PENSION RIGHTS CENTER

FACT SHEET

Should you take your pension as a lump sum?

Some companies have offered to cash out the pensions of certain retirees and former employees and instead give them a one-time lump-sum payment.

While the idea of suddenly having a large sum of money is tempting, **this is a decision that you will have to live with for the rest of your life**. Anyone who accepts the lump-sum offer will lose the benefits of a lifetime income and will be responsible for taking care of their own investments and making sure the money lasts through retirement.

UPDATE: In July 2015, the IRS and Treasury announced that they would move to prohibit companies from offering lump-sum buyouts to retirees who are already receiving a monthly pension. This is good news for retirees and will help to stop the most harmful of these risk-transfer practices (also known as "derisking"). Lump-sum buyouts can still be offered to former employees who qualified for a pension but who haven't started getting their benefit yet.

For most retirees, **a guaranteed stream of income for life is a better option than a lump sum**. The only situations in which a lump sum should be seriously considered are

- if you are in poor health, you don't expect to live long, and you will not have a surviving spouse who will need lifetime income; or
- if you already have a substantial nest egg or other secure source of adequate income, such as a spouse's pension.

Here are some questions to consider:

- **Could I or my spouse live longer than average?** Your lump sum is calculated based on average life expectancies. If you or your spouse lives longer than expected, your lump sum won't be enough.

- **Can I afford to lose some or all of the money?** If you take a lump sum, no one is responsible for taking care of you except you. If you are wealthy enough that you don't need your monthly pension or if your spouse has a large pension, you have greater flexibility to consider taking the lump sum.
- **How good are my investing skills? How good are my spouse's investing skills?** If you already own stocks and bonds, look at your past investing history. Can you earn enough through investments to make the lump sum grow and last throughout your retirement years? Bear in mind that retirees generally invest much more conservatively than younger workers, and, therefore, have lower investment returns. Also, if you take a lump sum and then die, it will be up to your spouse to make the money last through his or her lifetime.

Differences Between Lifetime Payments and a Lump Sum		
	Lifetime Payments (Annuity) (whether from your pension plan or an insurance company)	**Lump Sum**
Is my income guaranteed?	Yes*	No
What if I live longer than expected?	I continue to receive my monthly income	I can run out of money
How is the money distributed?	In a continuous stream of lifetime payments	All at once, now
Am I responsible for investing the money?	No	Yes
What if the stock market falls or I make bad investments?	My monthly income is safe*	My money can be lost
Do I pay investment management or other fees?	No	Yes, and fees can be high
Is the money protected against inflation?	Only if my pension or annuity includes a cost-of-living adjustment	Only if I am willing to accept low returns or risk investment loss
Can I leave anything for my spouse or children?	Yes, if I chose a survivor benefit for my spouse or ex-spouse.	Yes, if there is money left when you die
*Subject to certain limits. Payments from your pension plan are backed by your employer and the Pension Benefit Guaranty Corporation. If your annuity comes from an insurance company, those payments are guaranteed by the insurance company and are backed by state insurance funds.		

- **What are the tax implications of the lump sum?** If you take the lump sum and don't roll it over directly into an IRA, the lump sum will be counted as income for the year. Depending on how much money it is, that might push you into a higher tax bracket.

- **How large is my current pension benefit?** If your pension is paid by your former employer and that employer goes bankrupt, the Pension Benefit Guaranty Corporation (PBGC), the federal pension insurance agency, might take over your pension. The PBGC has limits on the benefits that it can pay, so your monthly benefit might be reduced. However, the vast majority of retirees who get their benefits from the PBGC receive the same amount that they were getting before the PBGC took over their plan.

If your annuity comes from a private insurance company, in the unlikely event that the insurance company goes under, your benefits will be guaranteed up to certain limits by insurance industry state guaranty associations. These limits vary depending on where you live. (See our related fact sheet, What Happens When a Pension is Transferred to an Insurance Company?)

- **Will I change my mind?** If you take a lump sum and decide later that you want to use the money to purchase an annuity from an insurance company, you should know that individual annuities typically are very expensive, and you will likely get a lower monthly payment than if you had stayed with the annuity purchased by the plan. To see how much of an annuity you might be able to purchase with your lump sum, check out an annuity calculator, such as ImmediateAnnuities.com.

Individual annuities are expensive, particularly for women, because they are charged even more for annuities on the assumption that, as a group, women have a longer life expectancy. Women do not face such discrimination when getting a traditional pension or an annuity that was purchased by the pension plan.

While most employers did not offer lump sums to active workers, workers who are not yet retired should know that the value of their lump sums will depend on interest rates when they retire. Also, if you have earned the right to receive special early retirement benefits or subsidized survivor benefits, you could lose these subsidies if you take a lump sum.

Other points:

1. Unless you have other sources of income, **don't be tempted to take a lump sum for non-retirement purposes**, such as paying off debt, paying for everyday expenses, or helping out family or friends.
2. **Check into the financial interests of anyone advising one option over another**. For example, a financial adviser might urge an individual to take a lump sum because the adviser will get fees from managing the money or commissions for selling you certain products. These fees and commissions will lower your rate of return.
3. Some retirees have expressed concern about the long-term stability of an annuity provider, whether it is an insurance company or the Pension Benefit Guaranty Corporation. For most people, **the risks posed by taking a lump sum still outweigh the remote possibility that an established financial institution or the PBGC will not be able to continue to make payments**.
4. **Make sure that your employer has the correct information** regarding your age, salary, dates of employment, and any spousal or other benefit you have chosen.
5. **Make sure that your employer gives you all of the information that you need to make an informed decision**. A Government Accountability Office study published in February 2015 found that lump-sum offer packages routinely lack key pieces of information that the recipient should have, such as the formula used to calculate the lump sum.
6. If you think your benefit has been calculated incorrectly, **you might be able to get assistance from one of the U.S. Administration on Aging's** pension counseling and information projects, which provide free legal counseling (not financial advice) in 30 states.

Related resources

Companies that are offering lump-sum pension buyouts (Pension Rights Center)

Pension Counseling and Information Projects (Pension Rights Center)

What Happens When a Pension is Transferred to an Insurance Company? (Pension Rights Center)

Participants Need Better Information When Offered Lump Sums That Replace Their Lifetime Benefits (Government Accountability Office)

Your Guaranteed Pension (Pension Benefit Guaranty Corporation)

Maximum Monthly Guarantees (Pension Benefit Guaranty Corporation)

How to Tell Whether Your Adviser is Working in Your Best Interest: A Fiduciary Guide for Individual Consumers (Employee Benefits Security Administration)

A Defined Pension Benefit Buyout Information Sheet (National Retirees Legislative Network)

Further reading

8 Questions to Ask Before Taking a Pension Lump Sum Offer (Forbes) This article summarizes the information that your employer should provide to you when making a lump-sum offer.

Should You Take a Lump Sum Payment from Your Pension Plan? A Trap for the Unwary! (Rest-of-Life Communications/Steve Vernon, FSA)

Six Ways Pension Annuities Almost Always Beat a Lump Sum (Wealth Management)

Decision time nears for GM, Ford retirees on lump sum offer (Detroit Free Press)

Pension or buyout? GM retirees make the tough call (Reuters)