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21st century retirement

An Alternate Pension Strategy

Consider this scenario: You are about to retire and are offered a pension of either $3,000 per month during your lifetime or $2,500 per month over the lifetimes of both you and your spouse. If you are married, taking the lower amount may initially seem like the best choice to help ensure continued income for your spouse should you die first.

However, there is another strategy that may allow you to select the higher monthly pension benefit, while still providing income for your surviving spouse. This alternate pension strategy involves coupling the higher monthly pension benefit with a **life insurance** policy. If you predecease your spouse, the policy's death benefit will help provide a supplemental source of retirement income to offset the loss of your pension benefit (which will end at your death). This approach offers a number of advantages:

- **You and your spouse receive added monthly income from the higher pension benefit.** You can use a portion of these funds to pay the premium on the life insurance policy. As long as you keep an adequate life insurance policy in place during retirement, your spouse will have a source of retirement funds if you should die an untimely death.
- **A life insurance policy can help provide you and your spouse with a ready source of cash for emergency or other needs.** Some life insurance policies accumulate a cash value, in addition to providing a death benefit. These cash values accumulate on a tax-deferred basis. The insured can borrow against the cash value during his or her life, generally at a minimal cost, although an unpaid loan will reduce the death benefit amount. Policy withdrawals are not subject to taxation up to the amount paid into the policy. Policy loans and or withdrawals will be taxable to the extent of gain if the policy is a Modified Endowment Contract (MEC). Access to cash values through borrowing or partial surrenders may reduce the policy's cash value and benefit, increase the chance the policy will lapse, and result in a tax penalty.
- **Life insurance provides a source of funds for your surviving spouse.** Policy cash value or death benefit proceeds can be used in whatever manner your surviving spouse chooses, such as for a source of supplemental income.

However, this type of pension strategy requires disciplined management to achieve the desired results. First, you may not qualify for life insurance,

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Getting to the Bottom of Inherited IRAs

The IRS stipulates that an IRA owner must begin taking **required minimum distributions (RMDs)** by April 1st of the year following the calendar year during which he or she reaches age 70½, commonly referred to as the "required beginning date." IRA beneficiary rules involve two separate issues: 1) the *age* of the IRA owner at the time of death, and 2) the *identity* of the IRA **beneficiary**.

If an IRA owner dies *before* RMDs have begun, a spousal beneficiary can choose to withdraw all IRA assets within five years, to maintain the IRA under the deceased spouse's name, or to treat the IRA as his or her own. Suppose Jim Bradshaw (a hypothetical case) dies and his wife, Linda, is the beneficiary of his IRA. If Linda maintains the IRA in Jim's name, minimum distributions do not have to begin until December 31st of the later of 1) the year following the year of Jim's death, or 2) the year in which Jim would have reached age 70½. However, distributions would be based on Linda's life expectancy. If Linda chooses to treat the IRA as her own, she is entitled to name new beneficiaries, and the rules governing RMDs would be the same as if the IRA were originally her own. Therefore, distributions would have

to begin by April 1st of the year after the year in which she turns 70½, and the required amount would be based on her life expectancy.

If Jim were to die *after* RMDs had begun, the options for Linda would be different. She could choose to continue receiving distributions based on either Jim's life expectancy or her own. As another option, Linda could opt to **roll over** Jim's assets into her own IRA. (This option is not available for IRAs that have been annuitized.)

Non-spousal beneficiaries may not treat IRAs as their own and cannot name additional beneficiaries. If the owner dies before the required beginning date, all assets in the account must be distributed by the end of the fifth anniversary year of the owner's death. Alternately, the beneficiary may elect to receive distributions over his or her life expectancy. The amount of distributions is based on the *beneficiary's* life expectancy, and distributions must begin by December 31st of the calendar year immediately following the calendar year of the owner's death. If the owner dies on or after the required beginning date, the assets must be distributed over a period not exceeding the larger of the owner's or the beneficiary's life expectancy.

an alternate pension strategy

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or premiums may be higher than anticipated. Also, your life insurance policy may not perform as anticipated or may lapse if the premiums are not paid. Second, a lump-sum death benefit must be properly managed to yield the anticipated income. Your surviving spouse must be able to reinvest the death benefit for retirement income with the risk that the investment may not perform as anticipated or may produce less income than required. There is an additional risk that your spouse may outlive the death benefit income or that the death benefit may "over fund" your spouse's needs. Third, if you waive the spousal provision, your spouse may lose benefits provided in conjunction with a pension, such as health insurance or cost-of-living adjustments, and he or she may be unable to independently obtain them. Finally, the issuance of a life insurance policy is subject to underwriting and is not guaranteed, whereas with a pension, you can be a smoker or in poor health and still receive benefits. You have to be a specific age and health to make the numbers work. It's important to find out whether you can make the difference in pension plan distributions less taxes cover the cost of the insurance. For assistance with your situation, be sure to consult a qualified financial professional.

Higher Share of Households at Risk of Financial Trouble in Retirement

A combination of factors, including declining Social Security income replacement rates, lower real interest rates, and the ongoing shift from defined benefit to defined contribution plans, mean that a growing percentage of working-age U.S. households are at risk of being unable to maintain their living standard in retirement, according to a report published by the Center for Retirement Research (CRR) at Boston College.

The study's findings were based on the CCR's National Retirement Risk Index (NRRI), a measurement tool which used data from the Federal Reserve Board's 2004 and 1992 Surveys of Consumer Finances to project how much income various types of households will have in retirement relative to their income while working.

Risk Factors

The index showed that 43% of the households sampled in 2004 are at risk of being unable to maintain their standard of living in retirement, even if they do not retire until age 65. In addition, NRRI projections suggest that younger Americans are more likely to be unprepared for retirement than older workers: 35% of "early boomers" (ages 53 to 61) were found to be at risk, compared with 44% of "late boomers" (ages 43 to 52) and 49% of "Generation Xers" (ages 35 to 42).

According to study authors Alicia H. Munnell, Anthony Webb, and Francesca Golub-Sass, this pattern "reflects the impact of increasing longevity and a contracting retirement income system."

Compare and Contrast

To illustrate these trends, the study compared the NRRI of people ages 51 to 61 in 2004 and the NRRI of the same age group 12 years previously. In 1992, the analysis showed, just 19% of this cohort was considered at risk of having too little income in retirement. But, by 2004, however, 32% of this group was found to be at risk.

The reasons for this sharp adjustment, according to researchers, include changes in Social Security replacement rates and the decline in the percentage of one-earner couples over this period. Because the system provides a 50% spousal benefit, one-earner couples tend to have higher replacement rates than two-earner couples or singles, the study's authors pointed out. Therefore, they noted, the median Social Security replacement rate for one-earner couples in 2004 was 58%, compared with 32% for two-earner couples.

Other Factors

The study also emphasized the effects of the increase in the Normal Retirement Age from 65 to 67 on the decline in Social Security replacement rates. In addition, researchers said, the decline in real interest rates to 2.2% in 2004 from 3.4% in 1992 means that households will likely receive less income from annuitizing their financial assets and 401(k) balances.

Finally, the report noted, the percentage of households in this age group due to receive a substantial portion of their income from a defined benefit plan declined markedly over the period. In 1992, 52% of these households were covered by a defined benefit plan only; 20%, by a defined contribution plan only; and 28%, by both. But in 2004, 34% of these households were covered by a defined benefit plan only; 35%, by a defined contribution plan only; and 31%, by both.

One development that was found to mitigate these negative effects on retirement income for people between the ages of 51 and 61 was the change in housing wealth and mortgage debt. Results of the analysis showed that, between 1992 and 2004, gross housing wealth among this cohort rose from 2.4 times income to 2.6 times income. However, researchers added, the positive effect of increasing home values was offset in part by a rise in mortgage debt.

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Thinking Ahead for a Secure Retirement

Americans are now living longer than ever before. With increased longevity, retirement resources may need to last 20 years or more.

Everyone has numerous financial challenges they face each day. As a result, many people put off planning for the future. Some people even assume that Social Security will take care of them when the time comes. Then, when they reach retirement age, they find that Social Security will not provide enough income to maintain the quality of life they had during their working years.

In the past, many retirees depended on corporate pension plans to provide a major portion of retirement income. However, current trends find businesses offering more ***defined contribution plans***, which rely on employee initiative, and fewer ***defined benefit plans***. In addition, since several job changes in one's career seems to be a normal course of action today, building up significant retirement benefits can be difficult, making it unrealistic to count solely on defined benefit plan payments.

Today's retirees may require 60% to 80% of their pre-retirement income in order to maintain their current lifestyles during non-working years. But what about inflation? Living expenses are likely to cost more in the future, because over time, the purchasing power of the dollar generally decreases as a result of inflation. It is important that your retirement plan account for the effects inflation can have on the future value of your savings. Remember, it's never too early to save for your retirement.

Three basic steps can help you budget:

1) Set your retirement goals;
2) Determine your sources of retirement income; and
3) Devise a savings strategy that will make up for any shortfall or, if you are fortunate enough to have excess savings, a strategy to wisely manage your money.

Start now. Determining *how much* income you will need at retirement and deciding among the various options are the keys to your long-term success. Therefore, it is essential to draw up a retirement plan that best fits your individual needs and promotes a happy, secure retirement.

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In Conclusion

"Unless households begin to save more or work longer," Munnell and colleagues warned, "the NRRI will continue to increase as the Social Security Normal Retirement Age rises to 67, the shift from defined benefit plans continues, retirement periods become longer with increased life expectancy, and the one-income couple virtually disappears. Yes, there really is a retirement savings crisis."

[1] Alicia H. Munnell, Anthony Webb, and Francesca Golub-Sass, "Is There Really a Retirement Savings Crisis? An NRRI Analysis," Center for Retirement Research at Boston College, August 2007, Number 7–11.

The information provided is not written or intended as tax or legal advice and may not be relied on for purposes of avoiding any Federal tax penalties. Individuals involved in the estate planning process should work with an estate planning team, including their own personal legal or tax counsel.

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