retiring employee's life with the surviving spouse as the beneficiary. Prior to retiring and taking the single life annuity, they apply for and receive the policy on the retiring employee's life. They now have a self-completing retirement plan for the non-employee spouse in the form, of the life insurance and can realize additional income in retirement by taking the single life option. If the retired employee lives for a long period, there will be money from the life insurance policy to pass on to children and if the retired employee does not live to life expectancy leaving a surviving spouse, the spouse should have enough income from the life insurance death benefit to fund retirement and may have something left over for children and grandchildren. And if both live a long life, they are able to borrow from cash value to meet life style needs when they are older. Of course, loans could have an adverse effect on the policy value and death benefit.

The following are examples of scenarios offered by some companies as retirement options. Note that if Option 2 or 3 are chosen, a retiring employee could:

- Permanently lose potential income while living if predeceased by your spouse
- Give up ability to keep pace with inflation
- Lose control of money to meet changing future needs

Without Pension Maximization ...

Example of Option 1: Receive $1,800/month for the rest of the retired employee's life. At death, no further income is received.

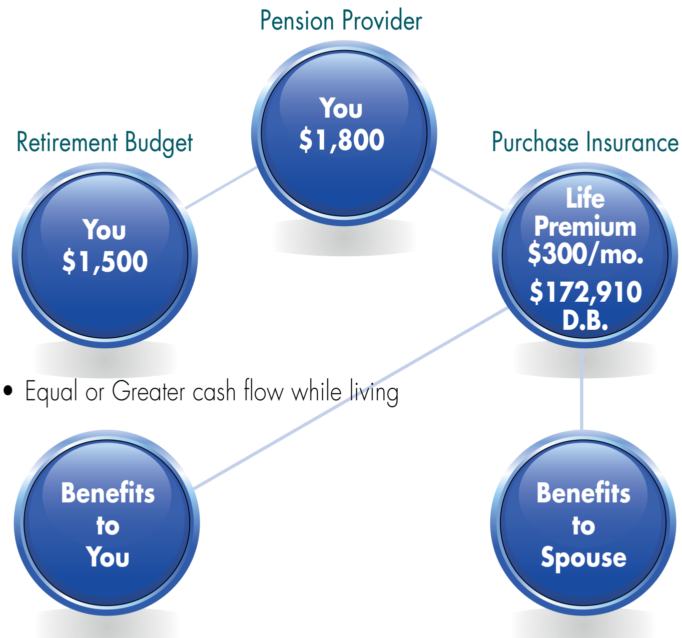
Example of Option 2: Receive $1,320/month for the rest of the retired employee's life, and at death your surviving spouse will receive $660/month for the remainder of their life.

Example of Option 3: Receive $900/month for the rest of the retired employee's life, and at death your surviving spouse will receive $900/month for the remainder of their life.

With the Pension Maximization Strategy, your scenario may look like the following:

(Example: If you qualify medically, 60-year old male standard non-tobacco user)

- Choose Option 1 to create largest living cash flow



- Equal or Greater cash flow while living

Benefits to You, the Retired Employee:

- Cash values of policy available for emergencies while living
- If predeceased by spouse your insurability is protected and you can maintain insurance
- If predeceased by spouse you can surrender policy and receive cash values (minus surrender charges or loans)
- If policy is surrendered, the surrender values can then be put to work to help generate greater retirement income

Benefits to Your Spouse:

- Cash values of policy available for emergencies while living
- Death benefit is generally income tax free
- Death benefit can be available for unforseen debts
- Death benefit can be invested or annuitized at spouse's choice
- Death benefit is large enough to be able to create a larger monthly income for spouse
- Ability to reduce the effects of inflation
- Principal available to pass on to heirs

The Advantages of the Pension Maximization Strategy ...

- Possible higher retirement income through a single life annuity
- Can pay premiums with earned income if policy purchased prior to retirement
- Pension Maximization may produce a higher total benefit if the beneficiary dies close to the retiring employee's death leaving more for children and grandchildren
- Whereas pension income is fully taxable, the death benefit will generally be received tax free
- Ability to name new beneficiaries if beneficiary dies first
- Can borrow out cash value to enhance retirement income as policy matures over time*
- Protects surviving spouse with life insurance on retiring employee's life

Risks of the Pension Maximization Strategy ...

- If the retiring employee dies, the surviving spouse could outlive benefits if they do not annuitize.
- If the retiring employee has health problems, life insurance could be too expensive.
- If the insured misses a payment, the policy could be cancelled. Life insurance premiums are funded with after-tax income ... so will the beneficiary be able to manage investing the death benefit?
- If the spouse were to survive the retired employee, the spouse could be left without a retrement income stream.
- The benefit provided to the surviving spouse may not be sufficient. This could occur if the amount of death benefit purchased is insufficient.
- Election of the maximum monthly income for the life of the retiring employee may cause the spouse to lose his or her medical benefits upon the death of the retired employee. Some defined benefit plans require the surviving spouse to have a continued connection with the employer (such as a pension benefit) in order to continue to be eligible to receive survivor medical benefits.

Purchasing permanent life insurance on the retiring employee's life prior to retirement and then taking a single life annuity option should result in more money available during retirement. In addition, you are creating a fund, that if not fully utilized during the non-employee spouse's life, will provide a legacy for children and grandchildren once you are gone.

Consult your financial advisor before entering into such a transaction and, if you and your advisors decide to move forward, be sure to have the life insurance policy in effect prior to locking into a single life annuity strategy.

*Loans could have an adverse effect on the policy value and death benefit.

Neither American National nor its representatives provide legal or tax advice. Individuals should speak with their attorney or tax advisor regarding their specific circumstances before entering into such a transaction.

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