SHOULD YOU TAKE A PENSION BUYOUT?

What factors should you consider before you make the irrevocable choice?

Presented by IWM Partners

If you get a pension buyout offer from your longtime employer, you may be more than a little anxious. Does that lump sum constitute a good deal for you, or for the corporation or organization bringing you retirement income?

With General Motors and Ford offering lump sums to tens of thousands of former workers this year, pension buyouts are receiving more scrutiny in the media. Expect to see more of them: in an October 2011 poll of more than 500 human resources professionals, Aon Hewitt discovered that 35% intended to offer lump sums to vested pension participants in 2012.[1]

GM & Ford offers grab the headlines. GM ended its Salaried Retirement Program this year and gave those salaried retirees and their surviving spouses a choice: take a lump sum, or a get a new form of monthly benefit courtesy of an insurance company.[1,2]

GM retirees who rejected the lump-sum offer realized that their pension plan was being taken over by a major U.S. insurer. (*U.S. News & World Report* said that this transfer of pension plan assets and liabilities was projected to save GM around $26 billion.) Yet in the process, they lost pension protection coverage afforded through the Pension Benefit Guaranty Corporation, an independent agency of the federal government that provides insurance for a majority of traditional private-sector pension plans. Their pensions are now insured by State Guaranty Funds.[1,2]

In April, Ford announced that it would offer its salaried retirees the option of a lump-sum pension payment instead of monthly payments. Some of them will have to decide whether to take a buyout by October 29, others by November 12. Yet others will be facing the decision in 2013.[3]

Should you ignore a buyout offer? Your decision to reject or accept a buyout can only be made after looking at some key variables - and you should also consult the financial professional you know and trust.

How large is your buyout offer? Stack it up against the estimated total pension payments you think you will receive over your lifetime. Run some numbers and weigh that lump sum offer against 20, 30 or 40 years of accumulated pension checks.

How long do you think you will live? If your health is poor, taking the lump sum might be a better choice. You could access the money you need or want now. If you anticipate a long retirement, accepting a buyout could be risky. What if you spend or outlive that money? Consistent, lifelong monthly income is hard to abandon. Also, you may have set up a joint-and-survivor pension to provide your spouse with income after you are gone. This is another factor that may make you reject a buyout.

***Could you handle the taxes from taking the lump sum?** The IRS views a lump-sum pension payout as taxable income. By "rolling over" the lump sum into an IRA or other qualified retirement account, you will not face the income taxes resulting from distribution of that money.[2,4]

***What kind of return might you get if you invested the money?** Could you invest a lump sum in such a way that it grows faster than inflation? Monthly pension payments aren't usually inflation-indexed; could investing your buyout generate greater retirement savings and/or income for you in the long run?

***Who will help you invest a lump sum?** Pension funds are overseen by professional money managers. Are you one of those? It will be wise to seek input from an investment professional if you want to grow that money. Consider also that you could lose money as a result of investing. You could see that lump sum diminish – and presumably, your fixed monthly pension payments will not.

***How long might that lump sum last?** A lump sum is all too easily spent. Examples abound of lottery winners and plaintiffs who have exhausted six-figure or even seven-figure amounts in remarkably short time. Monthly pension payments help you avoid that possibility.

***Will a buyout change your lifestyle?** Sometimes a "windfall" can subtly alter a retired couple's financial outlook – they live it up, only to have financial regrets later. Even if your lifestyle will not change in the least upon getting a lump sum, you will still want to map out a long-range strategy to make the money last across the perceived length of your retirement.

If you elect to take a pension buyout, you can't take that decision back. So the choice must be scrutinized, preferably with the input of a financial professional aware of the potential upsides and downsides.

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Citations.

1 – money.usnews.com/money/retirement/articles/2012/06/07/should-you-take-a-lump-sum-pension-payment [6/7/12]
2 – www.freep.com/article/20120621/COL07/206210454/Susan-Tompor-Financial-planners-say-GM-salaried-retirees-shouldn-t-fear-Prudential-annuity [6/21/12]
3 - www.freep.com/article/20120805/COL07/308050131/Susan-Tompor-Lump-sum-opinions-are-everywhere [8/5/12]
4 - www.irs.gov/taxtopics/tc412.html [12/22/11]