Being Affluent May Not Guarantee a Comfortable Retirement

One would think that having a comfortable retirement is not something of concern to an affluent individual or couple. If the definition of a comfortable retirement, however, is being able to maintain one's current lifestyle, then many of these affluent income earners may be facing a potential retirement income shortfall.

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Pacific Life's Advanced Designs Unit (ADU) consists of seven highly respected professionals who specialize in advanced life insurance planning.

Bringing You Planning Ideas that Incorporate Life Insurance

Why might affluent people be unable to save enough for retirement?

- **Expensive Lifestyles**—Affluent income earners may be spending most of their income to maintain their current lifestyle.
- **Late Start on Saving for Retirement**—Affluent business owners may be using most of their income to build their business in the early years rather than saving for retirement.
- **Qualified Plans and Individual Retirement Accounts (IRAs) Contribution Limits**—It may be difficult for the affluent individuals to put away a high enough percentage of their income on a tax-deferred basis to maintain their current lifestyle during retirement due to contribution limits.

So how could affluent individuals better prepare for retirement? Step one is to conduct an analysis and determine if they are on track to meet their retirement income goals.

Retirement Planning Analysis

First, the life insurance producer or financial professional* works with their client to establish the individual's or the couple's retirement income goal either as a set amount or a percentage of current income. Next, the client's projected retirement income should be calculated based on the current balances of the primary retirement assets, including qualified plans, IRAs, pension benefits, and Social Security, plus growth and anticipated future contributions. Finally, the retirement income goal should be compared with the projected retirement income to determine if there is a potential retirement income shortfall.

If an individual or couple determines there is a potential retirement shortfall, step two is to establish a supplemental retirement strategy, ideally on a tax-deductible or tax-deferred basis. One possible asset to help supplement retirement income is a cash value life insurance policy.

*In order to sell life insurance, a financial professional must be a properly licensed and appointed life insurance producer.

The primary purpose of life insurance is to provide financial protection in the event of the insured's premature death. Cash value life insurance also has the potential to help an individual build another valuable asset to help supplement their retirement income needs.[1]

Among the key features are:

- Any available cash value in the policy grows tax-deferred.
- Any available cash value in the policy may be accessed through withdrawals and loans income tax-free.[2]

How the Strategy Works

Assume an affluent couple in their early fifties has a combined annual income of $350,000. Also assume that to maintain their current lifestyle they need an income during retirement of $200,000 a year (without taking into consideration the impact of income taxes). Finally, assume the couple is currently making the maximum permissible contributions to their retirement accounts and, when taking into account anticipated Social Security benefits, will have a projected retirement annual income of $170,000 beginning at age 65.

If this projection is accurate, the couple may have a retirement income shortfall of $30,000 a year. If they cannot or are unwilling to make up this deficit using other assets, these affluent earners may have to cut back on their desired spending during retirement. Alternatively, the couple may save more now to mitigate the chances of a retirement income shortfall. Given that they are already taking maximum advantage of tax-deductible retirement accounts, this strategy may be a challenge. If this affluent couple has a need for additional death benefit coverage to protect their family from the loss of one of their incomes, they may want to consider a cash value life insurance policy because it can also provide supplemental retirement income.

Assuming the couple are able to pay enough premiums into the life insurance policy without causing it to lose its income tax benefits,[3] they can target accumulating sufficient cash value in the policy to help enable them at age 65 to begin taking annual distributions from the policy's available cash value. The potential to access the policy's available cash value could help them reduce or eliminate their projected retirement income shortfall.

Conclusion

Just because individuals or couples are considered "affluent" doesn't mean they will have the type of retirement they envision. To help provide for a comfortable retirement, it's important to conduct an analysis of current retirement assets and, if necessary, do additional planning to avoid an unexpected retirement income shortfall.

[1]Life insurance is subject to underwriting and approval of the application and will incur monthly policy charges.

[2]For federal income tax purposes, tax-free income assumes, among other things: (1) withdrawals do not exceed tax basis (generally, premiums paid less prior withdrawals); (2) policy remains in force until death (any outstanding policy debt at time of lapse or surrender that exceeds the tax basis will be subject to tax); (3) withdrawals taken during the first 15 policy years do not cause, occur at the time of, or during the two years prior to, any reduction in benefits; and (4) the policy does not become a modified endowment contract. See IRC §§ 72, 7702(f)(7)(B), 7702A. Any policy withdrawals, loans and loan interest will reduce policy values and may reduce benefits.

[3]For more information about the income tax features/benefits of life insurance, please contact your legal or tax advisor.

For more information about advanced life insurance planning, please contact our Advanced Designs Unit at AdvancedDesigns@PacificLife.com or (800) 800-7681, ext. 3690.

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