Sweetgum Labs

Insights

Pension Maximization

If you're fortunate enough to accumulate a pension you've likely heard mumblings, at least around the water cooler, about a pension maximization (max) strategy. The pluses and minuses of this strategy need to be weighed and considered before implementation. If after careful analysis the math checks out, this strategy can put more money in your pocket and provide a lump sum for your beneficiaries.

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>
> *highly rated insurance companies are strongly recommended."*

Conceptually

A pension max strategy is introduced when an individual with a spouse is nearing retirement. The pension owner elects the life only option (highest payout) and the delta (payout difference) between the spousal and life only option is used to purchase life insurance (ideally for less "cost" then the spousal benefit.) Any remaining difference is kept by the pension owner.

Visualize

the

strategy

A pension max is an attempt of arbitraging the assumptions that the pensions actuaries assume with insurance that has lower cost. Implementation works best with healthy individuals (to keep premiums low) and at the peak of the interest rate cycle (when filing the paperwork) due to the assumptions to recreate the income. **It is critical that both spouses are involved in this decision making** since pension elections cannot be changed and moving parts can make this confusing to an outsider peaking in.

Structure

Depending on interest rates, desired risk retained, and investment assumptions, different types of insurance policies can be used. Term(-life) may be best to help fund the early retirement stage, but as term becomes cost prohibitive in later years, a permanent (life) policy will be needed. Visualize the strategy like a fixed income ladder with different maturities (or expirations in this case.) Don't expect the insurance plan numbers to fit perfectly and review frequently as changes to assumptions will occur. Tax considerations of life insurance proceeds should be embedded into the plan. Your surviving spouse is likely to rely on this income so highly rated insurance companies are strongly recommended.

Benefits/Considerations

- Retirement typically coincides with becoming an empty-nester. Many times, those who have considered allowing their insurance policy to lapse could actually recycle it as a component of a pension max—always consult with your financial planner before making major changes.

- Your health matters, those in better health may find more attractive benefits of a pension max than others.

- If the beneficiary spouse passes away before the insured, it is possible to let the policy lapse and thus eliminating some or all of the monthly insurance expenses.

- The annuitization assumptions used for the lump sum (in the event of your death) should be very conservative (the actual investment gains could outperform and make it more lucrative.)

Risk

This is a complicated strategy that needs to be fully understood by all parties involved. Pitfalls such as an insurance carrier running into trouble can jeopardize the whole strategy. Other risks (not comprehensive) can be part of a plan aimed to pay premiums in cases such as dementia, Alzheimer's, and other potential incapacitation situations.
Divorce could complicate the structure. Assumptions could be too high, and rates may go lower. Always have approval from the insurance company before elections are inked (in case of insurability issues.)

Conversation

It's highly recommended to have a pension max conversation with your advisor prior to making elections. Empirically most folks either don't qualify or the gains are small enough that qualitatively its not worth the (hassle with rates being as low as they have been since '08). If the strategy makes sense, it will provide for a larger stream of income in retirement and a stronger overall financial plan.

Financial planning has *evolved.*

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