Pension Plans & Derisking

Corporations are transferring pension liabilities to third parties. Where does this leave retirees?

Provided by *Benedict A. Mitchell Jr.*

A new phrase has made its way into the contemporary financial jargon: derisking. Anyone with assets in an old-school pension plan should know what that phrase signifies.

The derisking trend began in 2012. In that year, Ford Motor Co. made a controversial offer to its retirees and ex-employees: it asked them if they wanted to take their pensions as lump sums rather than monthly payments. Basically, Ford realized it could someday owe these former workers more than its pension plan could pay out. The move was clearly motivated by the bottom line, and other corporations quickly imitated it.[1]

If you work for a major employer that sponsors a pension plan, you may soon face this choice if you haven't already. By handing over longstanding pension liabilities to a third party (i.e., a major insurance company), the pension plan sponsor unloads a risky financial obligation.

In theory, retired employees tended this kind of offer gain added flexibility when it comes to their pension: a lot of money now, or monthly payments from the insurer for years to come. Does the lump sum constitute a sweet deal for the retiree? Not necessarily.

If you are offered a lump sum pension payment, should you accept it? Making this kind of pension decision is akin to deciding when to claim Social Security – you've got to look at many variables beforehand. Whatever choice you make will likely be irrevocable.[2]

What's the case for rejecting a lump sum offer? You can express it in three words: *lifetime income stream.* Do you really want to forego decades of scheduled pension payments to take (potentially) less money now? You could possibly create an income stream off of the lump sum, of course – but why go through the rigmarole of that if you're already getting monthly checks to begin with?

As American longevity is increasing, you may spend 20, 30, or even 40 years retired. If you are risk-averse and healthy, turning down decades of consistent income may have little appeal. Moreover, if you are female you have a decent chance of living into your nineties – and an income stream intended to last as long as you do sounds pretty nice, doesn't it? If you are single or your spouse has very little in the way of assets, this too reinforces the argument for keeping the payment stream in place.

Also, maybe you just like the way things are going. If you don't want the responsibility that goes with reinvesting a huge sum of money, you aren't alone.

What's the argument for taking a lump sum? Sometimes a salaried retiree is in poor health or facing a money problem. If this is your situation, then it may make sense to claim more of your pension dollars now.

On the other hand, you may elect to take the lump sum out of opportunity. You may base your choice on *timing* rather than time.

If you want to build more retirement savings, taking the lump sum might be instrumental. Pension payments are rarely inflation-adjusted; maybe you would like to invest your pension money so it can potentially grow and compound for more years before being withdrawn. Maybe your spouse gets significant pension income, or you are so affluent that the pension income you get is nice but not necessary; if so, perhaps you want to redirect that lump sum toward some other financial objective. Maybe you don't want regular income payments this year or next because that money would put you into a higher tax bracket.[3]

The key is to avoid taking possession of the lump sum yourself. If you do that, your former employer has to withhold 20% of the lump sum (per IRS regulations) and you risk a taxable event. Instead, you may want to arrange a direct rollover, or trustee-to-trustee transfer, of the assets to avoid withholding and a huge tax bill. Through this move, the funds can be transferred to an IRA for reinvestment. In most cases, you need to leave your job (i.e., retire) before you can roll money out of a pension plan.[4]

Consult a financial professional about your options. If you do feel you should take the lump sum, talk to someone before you make your move. If the move makes sense, that professional may offer to help you invest the money in a way that makes sense for your near-term and long-term objectives, your risk tolerance, your estate and your income taxes. If you feel monthly payments from the usual joint-and-survivor pension might be the better choice, ask if some model scenarios might be might presented for you.

Florida Benefit Specialists
Primary Address: (North Florida Office) 2233 NW 41st Street, Suite 700-A, Gainesville, FL. 32606
(South Florida Office) 6451 North Federal Highway, Suite 1201, Fort Lauderdale, FL. 33308
Cellular Phone: 954-461-5502 Toll Free: 888-236-9894 Ext.1. Fax: 888-236-9894

Benedict A Mitchell Jr may be reached at 1-888-236-9894 Ext 1. or bmitchell@ksifa.com

http://www.floridabenefitspecialists.com/

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