ALL ABOUT PENSIONS

What every employer and pension recipient should know

By Paul E. Fair, Paul Fair Associates, LLC

After 45 years of employment, you are now approaching retirement. You've been working toward this goal for a long time, and are looking forward to the change with excitement – and a bit of trepidation. Retirement, after all, is a life-changing event that involves a substantial number of important decisions. Financial decisions, for example, should be at the top of your list, especially if you are due to receive a pension. If you are retiring from a job with an employer-sponsored pension, it's critical that you use those funds in the most efficient, effective manner possible – otherwise, it might not be possible to achieve all of your financial goals.

A defined benefit pension plan provides a specific and guaranteed retirement income, typically based on the number of years of employment and the amount of salary you received. The benefit is usually offered as a monthly amount for life *or* as a lump-sum payment. If you prefer the monthly route, there are several options you'll need to choose from. Only one option may be selected, and once it's chosen, that selection cannot be changed – so it's important to consider all possibilities before making your decision. You don't want to lock yourself into something that you'll later regret. More on this in a moment.

Lump Sum Payment

Taking your pension as a lump sum (meaning all at once) comes with a lot of options, too – at least when it comes to deciding what to do with your money. For example:

- you can invest the money for growth so that your retirement income keeps pace with inflation;
- you could also choose to use part of the lump sum payment to buy an immediate income annuity from an insurance company, then keep the rest in investments you control;
- or, if you roll over the money into a traditional Individual Retirement Account (IRA), you won't have to pay taxes on the money until you begin taking withdrawals. Any money that is not transferred to an IRA would be taxed as ordinary income as you receive it.

When making a decision, it's important to consider how the money will affect your entire financial situation. You'll need to evaluate the tax impact of keeping the money and paying taxes today versus deferring those taxes to future years by putting some or all of the money into an IRA.

Regardless of what you do with the money, taking your pension as a lump sum comes with definite benefits. Besides giving you complete flexibility over how you want to handle the money, another possible benefit is that you will have a cash reserve you can tap into in case of emergency.

The downside to lump sums is that you must bear all the risk of managing your money in the years ahead. You may also incur investment costs, fees, and penalties you weren't aware of. If you spend too much of your lump sum too soon, or have disappointing investment results, you could run out of money. This is why many retirees, especially those receiving pensions, rely on the experience of a professional Financial Advisor who can help you both manage and potentially grow your money.

Monthly Annuity

When you take your pension as a monthly annuity, you establish the security of a guaranteed income. You will receive a known amount of money each month, and that income will continue for both your lifetime and possibly your spouse's as well. Like the lump sum route, there are both pros and cons to selecting a monthly annuity. The biggest advantage with monthly annuities is that making a financial mistake is less likely to be a disaster, because it can't affect all of your money at once. One drawback to annuity payments, however, is that they may not be transferred to an IRA, and must be declared as income and taxed as such in the year received. Also, in most cases the monthly amount you receive will not change, so when you factor inflation into the picture, you are likely to lose purchasing power over time.

As previously mentioned, there are a number of options available when you select this type of pension.

Monthly Annuity Options

Most pension plan annuities offer several payment options which may include:

> "**Single Life"** provides the largest monthly payment, but pays only during your lifetime, so there are no benefits for your surviving spouse.
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> "**Joint and Survivor"** means you will collect a payment for life. When you die, your spouse – or another named beneficiary - will continue to receive payments for the remainder of his/her life. Typically, you can choose a 100, 75, or 50 percent continuation amount for your spouse, but remember that the higher the survivor benefit, the lower your own monthly amount will be during your lifetime.
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> **"Period-Certain and Life"** means you will collect a payment for life, but a survivor benefit will be available only for a specified number of time, typically 5, 10, 15, or 20 years. For example, if you select a 10-year period-certain and life and you die eight years after retirement, the survivor benefit will continue for only two years until the 10-year anniversary of your retirement.

Focus on Your Goals

To analyze pension retirement options, it is necessary to consider your health, longevity, taxes, investments, and personal desires. However, trying to calculate which option will pay you more over your lifetime is virtually impossible since you would have to know the unknowable – how long you'll live and what results your investments would produce if you selected the lump sum payment.

It makes more sense to focus on your pension in the context of an overall financial plan and consider what you want to accomplish with your money. Ask yourself the following questions.

How Will I Pay My Bills?

Draw up an estimate of your post-retirement expenses, making sure to include all of your projected financial obligations. Then get an estimate of the Social Security benefits you'll collect (available at www.ssa.gov). Social Security is like a private pension that is also indexed for inflation.

If Social Security will cover all or most of your expenses, you might not need or want another annuity. If Social Security doesn't come close to covering your bills, it might make sense to take your pension as an annuity. However, if you have minimal assets and you annuitize your pension, you won't have any liquid assets to draw on in an emergency.

How Will My Surviving Spouse Manage?

Federal law assumes that your spouse will need to continue receiving monthly checks from your pension after you die. So a joint-and-survivor annuity is the default option on most plans unless your spouse agrees in writing to waive it. The monthly payments are lower because it is expected to pay out for a longer time. Because it provides continued payments to your spouse, you may select a joint annuity option without having your spouse sign off on the choice. However, if you choose the single life, period-certain, or lump sum option, the law requires that your spouse must sign a notarized statement acknowledging he/she would not be entitled to any further benefit at the time of your death.

If both you and your spouse will receive a pension, each of you might prefer to take a single-life annuity. Or, one of you might select a joint-and-survivor annuity while the other chooses a lump sum payment.

Example

The following table shows some of the possible options for pension distribution and the associated benefits and concerns.

Monthly Payments to JOHN	Monthly Payments to MARY	Distribution	Monthly Payment Insurer	Benefits and Concerns
$4327	**None**	**Mary assumes the risk of future payments**	**Pension Company to John only**	**When John dies, benefits stop; income-producing assets must be in place to provide for Mary.**
$3769	**$3769**	**John and Mary (after John dies) are entitled to monthly payments only**	**Pension Company to John and Mary**	**When John dies, payments are passed to Mary. Passing in a common accident or illness may disinherit all others.**
$4327 Minus $600 Monthly Insurance Premium	**$2850/mo. or Lump Sum Payment**	**Insurance Company to pay Mary future payments or lump sum payment - may have tax advantages**	**Pension Company to John only**	**Each year John lives, the monthly benefit available to Mary may increase. After John and Mary have both passed away benefits may be available to additional beneficiaries. Should Mary pre-decease John, the insurance plan can be canceled, leaving a higher benefit amount for John.**
$4327 Minus $800 Monthly Insurance Premium	**$3769/mo. or Lump Sum Payment**	**Insurance Company to pay Mary future payments or lump sum payment - may have tax advantages**	**Pension Company to John only**	**Each year John lives, the monthly benefit available to Mary may increase. After John and Mary have both passed away benefits may be available to additional beneficiaries. Should Mary pre-decease John, the insurance plan can be canceled, leaving a higher benefit amount for John.**

The above illustration makes certain assumptions. Underwriting is needed to determine if life insurance is available and at what rate. Investment results will vary and are not guaranteed. This information is for illustration purposes only and should not be relied upon as an offer.

As you can see, preparing for retirement can be a complicated process involving critical decisions about benefits, healthcare, future income, and lifestyle that can affect the financial security of you and your spouse for the rest of your lives. At first glance, making these kinds of decisions may seem daunting. Fortunately, it doesn't have to be. As mentioned, most retirees with pensions choose to work with an experienced financial advisor. That's because working with a professional retirement expert can make the decision-making process much simpler and easier.

As a financial advisor and retirement planner, I have been providing information and recommendations to local retirees for over 25 years. I believe I can assist you in making informed decisions. If you would like to learn more about your pension options, and how I can help, please feel free to contact me at the number below. Informational seminars are also available for employers who would like to educate their pension recipients on the various options available under their plan.

Most retirees can enjoy a comfortable, secure lifestyle…but only if they have their retirement finances in order. Start putting *your* finances in order by calling today!

Paul Fair is an investment advisor in Birdsboro, PA
"Providing Retirement & Income Solutions"

Contact information: **Phone: 610-478-9500**
Email: contact@paulfair.com
Website: www.paulfair.com