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Business News

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The Private Sector: Lump it?

A lump sum distribution can give you more flexibility than monthly pension payments

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By Robert Fragasso

Today's retirement decisions are more complicated. That is especially true when your employer offers a defined benefit pension plan. The dilemma often involves choosing between monthly pension payments and a lump sum distribution. This can be one of the biggest decisions you make regarding your retirement security and comfort, so it's important to be aware of how this choice will affect you and your family.

Electing to receive monthly pension payments over your lifetime will provide you with a fixed, monthly payment that can never be changed.

Alternatively, your lump sum distribution would be equal to the present value of all of the pension payments that you would otherwise have received.

This amount is calculated using assumed earnings rates (which are based on current interest rates) and life expectancy assumptions. The calculated amount would then be transferred to an IRA rollover account, which the participant would own and have managed, hopefully, in accordance with sound investment management principles.

Once either option is chosen, it cannot be reversed or altered.

If you choose to receive monthly payments, they must be made to the participant and may continue upon the employee's death to a spouse or other beneficiary over the beneficiary's life expectancy. This method of receiving your pension represents security to some folks because the pension fund guarantees that the participant will receive these payments.

However, the guaranteed nature of this arrangement, intended to provide security for participants, is in itself a source of potential risk and could be cause for concern.

First, it sometimes has happened that the pension plan defaulted and the federal government had to step in to make good on payments. But the full benefit amount is not always covered by the federal action.

Some middle-level and higher-compensated employees found their pension

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amounts reduced under this type of reorganization.

A more common concern is that, once your monthly pension has been set, it usually can never be changed.

While you may take comfort in the fact that your pension can never be reduced and will last for your entire lifetime, realize that your payment also can never be increased during the rest of your life, regardless of need.

Such an arrangement allows for zero inflation in your retirement years. Assuming even modest inflation, the increasing cost of living may eventually erode your purchasing power. Data suggests that retired consumers face greater inflationary pressure than the general populace, as the products and services they consume are more sensitive to inflation.

Consider the ever-increasing costs associated with health care, prescriptions, utilities, property taxes and other personal services and living expenses. What may seem like a generous monthly income at retirement may, after adjusting for the effects of inflation, in time prove to be constraining to your desired lifestyle.

Indeed, many retirees find that they must adjust their lifestyles in accordance with the decreasing purchasing power of their monthly pension payments.

Beyond the above financial considerations, emotional concerns can be a factor in making a decision.

When trying to decide between pension payments vs. a lump sum, the question most people forget to ask themselves is: "Do I want to disinherit my heirs?" This is a real concern because the remainder of the family beyond the initial beneficiary, even if one is chosen, is disinherited with a typical monthly pension.

Payments cease upon the death of the participant and/or the surviving beneficiary. There is no residual left for other heirs, no matter how long the period in which payments had been disbursed. However, taking the lump sum distribution into an IRA rollover account offers the possibility of a residual amount at your death that would go to your heirs, and even their heirs, assuming prudent management.

Choosing a lump sum can offer increased flexibility in your living years. With traditional pension payments your lifestyle may be constricted by how far you can stretch that payment each month.

Conversely, electing to receive a lump sum distribution puts you in control of your own destiny.

You will decide how much you need to draw from your IRA on a periodic basis of your choosing. You also have the flexibility of changing that amount as your situation merits -- increasing or decreasing your draw based on your needs and family circumstances.

Because both pension payments and IRA withdrawals are subject to federal tax, managing your own rollover account also gives you control over the

amount of taxable income you take each year by adjusting the amount you withdraw.

You could, for example, defer taking IRA distributions until future years if you had earned income from part-time or consulting work or from a windfall such as an inheritance.

You would not have that flexibility with a locked in monthly pension payment.

Certainly, this is a very complicated issue. There are many factors to consider, and everyone's situation is different.

However, it is clear that electing the lump sum option for your defined benefit plan will allow you flexibility in retirement while also possibly providing a residual sum to your heirs at your death.

With proper planning and a sound, long-term investment management policy, the principal balance of your rollover may continue to grow even as you are withdrawing a monthly stipend.

Consult a competent financial adviser for a complete analysis of your particular situation so that you can be better assured that you are making the best possible decision for you and your family.

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