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# Helping your Employees Choose Between a Lump Sum or a Monthly Pension

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Employer-sponsored retirement plans are an important source of retirement security for those employees with long service in companies that provide these plans. For many employees, the employer-sponsored plan is their most important source of retirement funds in addition to Social Security. If the employer offers a defined benefit plan with a lump sum option, the distribution choice the employee makes may be the most important financial decision of their life. The choice is not easy, and once made, is irrevocable.

The Society of Actuaries recently released a new decision brief, “Lump Sum or Monthly Pension: Which to Take?” which offers a discussion of the choice, the considerations and a summary of pros and cons.<sup>1</sup> This brief is the newest addition to a series of decision briefs—guides designed to help employees make better and more informed retirement decisions.<sup>2</sup>

The “best” retirement option decision depends on an individual’s situation and priorities. Many of these decisions involve trade-offs, and experts often do not agree on the best course of action. In the practice of medicine, there are very often widely accepted treatment protocols for various conditions. In retirement practice, there are many areas where there are no generally accepted “best practices.” The situation can be particularly challenging in that many individuals do not plan for the long term, and the choices have different ramifications depending on whether they are considered through a long-term vs. a short-term perspective.

Important points for employees to think about with regard to the distribution decision include:

- The composition of their overall portfolio and their resources for retirement. Employees with a significant 401(k) balance or other financial assets have different considerations than those who primarily have a defined benefit plan plus Social Security.
- Individual tax situations.



- The availability of guaranteed income for life to protect against outliving assets. It should be noted that sources of guaranteed life income will probably not be inflation protected.
- The portion of regular recurring expenses covered by Social Security and the amount of additional monthly income needed to maintain a desired standard of living. Electing guaranteed income from a retirement plan is often a better choice than purchasing an annuity in the open market. But if the amount of additional income needed is less than the income provided by the plan, then the lump sum option may be a good choice.
- How important liquidity is to the household, including how important it is to leave a bequest.
- How the distribution choice will affect a surviving spouse.
- The value of flexibility in investing and spending retirement income funds
- The impact of the decision on other benefits, such as retiree health benefits.
- Investment and money management skills—employees who choose lump sums must invest the money and manage the drawdown, and potentially can lose it if investments do poorly. The availability of the funds may also become targets for elder fraud and scams.
- Health status—employees in poor health who are likely to die fairly soon are probably better off with a lump sum. How-

ever, if a spouse is to be considered, then a joint and survivor annuity may be a better choice.

- Whether or not a retiree has long-term care insurance. Retirees without long-term care insurance may need significantly more liquid assets.
- The position of the retiree with regard to supporting other family members. This may require more liquidity.

The decision brief has deliberately been written to objectively explain the issues involved in the decision, and not to favor any particular or combination of financial products.

The decision brief includes an example of a middle income couple nearing retirement and takes them through the considerations and a thought process involving multiple scenarios. The discussion should help employees think through the issues as they make this important decision. ■

#### ENDNOTES

- 1 <https://www.soa.org/Files/Research/Projects/research-2016-lump-sum-mrd.pdf>
- 2 <https://www.soa.org/research/research-projects/pension/research-managing-retirement-decisions.aspx>



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