CHARTER OAK
CAPITAL MANAGEMENT

The Acorn

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Lump Sum Pension Payouts:
Should You "Take the Money and Run"?

In 1976, the Steve Miller Band sang an iconic song about two people named Billy Joe and Bobbie Sue robbing a man's castle before making a successful getaway. The lyrics rang out, "*Go on, take the money and run.*" Depending on your age, you're either singing the words to that song in your head with a smile on your face or you're a little confused.

Upon retiring, those of you enrolled in a pension - also known as a defined benefit plan – will either elect an annuity and receive a monthly benefit for life or will take a lump sum and make off like the fictional Billy Joe and Bobbie Sue.

A recent study conducted by Harvard professor of economics David Laibson revealed that approximately 75% of defined benefit pension plans are received as a lump sum. It appears that Americans *do* like to take the money and run.

There are potential benefits AND cautionary factors when choosing a lump sum.

Waiving an annuity in favor of a lump-sum payment.

There are many types of annuity elections you can make, some with guaranteed lifetime income ("single life") for the retired employee and others that provide smaller sums of income to surviving spouses or a designated beneficiary or beneficiaries for a certain period of time. Whether to take the lump sum or an annuity can be a difficult decision. Here are some things to consider:

1) **Giving up guaranteed income for life.** A married individual must have the consent of his or her spouse, which means electing out of a lifetime-guaranteed income stream for both partners.

2) **Your investment experience**; **longevity**; **inflation; and other factors that are currently unknown.** You assume all risk for your investments once the sum is paid. You'll also need to consider whether your annuity benefit would have been eligible for inflation (COLA) adjustments or other employer subsidies to properly decide whether the lump sum is the best choice in the long run.

3) **Your health.** A lump sum might be the most attractive alternative if you're in poor health. If you roll the funds over to an IRA, your beneficiary will receive any balance left at your death. Your beneficiary can then take withdrawals and use the balance themselves.

4) **The size of your nest egg, minus the pension.** You may also find the lump sum attractive if you have other resources available and don't immediately need the income when you retire.

Advantages of selecting a lump-sum payout.

1) **Complete control over when and how you use and invest your pension benefits.** Annuity benefits, like other fixed-income payments, can be eroded by inflation. With a lump sum, you may be able to rebalance your portfolio to counter inflationary trends.

2) **A lump sum can be rolled over into an IRA where it can continue to grow tax-deferred.** However, if you're over 70½, you can't roll over any part of the lump sum that constitutes a

3) required minimum distribution. Your plan administrator will calculate this amount for you.

4) **Leave funds to your heirs or charity.** A lump sum may be particularly attractive to single employees for this reason. Payments stop upon death with a single life annuity.

Disadvantages of selecting a lump-sum payout.

1) **You may be tempted to use the funds without incorporating your withdrawals into a comprehensive retirement income strategy.** If you use your retirement nest egg too soon, you could find yourself without sufficient funds to last through your and your spouse's retirement.

2) **You'll be responsible for investing your lump-sum dollars until you need them.** Investment losses, especially in the early years of retirement, can result in a retirement income shortfall.

3) **You may underestimate life expectancies for you or your spouse, causing you to run out of funds too early.**

4) **Unless rolling over your lump sum to an IRA, the entire amount will be subject to income tax at ordinary income tax rates when received.** A 10% premature distribution penalty may also apply if you retire before age 55 (age 50 for qualified public safety employees participating in certain state or federal governmental plans) unless an exception applies. You will also lose the benefit of tax-deferred earnings.

5) **Some employers tie eligibility for retiree health coverage to the pension payment.** Choosing a lump sum can mean potentially forfeiting your retiree health coverage.

"The best preparation for tomorrow is doing your best today."

– H. Jackson Brown, Jr.

These are general considerations for choosing whether to take a lump sum in retirement. Charter Oak sees every client relationship as unique. Every individual has his or her own story to tell and journey to experience. Our recommendations and advice are based on the individual circumstances of our clients and their families.

The choice to elect monthly benefits from a pension or take a lump sum is one of the most important decisions retirees make. We advise clients to make an educated decision based on individual circumstances and goals.

As your wealth management team, we will try to do everything in our power to keep you focused on where you want to go, advise you on how to get there, and remind you of the importance of maintaining a disciplined approach to realizing your goals. And of course, we're always happy to chat about a great game or check in to talk about your island vacation!

Thank you for the opportunity to help.

Charter Oak Capital Management is a registered investment advisor that provides retirement planning, financial planning and fee-based investment portfolio management to individuals and non-profit organizations. Our offices are located in Portland and Kennebunk, Maine and Portsmouth, New Hampshire.

The Acorn is written by the professionals of Charter Oak Capital Management exclusively for its clients. If you have questions or comments about anything you read here, or if there is a particular topic that you would like to see addressed, please let us know.