Pension Maximization

A Pension Payout Option Strategy

By Steven WERYHA
Financial Advisor

BECAUSE IT IS DESIGNED TO PROVIDE A GUARANTEED stream of income to the employee in retirement, a Defined Benefit Pension Plan has been viewed as the most coveted retirement plan an employer can offer. But the costs to the employer of funding and maintaining the plans are comparatively high, and most companies have moved away from offering them.

If you are covered by a pension plan, you will have several annuity payout options to choose from at retirement, including single-life, single-life with a certain term, and joint-and-survivor. Additional options may be available depending on the specific terms of the pension.

The joint-and-survivor options normally allow for 50 to 100 percent of the monthly benefit to continue to a beneficiary after the individual who earned the pension passes away. The beneficiary would then receive a monthly benefit until they pass away, at which point the pension terminates. The joint-and-survivor option is generally the payout choice of married retirees as it provides an ongoing stream of monthly income to the surviving spouse. The caveat is that to fund the survivor benefit the amount the retiree receives while living is less than the single-life monthly benefit.

"Pension maximization" is a strategy that involves selecting the single-life annuity option and coupling it with life insurance. The single-life annuity option provides the largest monthly payout but does not pay a survivor benefit when the individual receiving the pension passes away. This can create a significant planning issue if the individual receiving the pension is survived by a spouse. The life insurance policy can provide protection to a surviving spouse if the spouse receiving the pension passes away prematurely. The higher monthly benefit of the single-life option may provide more than enough extra income to pay the life insurance policy premiums. As well, the insurance can deliver additional benefits, such as a tax-free death benefit and other, flexible beneficiary options. While the appropriate amount of insurance will vary case by case, the death benefit should be large enough to compensate for the loss of the pension income.

A Defined Benefit Pension Plan has been viewed as the most coveted retirement plan an employer can offer, but most companies have moved away from offering them.

The insurability of the pensioner and the cost of the life insurance will be key factors in determining whether pension maximization is worth pursuing. While it can make sense for a healthy individual who can obtain life insurance at a reasonable rate, it might not be a good option if the cost of life insurance is greater than the difference between the single-life and joint-and-survivor monthly payouts.

There are other important factors to consider before attempting this strategy, including the health of both spouses, other sources of income, tax implications, and the terms of the pension. Pension maximization can be complicated and should be discussed with a licensed insurance professional, financial planner, or financial advisor.

Stephen Weryha
Financial Advisor, HBKS® Wealth Advisors

Steven Weryha serves as a Financial Advisor in Erie, Pa. He can be reached at 814-836-5776; or by email at sweryha@hbkswealth.com.