How to Maximize Your Pension Benefits

Bert Salazar, Managing Member

As a public employee working for a governmental agency, having a guaranteed pension benefit is paramount in reaching your future retirement goals and objectives – nevertheless, choosing the correct distribution rates out of these pensions systems is an art worth exploring in this white paper.

Cambridge Financial Partners, LLC
2000 Ponce De Leon Boulevard Suite 500 Coral Gables, FL 33134

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For the past twenty five years, I have worked with hundreds of public employees (federal, state, municipal) along with dozens of private sector employees in the area of Pension Maximization – this sophisticated technique utilizes economic principles and models that take a number of factors in determining a specific pension benefit strategy. This white paper will address some of these factors in detail in order to provide a telescopic view of how proper decisions should be made and evaluated as these employees exercise their guaranteed pension benefits.

As a retirement distribution specialist, I address, review, and audit the following items that have a tremendous impact on the outcome when choosing the right distribution option at retirement from a specific pension system:

- *What type of system does the public employee have?*
- *How many retirement options are available under said system?*
- *If the client is married, does the spouse participate in the same pension system as the employee, or does the spouse participate in another system that requires pairing calculations?*
- *Does the pension system allow for revocable decisions during retirement or are all decisions irrevocable at time of choosing and/or separation from service?*
- *Does the system provide a cost of living arrangement (COLA), and if so, at what percentages and how is it triggered?*
- *Are the benefits fully or partially taxable?*
- *What is the retiree's financial condition? What other assets are available for income and/or survivor benefits? Are they taxable or tax-free? Are they guaranteed or non-guaranteed?*
- *What is the pension system cost for providing survivor benefits?*
- *Has the employee contributed to any other qualified plan during working years (TSP, 403b, Deferred Compensation)*
- *Has the employee contributed to Social Security while working as a public employee?*
- *Does the pension system provide for Deferred Retirement Option Program (DROP)?*
- *Will the public employee be impacted by the Windfall Elimination Provision (WEP)?*
- *Will the surviving spouse be impacted by the Government Pension Offset (GPO)?*
- *Is there a disparity in age between the public employee and his/her spouse?*
- *Does the public employee and his/her spouse wish to protect children and/or grandchildren in case of premature death?*
- *Will the pension option decision factor the 4 major potential retirement outcomes?*
- *Will the public employee continue to work after retirement?*
- *Is the public employee a public safety employee (police or fire), or an Air Traffic Controller (ATC)?*
- *At what age would the public employee wish to disinherit his/her family…really!*

As you can see, the vast majority of public employees I engage have never anticipated and/or gone through all the above-depicted questions – in the next several pages, I will address some of these questions and/or issues in order to give the reader ample opportunity to see and understand the complexity of this crucial decision making process.

I normally advise my clients that I can help everyone, but I can't save everyone! The reasons are simple yet complex:

- *Most public employees feel that the system is going to take care of them, and that current pension benefits at retirement will be sufficient to maintain their standard of living over their lifetime*
- *Public employees have a tendency to perform cubicle financial planning (they gather critical information from the person sitting in the next cubicle and they apply the same decision making process to their own situation) – the blind leading the blind*
- *Public employees do not realize and/or comprehend that an irrevocable pension retirement decision will represent a $2,000,000 decision for themselves and their families*
- *If public employees had a clear understanding of the questions, issues, and concerns that arise from making these critical decisions, they would be lining up at my door every single day of the week*
- *Most sadly, the spouses of public employees seldom participate in the most critical aspects of the pension retirement income process, and thus end up destitute with very little safeguard for their own retirement benefits and the rest of their lives*
- *As a point of reference, many of my current public employee retirees are currently working in other careers, and many of them will become WalMart greeters at some point in time in the future – That's absurd since they have a guaranteed pension and because of said pension they stand at the top 1% of the food chain when it comes to the American retirement system*

Do I have your attention now? I hope so, but if not, let's start addressing some of the previous questions and/or concerns from the beginning of this white paper on a systematic basis.

Although most of the systems provide similar benefits, the access to these benefits are often different and convoluted.

For example, the U.S. Government has had two major systems for most of the last century – the Civil Service Retirement System (CSRS) and the Federal Retirement System (FRS). CSRS started August 1, 1920 and ended on January 1, 1987, but most employees starting with the government after January 1, 1983 were automatically included in the replacement system, FRS.

CSRS employees never contributed to Social Security (FICA) and therefore all of their pension benefits were much higher than the current system – in many ways, the federal government understood that they needed to find a way in which to transfer a large percentage of the pension retirement risk to the federal employee – they did have the ability to contribute to a Thrift Savings Plan (TSP) with no match, but the vast majority of their pension benefit came from the CSRS annuity.

A large number of CSRS employees are either currently retired or close to retirement, so I don't get to see as many as I did 10 years ago – some of these employees were sold a false bill of goods and a percentage of them shifted from CSRS to FERS and became CSRS Offset (a percentage of their pension benefit comes from CSRS and another percentage from FERS). Some of these CSRS employees are married to FERS employees so parity of pension benefits is paramount in determining best retirement option scenarios.

Moreover, since the majority of these employees did not contribute to Social Security (FICA) during their working years, they are impacted by the Windfall Elimination Provision (WEP) and/or Government Pension Offset (GPO) for surviving spouses – Employees that have some Social Security benefits employment but total accrual benefit contribution is less than 30 years will have a percentage of their Social Security benefits reduced under a specific governmental formula under WEP – for obvious reasons, surviving spouses of these employees will have Social Security benefits reductions under the GOP governmental guidelines.

Because of my extensive work with federal employees, I have dealt with many married couples whereby one of the family members is part of CSRS and the other member is part of FERS – to a lesser extend, I have CSRS Offsets and FERS as well, but the overall family pension benefits require proper economic calculations.

The FERS system was a brilliant idea by the federal government because it shifted a large amount of pension benefit responsibility to the federal employee as opposed to the government – FERS employees contributed a much lower percentage to their governmental pension annuity, but they contributed to Social Security (FICA) and received a TSP match on their contributions – numerically speaking, the numbers looked phenomenal on their TSP calculations due to contributions, governmental matches, and linear rates of return (the stock market and economic world does not work that way).

In addition to the different federal pension systems, certain federal employees have mandatory retirement guidelines:

- *Federal public safety employees have mandatory retirement ages of 57*
- *Air Traffic Employees (ATC) have mandatory retirement ages of 56*

Due to these mandatory requirements, safety and ATC employees contribute a larger percentage to their federal pension annuity because they have a shorter amount of time in order to accumulate adequate pension benefits.

Since I lived in California for 12 years, I had an opportunity to work with California Pension Employees Retirement System (CALPERS) and California State Teachers Retirement System (CALSTRS) employees – their benefits are totally different than those of federal employees, and I dealt with a number of couples that were part of CALPERS, CALSTRS, CSRS, and/or FERS. Calculations are complicated and require economic modeling as well in order to obtain proper retirement distributions throughout a lifetime. Remember, no one ever dies at the right time!

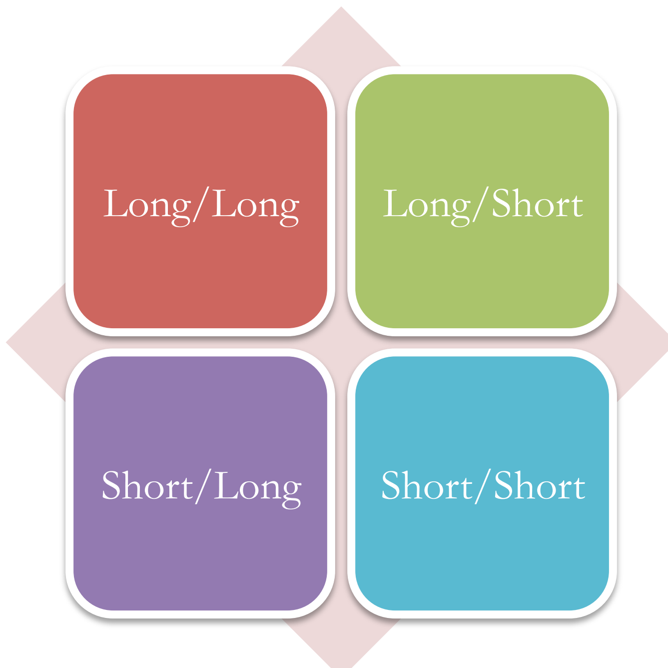
Most municipalities in Florida follow much of the same rules amongst themselves, but the Florida Retirement System (FRS) is a complete different animal when it comes to retirement benefits for existing state employees – for many years, state employees did not have to contribute to their state retirement system, but they are now contributing 3% of their income to said system with certain calculated formulas. For the most part, FRS provides 4 different retirement options:

- *Option I is a single life annuity option which provides a guaranteed monthly retirement benefit to the employee until his/her death – Upon the employee's death, said benefits will stop and/or die with the employee except for any unpaid employee plan contributions left if premature death occurred.*
- *Option II provides a reduced monthly benefit with a 10-year period certain – If retired employee death occurs after 10 years, no other benefits will be paid to surviving spouse.*
- *Option III provides a reduced monthly benefit lower than Option II but it provides a 100% survivor benefit to the surviving spouse.*

- *Option IV provides an adjusted monthly benefit lower than Option II but higher than Option III – Upon the employee's death, 2/3 of retiree decedent employee benefits are paid to surviving spouse for his/her life.*
- *Option III and IV further provides that upon the death of the employee member, a joint-annuitant under the age of 25 will receive the Option I benefit until age 25*

Contrary to popular beliefs, all decision regarding these pension options are more than likely irrevocable unless the employee works for the federal government – many times, this pension rule is overlooked by most public employees and can be detrimental and damaging for a successful pension retirement distribution planning.

What I'm about to share with you will have a major economic impact on retirement income distributions and may have a cost of hundreds of thousands of dollars during a retired employee's lifetime. During retirement, couples will experience the following possible outcomes of actuarial death:



- *Long/Long (the employee and spouse live a long life according to mortality actuarial tables equal to 84.6 years of age)*
- *Long/Short (the employee lives a long life and the survivor spouse lives a short life)*
- *Short/Long (The employee lives a short life and spouse lives a long life according to mortality actuarial tables equal to 84.6 years of age) Short/Long occurs approximately 25% of the time*
- *Short/Short (Both the employee and his/her spouse live a short life)*

Except for unpaid employee contributions to the pension system, there are no contingent beneficiaries to the pension system – actually, the pension system becomes the sole contingent beneficiary and thus children and/or other family members are automatically disinherited in most cases.

In the Long/Long scenario, both the retired employee and his/her spouse will live a long life to life expectancy or beyond, but at that age level, when the first person dies, the surviving spouse will not live much more than 2 to 3 years – therefore, there's never enough time for the surviving spouse to live long enough to recapture the lost income and/or opportunity cost of that income because a lesser retirement benefit was provided during retirement in order to protect both spouses.

The Long/Short scenario offers a different set of circumstances – on the one hand, the retired employee will live a long life, but his/her spouse will live a short life and thus provide a lifetime income deficit to the employees – most pension systems retirement choices are irrevocably made and by its very nature, provide for a major income loss and greater opportunity cost than most retired employees anticipate. The federal pension system does allow for the retired employee to notify the Office of Personnel Management (OPM) of a spousal death and thus have his/her income upwardly adjusted – the pensions systems in Florida do not allow for this process.

The Short/Long scenario happens approximately 25% of the time from a statistical standpoint – the retired employee lives a short life (under 5 years after retirement) and the surviving spouse lives a long life – again, the choices made create income losses and opportunity costs for many years in retirement which negatively impact retirement income and inflationary eroding factors (a number of former co-workers with the Miami Police Department have fallen into this category).

Last but not least, we come to the Short/Short scenario in which the retired employee and his/her spouse live a short life (I have had a few clients and co-workers that have fallen in this category as well).

As a former law enforcement officer in Massachusetts and Florida, I have an insider and/or microscopic view on traditional public pension systems – as an Economics advisor for the past 26 years, I have an outsider and/or telescopic view on how these systems work and where the flaws lie and how to address them from an economics standpoint.

Based on my experience of 26 years in this marketplace, 88% of all public employees choose a survivor option at time of retirement – what most of them fail to understand is that when a retiring employee chooses a survivor benefit, he/she is purchasing an irrevocable life insurance policy inside the system which is extremely expensive and seldom works properly.

Moreover, the annual cost of this insurance contract goes up every single year as predicated by the pension system – here's a typical example for the Florida Retirement System:

- *Retiring employee can choose Option I and receive $5,200 for life (the pension dies at the retired employee's death) – no survivor benefit.*
- *Retiring employee can choose Option II and receive $4,800 for life (the pension provides a 10 year guaranteed survivor benefit only) – partial survivor benefit.*
- *Retiring employee can choose Option III and receive $4,100 for life (the pension provides a 100% survivor benefit to surviving spouse).*
- *Retiring employee can choose Option IV and receive $4,400 for life (the pension provides a 66 2/3 survivor benefit to surviving spouse).*

Again, most retiring employees will choose Option III in order to protect their family for life (an honorable decision) – the road to hell is paved with a lot of good intentions!

The difference between Option I and Option III for this retiring employee is $1,100 per month and/or $13,200 annually, but there is an additional cost which most retiring employees fail to acknowledge and/or identify – most pension systems provide an annual cost of living adjustment (COLA) which in this scenario would only be paid on the $4,100 and not on the $5,200 – heretofore, the actual survivor benefit life insurance cost inside the pension system for this employee was $13,200 annually plus the annual COLA foregone on the $13,200 every single year. In 20 years, the cost of this survivor benefit to the retired employee and his/her family is $412,622 – on the other hand, the opportunity cost of this decision to the family unit is an enormous $557,038 over a 20 year period – most public safety employees retire in the early to mid 50s so over 30 years the cost of this benefit along with its opportunity costs equal $1,181,996…sad to see how these public employees are throwing their money away in the pension system provided life insurance survivor benefit program.

I don't have anything against life insurance, but what if you could choose a flexible life insurance program that allows you to maximize and enhance all survivor benefits while recapturing most of the premiums paid along with its opportunity costs – I guess you're paying attention at this point…

If you're fairly healthy, you're better off purchasing the life insurance survivor benefit from a life insurance company outside the pension system – the contract should have guarantees, longevity illustrations, and recaptured cash values and/or equity.

Over the years, a number of clients have wanted to purchase 20 year level term life insurance in order to provide said survivor benefit, but unless they die within the 20 year period, they will automatically disinherit their family in year 21 when the term insurance policy lapses – as a point of reference, 98 ½ percent of all term insurance policies never pay a death benefit – term insurance is priced not to pay!

If done correctly, the retiring employee could purchase a guaranteed life insurance contract payable for life (whole life, universal life, index universal life, variable universal life) – this paper will not address the different types of permanent life insurance, but we will address the benefits of this pension straddle process.

Instead of having the retiring employee choose a retirement survivor benefit pension option, I normally have the retiring employee choose the unmodified Option I which provides the highest income for said employee and his/her family ($5,200 instead of $4,100). Even if the life insurance cost equals the annual difference between the monthly amounts of $5,200 and $4,100 ($13,200), the retired employee will receive a pay raise every year because the COLA is paid on the entire monthly amount of $5,200 and the life insurance premium of $13,200 annually remains level for life on a guaranteed basis – this simple move has recaptured the COLA and its opportunity cost on behalf of the retired employee and his/her family for life – this recapture equals $557,038 in 20 years and $1,181,996 in 30 years!

As you apply this technique to the Long/Long, Long/Short, Short/Long, and Short/Short scenarios, here are the amazing results:

If retired employee and spouse live a long life and die within 2 to 3 years of one another, not only the surviving spouse at first death receive a tax free life insurance lump sum benefit, but he/she can start to receive an annuity income whereby the majority of benefits are free from federal income taxes due to the exclusion ratio rules of the IRS code. Upon the death of the surviving spouse, the remaining life insurance death benefit amount would be paid to contingent beneficiaries of choice or by will.

If retired employee lives a long life and spouse lives a short life, the retired employee has a number of choices that he/she can make…cancel the life insurance contract as the survivor benefit is no longer needed and thus recaptured the majority and/or all the premiums paid plus additional cash values and/or equity; keep the contract in place and use its guaranteed cash value and/or equity as a tax preferred supplemental retirement plan; or keep the contract and leave same as a tax preferred family legacy for generations to come…since no one can predict a future outcome, having flexibility is paramount.

If retired employee lives a short life and surviving spouse lives a long life, the tax-free death benefit proceeds can be used to purchase a guaranteed income annuity for the life of the surviving spouse with plenty of flexibility…take a portion of the death benefit and purchase a guaranteed income annuity that will pay for all fixed expenses and invest the remaining death benefit for later years; purchase Delayed Income Annuities (DIA) which will provided guaranteed income at different ages and/or stages of life (go-go years, slow-go years, and no-go years). Due to the IRS exclusion ratio option, this annuity payment program will pay a higher benefit to the surviving spouse due to its tax-benefit ramification.

If retired employee and his/her spouse live a short life and thus die prematurely, then tax-free life insurance proceeds would provide a benefit to surviving family members (children, grandchildren, and/or non-profit organizations of choice).

Regardless of how a retired couple may live or die, the purchase of a guaranteed life insurance contract outside of the pension system provides flexibility, guarantees, lower overall cost, recapture of foregone premiums, cost of living adjustments (COLA), opportunity costs, and…

- *Life insurance death benefit proceeds are received free from federal income tax.*
- *Life insurance cash values and/or equity is creditor protected in the State of Florida*
- *Depending on type of contract chosen, cash values are guaranteed and not impacted by market fluctuations…some contracts may pay additional dividends.*
- *Cash values and/or equity can be utilized on a tax-preferred basis for retirement, investments, business opportunities, with no regard to the premature or minimum distribution rules of the IRS code.*
- *Life insurance can be used as collateral for personal and/or business loans.*
- *Life insurance cash values and/or equity can be used as a banking system for personal and business financing (homes, automobiles, investment properties).*

Most of the public employee clients I engage are normally within 5 years of retirement, but I wished I had educated them 15 to 20 years earlier – here's what I would have said to them at the time…

- *Do not invest in qualified retirement plans while a public employee (403b or 457). You don't save taxes, you postpone taxes, and along the way, you postpone the tax liability as well.*
- *Most of my retired public employee clients find themselves in a higher tax bracket today than before they retired…taxes on their pension benefits, taxes on social security benefits for both spouses, taxes on 403b,*

457, and Deferred Retirement Option Program (DROP) options upon distribution, taxes on spouses' IRAs and/or 401ks, and taxes on investment and/or real estate income.

- *Our federal debt is at $19 trillion and counting; the unfunded liability for Social Security, Medicare, Medicare Part-D, and ObamaCare is currently at $120 trillion and counting…so do you think that future taxes will be lower, the same, or higher? If you guessed higher…you're right!*
- *The money invested and/or saved in qualified plans should go toward the purchase of guaranteed life insurance contracts at earlier ages if possible because of its cost and enormous tax benefits – the life insurance planning should include survivor benefit planning, tax preferred retirement income planning, and Social Security planning.*
- *For your information, a surviving spouse will choose the higher Social Security benefit at the death of the first spouse, but he/she would give up one of the Social Security benefit payments – the opportunity cost of that foregone benefit could be substantial in retirement.*
- *I have worked with a number of clients early enough whereby their life insurance contract has been fully paid at time of retirement or within 10 years after retirement.*

For many of my public employee clients, the Windfall Elimination Provision (WEP) will have a negative impact on their Social Security benefits – most public employees do not have a clear understanding of how WEP works in relation to their pension benefits…

- *If a public employee works for a governmental agency that does not withhold taxes for future Social Security benefits, then said potential Social Security benefits may be negatively impacted by a specific IRS formula.*
- *If a public employee has 30 years of substantial earnings under Social Security, then the WEP provision is not applicable and said employee will receive maximum Social Security benefits without any reduction in payments.*
- *For those public employees that have Social Security earnings but said earnings are less than 30 years, then a specific IRS formula applies to Social Security benefits which could reduce said benefits to as low as 40% of benefits for those with 20 years or less of Social Security earnings. Below you will find the IRS formula…*

Years of Substantial Earnings	Percentage
30 or more	90 percent
29	85 percent
28	80 percent
27	75 percent
26	70 percent
25	65 percent
24	60 percent
23	55 percent
22	50 percent
21	45 percent
20 or less	40 percent

The Government Pension Offset (GPO) is a law that affects spouses, widows, and widowers of public employees that do not have at least 30 years of substantial Social Security earnings. Social Security spousal benefits may be reduced by 2/3 of benefits – if 2/3 of that individual's government pension is more than the spouse's Social Security benefits, then said benefit might be reduced to zero. For these families, life insurance guaranteed planning takes an additional role in the overall planning and pension decision process prior to retirement.

Retirement income solutions and choices for public employees are quite complex and need professional advice from qualified advisors that specialize in pension systems – for many of them, lack of financial education coupled with the failure of working with qualified advisors have compounded the future problems these public employees and their families will encounter in the future.

At Cambridge, our job is to change the way people see things, because when people change the way they see things, the things they see change – as a public employee, you owe it to yourself and your family to maximize all pension benefits with the least amount of cost while providing the most amount of guarantees – remember, the ultimate contingent beneficiary of all pension systems is the pension system itself.

Bert Salazar, Managing Member
Cambridge Financial Partners, LLC
2000 Ponce De Leon Boulevard Suite 500
Coral Gables, FL 33134
(305) 766-1042
Bert.Salazar@CambridgeFPLLC.com