PENSIONS:
5 COMMON PITFALLS

GOLDEN YEARS
FINANCIAL

PITFALL #1

BEING HANDCUFFED TO PROPRIETARY PROVIDERS

What is a proprietary product?

Webster's Dictionary defines proprietary as one that possesses, owns, or holds exclusive right to something; something that is used, produced, or marketed under exclusive legal right of the inventor or maker.

Imagine you were in the market for a new car to celebrate retirement. You wouldn't want to make a final decision after only going to one dealership. Although there might be several makes to choose from at that dealership, wouldn't you want to continue looking to see if you like something better? The same can be true regarding limited options and the first offer concerning your pension.

How is that significant to your finances?

Proprietary products are commonly found at financial services firms that create their own financial products. It is important to look at the pros and cons before considering such products, as it could serve as a profit center for the firm, meaning you pay a fee to be in it or purchase it (just like any other company would do).

When considering a proprietary firm, do you think they are going to sell you a different type of investment or product (where someone else may make the lion's share of the profits)? It's important to understand the structure of these products so you can make educated and informed decisions about your investment strategies.

PITFALL #2

NOT HAVING A STRATEGIC INVESTING PLAN

We're not talking about a retirement plan that says, "If you max out your 401(k) for 20 years and get 8% a year on your money, you can retire."

We’re talking about knowing what you own and why you own it. We’re talking about not considering investing in something until you know how it is going to fit into your strategic plan for financial independence. A few things to consider are when to invest in something, at what price you should invest, how much to invest, how long to invest in it for, and most importantly, when to get out.

Let’s talk about that defined contribution plan — what are some of your choices?

Take it, leave it, move it, or roll it.

TAKE IT

You can take the money in a check made payable to you, but may be subject to a mandatory withholding of 20%, even if you intend on rolling it over. If you decide to roll it directly to another retirement account the withholding may not apply, keeping in mind you have 60 days to roll over the distribution and the “one-rollover-per-year-rule.” However, if not done correctly, you may still incur a substantial income tax liability. You may also incur early withdrawal penalties.

LEAVE IT

If permissible by the plan, you can leave the money in your defined contribution plan, resulting in potentially HIGHER investment costs than shopping for lower elsewhere, limited choices, and possible tax consequences for your estate if you pass away while the money is still in your defined contribution plan.

MOVE IT

You can move the money to another defined contribution plan if your new employer allows. However, the same rules from above apply because the money is still in a defined contribution plan account. It’s important to weigh your options so you don’t incur fees or additional taxes for your estate if you pass away while the money is still in your defined contribution plan.

ROLL IT

You can exercise a direct rollover to an IRA. While a defined contribution plan is an excellent accumulation vehicle, an IRA can be an excellent accumulation AND distribution vehicle. By design, IRAs offer more versatility than defined contribution plans. They are highly customizable in the areas of investment options available and beneficiary strategies, and they offer tax-free growth and income deductions. See if an IRA meets your retirement needs by working directly with a seasoned financial professional.

PITFALL #3

PENSION FUND IS NO LONGER AVAILABLE WHEN YOU'RE ELIGIBLE TO COLLECT

Your pension plan could possibly be insured by the Pension Benefit Guaranty Corporation (PBGC). The PBGC can reinforce an individual's pension within certain limitations, including a person's age, time of service, etc., in the event a pension plan goes under. But it's important to note that not all pensions are covered by PBGC. This is not something you want to find out the hard way.

Private sector pension plans always carry risk. Ask yourself: Is the company who manages your pension in the market of funding and addressing longevity? We have seen companies in the United States underfund their pension plans.

If there is no question as to whether your pension is adequately covered by the PBGC or your company itself can fulfill the full benefits of your plan, then this is a non-issue. However, if there is a question or doubt in this area, then considering a buyout can be much more serious. Most importantly, weigh your options and become educated on your decisions.

PITFALL #4

NOT EXAMINING THE MONTHLY PENSION OPTION

If you plan on retiring within the next 12 months and you need additional income, not considering all your pension benefit options could be a costly mistake. In our experience, it can be hard to beat an existing plan if this is your situation.
Let's look at a hypothetical example. John has worked for his employer for 30-plus years, is 68 years old, and is planning on retiring at the end of this year. His wife is 63 years old and plans on working for another five years at least. He just had his prostate removed because it was cancerous.

His single life option is $2,380* per month, but taking this option would offer too much risk because he has cancer and is five years older than his wife. An existing pension maximization plan isn't a good option either because he is uninsurable. His lump-sum payout is $220,000.*

What can he do? The 100% joint survivorship benefit is $1,870* per month, or $22,440* per year. In his case, he is getting almost a 10% guaranteed annual return compared to the lump sum because he needs to take the income right away.

In this hypothetical example, the smartest option for him is to choose the 100% joint payout option because of his health, the age difference between him and his wife, and the fact that he needs the pension income when he retires.

**This is a hypothetical example provided for illustrative purposes only; it does not represent a real-life scenario and should not be construed as advice designed to meet the particular needs of an individual's situation.*

PITFALL #5

NOT TAKING A CLOSER LOOK AT THE SINGLE VS. JOINT PENSION PAYOUT

Did you know that you might be able to get more income now by taking the single life payout and more income in retirement tax-free (if you qualify) for your spouse when you pass away?

Let’s talk about another hypothetical situation. Eric is 56 years old, and his wife, Janet, is 54. He has worked for his employer for 35 years and is planning on retiring early next year.

His lump sum option is $244,198.* His single life option is $3,642* per month, and joint survivor 100% is $3,057* per month. At first glance, you might look and think we need to do the joint payout, but do we? The difference between single life and joint is $585 per month. In our hypothetical example, Eric is healthy enough to get preferred rates on a $500,000 universal life insurance policy that has a no-lapse rider to age 120 for $554* per month! So Eric can net an extra $31 per month by taking single life payout and, if designed properly, can potentially generate $500,000 of tax-free benefit for his wife when he passes away.

If his wife passes away and he doesn’t need the life insurance, he can still keep the policy and, if purchased, use any long-term care benefits (available for an additional fee) for himself. Approximately $100,000* per year of long-term care benefits (for up to four years, if he needed it) could be available, and he would still have a residual death benefit! Or he could pass the entire $500,000 to his children. If he wanted to pass on less to his wife, another option could be to purchase a life policy for $400,000, which may cost around $444* per month and allow him to pocket an extra $141 per month.

The longer Eric lives, the better this gets for his wife. As she gets older, she won’t need the income for as long, which could help generate legacy planning dollars for their children. Without life insurance, choosing the joint payout option stops income with the death of the second person, and a single payout stops income with the death of the employee.

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Hypothetical Example:

STICKING IT OUT

I want to talk to you about a fictitious couple, Joe and Sue.

Joe is an employee with 40-plus years with the same company. His wife, Suzanne, recently retired and is collecting a pension, plus her Social Security.

Joe is planning on working at least two more years, and his health isn't very good. He has diabetes and kidney problems. His wife also has a heart condition. He can't buy any life insurance because he and his wife are uninsurable. He doesn't want to pass away in a couple of years and have his 40-year pension benefit roll back into the company if something happens to his wife as well.

The only benefit he would consider with his company plan is the joint payout at 100% because of his and his wife's health.

The joint payout at 100% is $4,650* per month or $55,800 per year. That sounds like a pretty good deal, right?

Wrong! He has the option to take a lump sum distribution of $525,000.* If we do the math in this hypothetical example, the joint payout option will take 9.4 years just to get his money back, and that's assuming he doesn't spend a dime of that income for those 9.4 years! Looking at using an annuity as another option, he is guaranteed to not lose money to market downturns. Plus, over the next 10 years, he has growth potential on his $525,000! In trade for these benefits, he may not have full access to his lump sum.

This doesn't take into consideration the taxes he may save on his pension. Additionally, he won't have to pay the increased rate on all of his other income that the additional $55,000 would cause. Not only can he take the income when he needs it, but he also has the opportunity for growth potential to help offset some inflation.

In sum, look at all your available options so you don't inadvertently cost yourself hundreds of thousands of dollars in lost benefit.

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The decision of a pension buyout can have a tremendous impact on the success or failure of your retirement. You owe it to yourself and your family to have a customized written strategy that focuses on income, investments, taxes, and your estate.

This information was developed as a general guide and is not intended as tax or legal advice. You should seek advice based on your particular circumstances from an independent tax advisor as tax laws are subject to interpretation and legislative change and are unique to every specific taxpayer's particular set of facts and circumstances. Financial professional is not affiliated nor endorsed by the Social Security Administration or any other government agency. Annuity guarantees are backed by the financial strength and claims-paying ability of the issuing insurance company.

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