

# Pension Lump Sum Payout

*Mainstay's Free Special Report*



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## Pension Lump Sum Payout

General Motors, Ford Motor Company, and other companies will occasionally offer eligible employees the option to receive their accrued pension benefits in a lump sum payment upon retirement or separation from the company. The lump sum payment of pension benefits shifts the investment risk from the employer to the retiree, but also affords the retiree many potential benefits. This Mainstay Capital Management Special Report will review some of the potential advantages and disadvantages of the pension lump sum payment option.



### Investment Risk

With a lump sum payment of pension benefits, the investment risk is transferred from the company to the retiree. Therefore, it is incumbent upon the retiree to ensure he or she has an investment plan to grow the lump sum payment amount over time and provide for a realistic and achievable income distribution plan.

While assuming responsibility for investing the lump sum payment has risk, it also provides several advantages. First, the retiree can invest the lump sum amount as they see appropriate for their individual situation. Second, the retiree now has flexibility in how and when income is distributed and taxed from the lump sum amount.

### Tax Risk

While the lump sum payment can be taken as a taxable distribution of your pension benefits, the preferable method is a direct rollover into an IRA. This provides for a non-taxable event and tax-deferred growth until distributions are taken. One advantage to the lump sum from a tax standpoint versus the traditional option of fixed income payments is that income distributions can be modified over time. That is, in years you don't need or want the taxable income from your pension you can modify or suspend payments from the lump sum IRA or taxable account now under your control (depending on IRA Required Minimum Distribution status). With the traditional fixed monthly payment method, the income keeps coming with tax liability on those monthly payments. The flexibility to modify income payments from your lump sum allows you to optimize income and tax strategy from year to year.

## Mortality Risk

With the traditional fixed monthly pension payments, the payments stop when you or your surviving spouse dies (with survivorship option). Therefore, if this occurs soon after retirement, nowhere near your full potential pension benefit is ever received. With a lump sum payment, your full pension benefits are paid out and become part of your estate. Therefore, no matter what your life span, your full pension benefits are yours to leave to your heirs or other financial legacy per your estate plan.

## Longevity and Inflation Risk

Longevity risk usually implies that if you live longer, you may outlive your retirement assets. The advantage to fixed monthly payments of your pension benefits is that you can never outlive your pension benefits. That monthly check keeps coming until your death and then to your surviving spouse (if you opted for a survivorship option).

However, there is a “double-edged sword” to longevity risk. With non-COLA (Cost of Living Allowance) pension plans, such as the GM and Ford salaried retirement plans, monthly pension payments are not adjusted for inflation. Therefore, the longer you live, the less your fixed monthly payment buys each year. This is the inflation risk, or purchasing power risk, suffered with fixed monthly payments over time. In today’s environment of low inflation this risk might seem trivial, but even with low rates of inflation, purchasing power continues to erode. If we experience higher inflation rates in the future, this risk could be significant. With a lump sum payment, if inflation rises, appropriate investments can be made to keep pace with inflation or even exceed inflation rates, therefore actually increasing the purchasing power of your pension benefits over time and at 3.5% inflation your purchasing power erodes by half every 20 years.

## PBGC Risk

This risk refers to the possibility that the Pension Benefit Guaranty Corporation (“PBGC”), the government agency that insures pension plans, someday assumes control of your pension plan. In this event, monthly pension benefit payouts could be substantially reduced. With the GM plan, the entire pension plan obligation will eventually be transferred to The Prudential Insurance Company of America. Therefore, this risk is eliminated and it becomes the responsibility of Prudential to make pension benefit payments to retirees. With the Ford plan, those retirees and former employees that choose to receive the traditional monthly pension benefits will still be subject to PBGC risk. BorgWarner (Delphi Technologies) salaried employees know this risk first hand.



## Pension Payment Considerations

- Which pension benefit payment option is best for my personal situation?
- What is the present lump sum value of my pension?
- What are my monthly cash flow needs in retirement?
- How are monthly pension payments impacted by inflation?
- What are the tax implications of a lump sum versus monthly pension payments?
- Do I want the ability to take distributions from my pension benefit at my discretion?
- How does the life expectancy of my spouse and I impact this decision?
- How can each pension payment option impact my estate planning and financial legacy?
- How would my overall retirement income plan change with a lump sum pension payment?
- How can a lump sum pension payment improve flexibility in my income and tax planning?
- What changes should I consider in my Ford SSIP or GM RSP, IRA, and Social Security distributions?

## Conclusion

The decision between the traditional monthly pension benefit payments or a lump sum payment of pension benefits involves many factors that must be carefully considered in light of your individual situation. For assistance in analyzing your situation and which option may be optimal for receiving your pension benefits, contact Mainstay Capital Management toll-free at **1-866-444-6246** or visit us online at **[www.mainstaycapital.com](http://www.mainstaycapital.com)** for more information on this important topic. Our advisors are standing by, ready to help with your questions, and prepared to provide analysis so that you can make a well-informed decision concerning your pension benefits.



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