



Utah Retirement Systems
Retiring Right!

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Pension Maximization

Is It for You?



Pension Maximization

Retiring Right!

If you plan to retire soon, you could get a call from an insurance agent explaining a way you can receive a bigger pension and leave a larger benefit for your spouse. Sounds good. What's the catch?

As a member of the **Public Employees Retirement Systems** you have two ways to structure your lifetime pension payments at retirement:

Single Life Only. You have two options:

1 – The highest possible benefit, ceasing when you die. 2 – A slightly reduced benefit, ceasing when you die; any unused member contributions go to your beneficiary.

Continuing Benefit. Four options pay a reduced benefit during your life and a continuing lifetime benefit to your surviving spouse after you die. (*Described above right.*)

In a plan called **pension maximization** an insurance agent will advise you to select Option 1, which gives you the largest benefit during your life, instead of the reduced payment of a continuing survivor benefit. You would then use that extra money to buy a life insurance policy with your spouse as the beneficiary. When you die, the insurance proceeds will replace the pension for your spouse who, the theory goes, will be better off than under a URS survivor option.

URS Retirement Payout Options

Option 1— Maximum lifetime benefit. No monthly payment to spouse after you die.

Option 2 — Reduced lifetime benefit. Allows any remaining member contribution balance to be paid to choice of beneficiaries.

Option 3 — Reduced lifetime benefit; same lifetime benefit for spouse after you die.

Option 4 — Reduced lifetime benefit; 50% lifetime benefit for spouse after you die.

Option 5 — Reduced lifetime benefit; same lifetime benefit for spouse after you die. If spouse dies first, payout reverts to Option 1.

Option 6 — Reduced lifetime benefit; 50% lifetime benefit for spouse after you die. If spouse dies first, payout reverts to Option 1.

PLSO (Partial Lump-Sum Option)

Select a one-time payment equaling 12 or 24 months' worth of your monthly benefit. Reduced lifetime benefit thereafter.

Will it work? Can you really give yourself a bigger paycheck now and provide a superior benefit to your spouse when you die?

Let's just say there are cases where pension max at retirement may work.* But for most people it does not measure up to its claims. Consider: (*Continued on page 3.*)

***Possible examples where pension max may work:**

- *The spouse is not expected to survive the member.*
- *Both spouses have full pensions.*
- *An alternate beneficiary is desired.*

- **The difference in after-tax payout** between Option 1 (single life) and an Option 3 or 5 (continuing benefit) may not be enough (at your age) to buy a safely adequate insurance policy to replace your spouse's full URS survivor benefit, considering the risks involved.
- **Insurance premiums are paid from your after-tax income**, which reduces your spendable income. Insurance illustrations often begin by comparing your larger *pre-tax* income.
- **By forgoing a URS continuing pension your spouse surrenders cost-of-living adjustments (COLA)**. For a price certain life insurance annuities will pay increasing amounts each year. Calculate the cost and the annuity payout for 25-30 years to see if it beats your URS COLA over that time.
- **Your age and health will dictate the cost of your insurance.** In reality many retirees can't qualify for the best rates. Make sure you qualify for the insurance you need — *from a well-rated company* — before choosing your URS pension payout option.
- **The URS payout option you choose is final.** If after retiring you feel you've erred in selecting Option 1, you cannot convert your payout to cover your spouse.

Learn more about life insurance. Visit www.insurance.utah.gov, then click on Shop for Insurance.

Insurance exists to manage risk. Why introduce any risk to your URS pension that's already 100% secure?

- **Insurance sales people can have a direct financial interest** in selling you the product that pays them the highest commission. Impartial retirement system counselors have no such incentives.
- **Is the insurance proposal guaranteed** to work exactly as claimed? Life insurance policies and annuities are often interest rate sensitive, meaning that premiums or cash accumulations can vary from your expectations. Insist on seeing a "worst case" scenario, then use that as your standard.
- **If inflation, illness, or an emergency requires all your resources**, cancelling your costly insurance policy cancels your spouse's retirement income source — the central point of pension max. For a price you may be able to buy a policy that guarantees your premium will be paid, if needed.
- **Will an aged spouse be able** to make prudent investment decisions about the insurance proceeds years after you're gone?
- **Why don't accountants and financial experts champion pension max?** Almost uniformly, professionals who have run the actual figures conclude that the results seldom support its claims, and that its high degree of risk can be detrimental to the retiree and spouse alike.

Compare Your URS Survivor Pension

- Your URS pension is free of commissions and fees. No incentive exists for personal gain by any URS employee.
- There are never misrepresentations about what you can expect.
- You know before you retire how much money you'll receive each month and how much your spouse will receive after you die.
- Interest rates have no bearing on the amount or payment of your URS pension benefit.
- Your URS pension is already paid for. There is zero risk that it will fail to work as promised.
- Old age or health issues will never disqualify you from receiving your URS pension benefit.
- Your URS pension will not be cancelled for non-payment of *anything* when you retire.
- Your URS pension has a built-in cost-of-living adjustment based on the consumer price index.
- Your widowed spouse need never make pension investments or shop for annuities.
- If you lose everything you own, your URS joint pension benefit will continue without fail to the day you both die.

Despite the agent's or planner's best projections, pension maximization cannot give you these security assurances.

Check It Out

If you want to make an accurate financial comparison between a pension maximization proposal and your guaranteed URS benefits, call or write us; we'll be happy to send you a worksheet. 801-366-7350 or 800-365-8772, ext. 7350. You may also print a worksheet from the URS website at www.urs.org. Click PUBLICATIONS, then click PENSION MAXIMIZATION WORKSHEET.

Sources Referenced

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- "Why-or Why Not-Choose Pension Max?" by W. John Allen, JD, Allen-Warren, Arvada, CO.
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- "Pension Maximizer: Boon or Bust" by E.M. Abramson, *AARP Modern Maturity* magazine.
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- Additional sources on file.

PENSION MAXIMIZATION WORKSHEET

Two tests must be satisfied to make pension maximization taken at retirement work: ¹

1. *Your net lifetime pension, after paying insurance premiums, must be greater than had you chosen a survivor option.*

2. *The insurance proceeds must buy your spouse a lifetime income at least equal to a survivor pension.*

You and the agent should fill in the following blanks to see if the proposal meets both tests: *(Always work from a URS benefit estimate showing all reductions or additions to your monthly benefit)*

Part I Your benefit

- | | |
|---|----------|
| 1. Your monthly retirement benefit if paid for your life only (Plan 1). | \$ _____ |
| 2. Your monthly benefit after all taxes. ² | \$ _____ |
| 3. Your monthly benefit if you take a survivor option (Plans 3 through 6). | \$ _____ |
| 4. That same benefit after all taxes. ² | \$ _____ |
| 5. Your spouse's monthly benefit after you die if you take a survivor option (100% or 50% of line 3). | \$ _____ |
| 6. This same benefit after all taxes. | \$ _____ |
| 7. Midpoint between lines 5 and 6. This is a first target for how much insurance you'd need under pension max. ³ | \$ _____ |
| 8. The cost of buying your spouse an annuity after you die, based on her/his age when you retire. ³ This annuity rate shows how much monthly income your spouse can buy for every \$1,000 of insurance proceeds.
Age: _____ Annuity rate: _____ | \$ _____ |
| 9. Insurance proceeds needed to provide the monthly income. Divide line 7 by line 8; multiply by 1,000 | \$ _____ |
| 10. Monthly life insurance premium required to secure the proceeds above. | \$ _____ |
| 11. Subtract line 10) from line 2. This is the disposable income you as a couple would have left to live on. | \$ _____ |

If your income after pension max (line 11) is less than your Option 3 or Option 5 income (line 4), stop here, it doesn't work. If pension max provides you with more income as a couple, continue the calculation to see if it protects your spouse.

Part II Your spouse's benefit

- | | |
|---|----------|
| 12. Your spouse's life expectancy based on her/his age when you retire. ⁴ See Life Expectancy table. _____ | |
| 13. The portion of your spouse's annuity income (line 7) that will be excluded from income taxes.
This is called the Exclusion Ratio. ⁵ Carry it to three decimal places. | 0. _____ |
| 14. Subtract the Exclusion Ratio from 1.000. | 0. _____ |
| 15. Enter the monthly income you targeted from line 7. | \$ _____ |
| 16. Multiply line 15 by line 14. This is the taxable portion of your spouse's annuity income. | \$ _____ |
| 17. Subtract income taxes from your spouse's annuity income, and enter that income after tax. | \$ _____ |
| 18. Enter the actual amount of net spousal income you need to protect with insurance (line 6). | \$ _____ |
- If line 18 is larger than line 17, you need more insurance. If line 18 is less than line 17, you could buy a smaller policy.

This worksheet does not consider your URS 4% cost-of-living adjustment (COLA). However, you can determine if life insurance will supply a comparable benefit for your spouse: Multiply your original retirement benefit by 4% (.04). Multiply the result by the years you're comparing (5, 10, etc., minus one year). Add the result to your original benefit to get your estimated future benefit. Your spouse's 100% continuing benefit will carry an annual COLA the same as yours; a 50% continuing benefit will carry an annual COLA half of yours.

Finally, have your agent do a present value analysis. This recognizes that \$1 spent on insurance *premiums* today is worth more than \$1 in future *benefits* and reveals whether they're worth the cost. Don't buy from anyone who won't (or can't) do this calculation for you. Always get a present value analysis for insurance with COLA features or where premiums or death benefits vary.

Notes

- 1 This worksheet is not effective for plans started earlier than at retirement. For such plans, the salesperson should compare the cost of the insurance premium with the after-tax pension benefits expected, adjusting for the fact that the costs come now and the benefits later.
- 2 Federal, state and local taxes. Do the exact calculation. Don't just estimate a percent. Use correct marital status.
- 3 Your agent or financial planner will be able to target this exactly.
- 4 For safety, refigure for five, ten and twenty years ahead. For each year the spouse lives, his or her life expectancy improves.
- 5 To get this ratio: multiply the spouse's monthly annuity income (line 7 or actual) by 12. Multiply the result by Life Expectancy (line 12); divide the result into the proceeds of the life-insurance policy.