

Evaluating Your Pension Options

By Dominic Garcia

Rising interest rates have recently impacted pension benefits for many automotive employees, reducing some lump-sum payouts by over 15%. The decision to retire is difficult, and quite often, a pension is one of the most substantial sources of retirement savings; it is critical to understand all available options.

Lump-sum balances can be large, and a significant reduction in the distribution could be the equivalent to one year's salary or more. In essence, by continuing to work and allowing the benefit to lessen, an employee may be "working for free." Thus, it is imperative that employees planning to retire in the next couple of years examine the impact such a decrease would have on their long-term financial plan.

With many plans, it is important to note that this decision only relates to the lump-sum option as the income option may remain unaffected. The bigger decision is determining whether a lump-sum is even the route to go. In general terms, pension payments may be more appropriate for those who are healthy, have a long life expectancy, and where the income stream relative to the lump-sum amount offers a favorable payout rate. On the other hand, if your life expectancy is in question, you prefer more control over your money, and/or the lump-sum payout rate is calculated to be more favorable, then the lump-sum may be worth considering.

A lump-sum may also allow for more control over your tax bracket in future years, creating the opportunity for Roth conversions, potential reductions in Medicare premiums, and more advanced tax planning strategies. Remember that the lump-sum must be managed such that it provides income for the rest of your life. If done correctly, you may be able to enhance your net worth and create an estate plan that benefits your heirs.

Outside of the pension decision, it is also important to evaluate your need for health insurance. An early retirement offer may include continued health coverage and other benefits such as life insurance. While some may think they need to get on COBRA prior to becoming eligible for Medicare, there are usually other options through a spouse's employer plan, private plans, or a government funded policy.

Based on our experience, the pension income is preferred by about 70% of those we speak with, whereas about 30% lean towards the lump-sum payout. It is never an easy decision, but it is one that can be calculated to provide you with the best probability of success. With inflation running high and most private-sector pensions not adjusting with the cost of living, there are now more considerations than ever.

