PENSIONS

A Lump-Sum Payout Might Make Sense

If you're considering taking a one-time payout, don't put it off. Its value will decline as rates rise. BY SANDRA BLOCK

Are you eligible for a traditional pension? It's probably a good idea to keep it to yourself. Retirees whose portfolios have been battered by the bear market would dearly love to get a monthly check for the rest of their lives.

But many employers that provide defined-benefit pensions offer employees the ability to take their pension as a lump sum instead of an annuity. Employers like this option because it gets the pension liability off their books, and some retirees prefer the flexibility a lump sum provides.

If you're considering taking a lump sum and there's an offer on the table, you may need to act before year-end to get the most out of your nest egg. Lump sums are typically calculated based on the present value of guaranteed monthly payments, using mortality tables and interest rates published by the IRS. Under the formula pension plans use, the lower the interest rates, the higher the lump-sum payout.

Large plans typically calculate the value of lump sums annually, which means many plans are offering lump sums based on interest rates published in October and November 2021, says Hogan Fulghum, a certified financial planner with Catalyst Financial Group, in Charlotte, N.C. Those rates were much lower than they are now.

Lump-sum offers in 2023, however, will be based on rates from late 2022 and could be much lower, says Josh Hawkins, a CFP with the Leverty Financial Group, in Hudson, Wis. He estimates that every one-percentage-point increase in the interest rate used to calculate a lump sum reduces the value of the payout by up to 10%.

For example, consider a 61-year-old worker who is eligible for a lump sum based on the present value of a $40,000 annual pension. A lump sum based on November 2021 interest rates would total about $660,000, Hawkins says, while one based on rates for August 2022 would total about $549,000.

With that in mind, it could pay off to accelerate your retirement date to take advantage of 2021 rates, Hawkins says. That may sound counterintuitive, because working longer typically results in a larger pension, along with additional income and potential bonuses. But if an employee is leaning toward taking his or her pension as a lump sum, Hawkins says, the higher payout may eclipse the advantages of staying on the job for a few more months.

An emotional decision. Interest rate calculations aside, the decision to take a lump-

ILLUSTRATION BY HUAN TRAN

DECISION TREE

HOW SHOULD YOU TAKE YOUR PENSION?

When you retire, you have to make decisions about your pension that could be worth hundreds of thousands of dollars to you and your spouse. Usually, the decisions are irrevocable.

TAKE A **LUMP SUM**

if you are comfortable investing the money yourself or using a money manager.

Pluses

- Money invested in an IRA could grow faster than the rate of inflation.
- You have more flexibility to take withdrawals.
- No need to worry about the financial health of your employer.
- Money left over can go to your heirs.

Minuses

- Down markets or poor investments may force you to reduce withdrawals.
- You could run out of money if you live longer than you expected or need it for a health or other emergency.

TAKE **LIFETIME PAYOUTS**

if you want a fixed monthly paycheck for life to supplement Social Security and other sources of income.

Pluses

- You're protected against market downturns.
- You can invest other assets more aggressively.
- Employers pay more than you can get on your own with an immediate fixed annuity.

Minuses

- Unless your plan has a cost-of-living adjustment, inflation will erode your purchasing power.
- If your employer declares bankruptcy and the pension is taken over by the Pension Benefit Guaranty Corp., your payments could be reduced.
- Payouts end at your death or the death of your spouse.
- Heirs get nothing.

TAKE THE **SINGLE-LIFE OPTION**

if you want a larger monthly payment and have other assets, such as life insurance or investments, to support your spouse after you die. A signed waiver from your spouse is required.

TAKE THE **JOINT-AND-SURVIVOR OPTION**

if you can make do with a smaller monthly payment and your spouse needs guaranteed income for life. Survivor options range from 50% to 100% of the original monthly pension.

sum payout or a lifetime annuity is deeply personal. Even a more generous lump sum must be invested—an unnerving prospect even when the markets are on the upswing. You may sleep better at night if you know that you—and perhaps your spouse—will receive a monthly check for the rest of your life. "If you're risk-averse, you're better off taking the annuity," says Thomas Gahan, a certified retirement plan specialist with Procyon Partners, in Shelton, Conn.

But if you want both guaranteed income and the flexibility a lump sum provides, you may be able to have your cake and eat it too, Hawkins says. You could take the lump sum now—which means you'll enjoy the more generous payout—invest the money and use part of the payout to purchase an immediate annuity down the road, he says.

With a single-premium immediate annuity, you give an insurance company a lump sum in exchange for monthly payments for the rest of your life (or a set period of time). And in this case, rising interest rates are your friend. Payouts are tied to rates for 10-year Treasuries, which recently rose to about 3.8%. And with rates expected to continue to rise in 2023, payouts could continue to increase. ■

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