

RETIRING WITH A PENSION PLAN

Pensions are a rare commodity in today's retirement landscape. The reason that it is the responsibility has shifted from the employer to take care of the employee's retirement to the employee to take care of their own retirement. The reason for this is that when pensions were enacted there was a wage freeze back in the 40s that did not allow companies to offer more competitive wages to higher performing employees however they were able to offer pensions as a recruiting tool to show that they would take care of the potential employee and therefore gain them as a key employee. The popularity of pensions continued until the employer figured out how expensive they were to maintain. This is why now you have so many options whenever you have a pension and go to retire. In the past pension has just been a guaranteed paycheck for the rest of your life after you retire. Now companies have realized that having pension payments that they have to make, makes them look less profitable so as a way to benefit the employee and make the company look more profitable a lot of pension plans offer lump-sum buyouts. A lump sum option can usually only be chosen when you separate service from the company before retirement or when you retire and get your pension packet they ask if you would like the lump sum or multiple types of income payouts for the rest of your life. The positive is you get multiple choices; the negative is once you choose you can never go back. So how do you make a decision on what option to choose? It's very simple, unless the company is giving some ridiculously low lump sum about option nine times out of 10 the lump sum is the way to go. The reason that it is is when you take the monthly annuity payment if you were to die and you chose the single-life option the pension would simply stop. If you chose the joint payout option for you and your spouse it would be much less than the single-life option and it would only last the life of you and your spouse.

The reason that the lump sum option is usually a better option is that when you take the lump sum you can invest it on your own and create the same monthly income or a greater monthly income and still have a large lump sum in the background that you have access to in retirement. This can be a night and day difference from what you pass down to your heirs and also provide large cash savings that you would normally have access to if you chose the monthly payout options.

So getting straight to the math how do you know if you should take the lump sum or if you should take the monthly income option. Take the monthly joint payout option and multiply it by 12; then multiply that number by 20. When you do this you should've arrived at a figure that will give you more clarity as to what option to take. Compare this number to the lump sum option. An easy indicator is if the lump sum is within about 75% of the monthly option multiplied by 12 and then by 20 you're usually better off taking the lump sum.

The reason that is is that if you take the lump sum and you invest it in a way where you can generate 7 to 8% annually not only will you take close to the same income you also leave a large lump sum for your heirs.

If you want any more context around how we make this decision for our clients reach out to us we'd love to help you.

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