# MONTHLY PENSION VS. LUMP-SUM PAYMENT

2022

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## GUIDE HIGHLIGHTS

- When retiring or leaving a job with a pension plan, the payment option you choose will almost certainly have significant repercussions on your finances later in life.
- Accepting a regular monthly pension payment ensures guaranteed income for life, but is 100% taxable and could restrict your earning potential.

- Taking a lump-sum pension payment does not guarantee income for life, but provides far more flexibility and control over your finances and investment options.
- With pros and cons to both options, working with a trusted financial professional is vital to ensure you make the right decision for your specific situation and needs.

## PENSION VS. LUMP SUM

If you're planning on retiring or leaving your job, and you have a pension plan through the company you work for, you will be faced with what is likely the most important financial decision you will ever make.


Once this decision is made, it cannot be reversed. Your decision will potentially impact you and your family for the next 20 – 40 years, or more… so why make this decision without getting experienced professional help?

Before you look at your potential choices, it is important to know what type of pension plan you currently have:

### DEFINED BENEFIT PLAN (DB PLAN)

A pension plan that guarantees employees a specific monthly benefit at retirement. Any shortfall in the plan must be funded by the plan sponsor.


### DEFINED CONTRIBUTION PLAN (DC PLAN)

A pension plan where the contributions of plan members and plan sponsors are invested towards the funding of a retirement income. Typically, the contribution going into the plan is known, but the final benefit is not known.

### OPTIONS UPON RETIREMENT:

**DB Plan Only**
- Accept the traditional, lifetime monthly payments from the company

**DB and DC Plans**
- Take a lump-sum cash payout of your pension (commuted value)

**DC Plan Only**
- Purchase a Life Annuity (a pre-set periodic payout amount)

Once you have determined your type of plan, let's look at the various choices you have available to you and the corresponding pros and cons of each option.

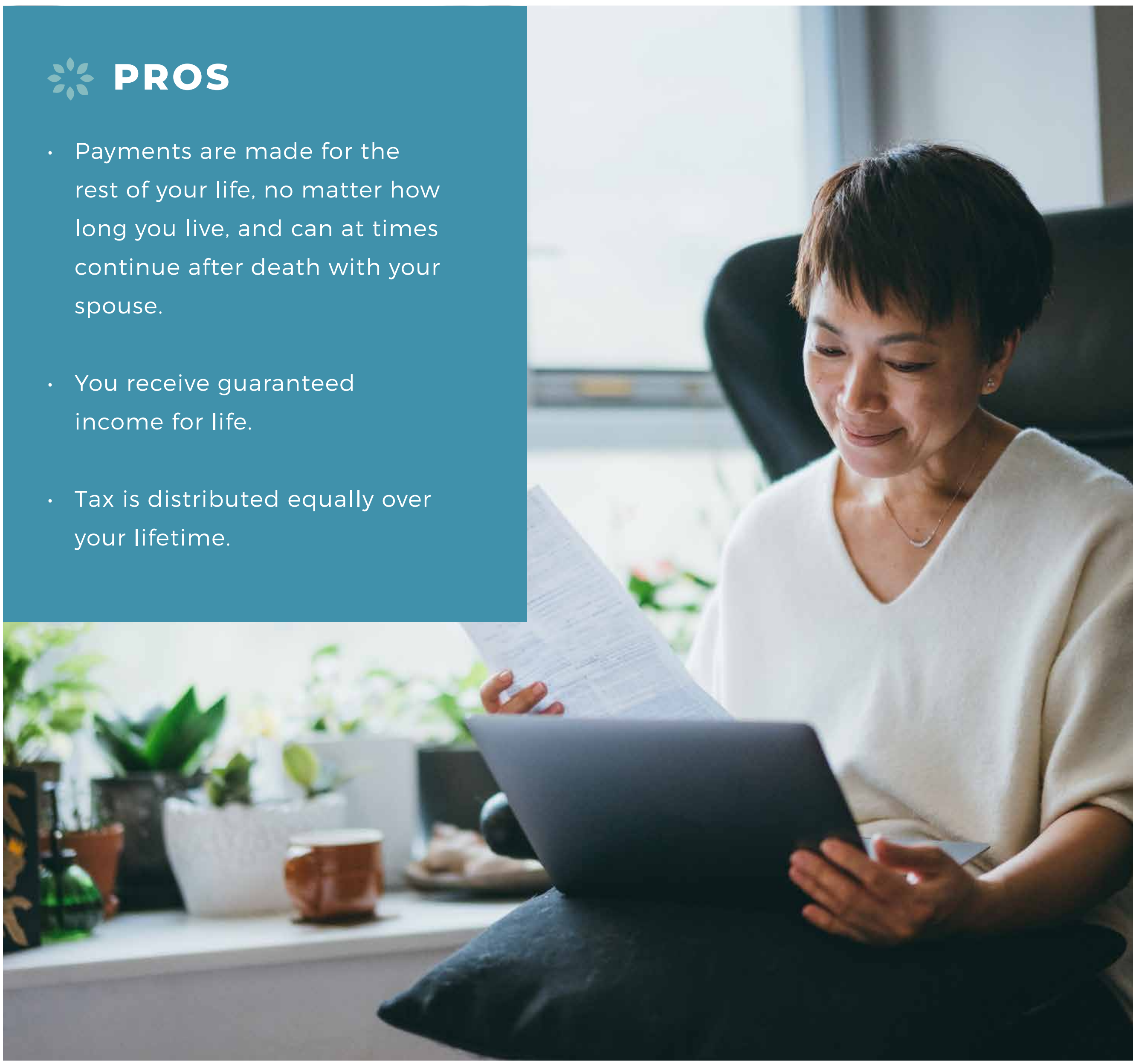
# REGULAR PENSION PAYMENTS / LIFE ANNUITY

Under a DB Plan, you receive a regular pension payment from the plan every month for life. In some cases (depending on your plan), this can continue after you pass away, in which case lower monthly payments are typically sent to your spouse until they pass.

A Life Annuity is purchased by the plan on your behalf from a life insurance company. The Life Annuity guarantees you will be paid a certain amount every month for life.

## PROS

- Payments are made for the rest of your life, no matter how long you live, and can at times continue after death with your spouse.
- You receive guaranteed income for life.
- Tax is distributed equally over your lifetime.



# REGULAR PENSION PAYMENTS / LIFE ANNUITY, CONTINUED

## CONS

- Your income will be 100% taxable for your lifetime.
- You cannot adjust the pension benefit amount.
- When you pass away, your spouse may only get 50% of your monthly pension payout.
- When they pass away, or if you have no spouse, there is nothing remaining that could be used as inheritance for your children or other family members.
- There is a certain risk of the company or the insurance provider not being able to fund their pension responsibilities; a lot can change in 20+ years. (Sears Canada is a recent example of a company that reduced retirees' pension payments by roughly 30% due to financial troubles.)
- The payout from a life annuity is highly dependent on interest rates at the time of retirement. The lower the interest rates, the lower the monthly payments will be. Since they are fixed, these payments are very susceptible to inflation.

# LUMP-SUM PENSION PAYMENT

A "lump-sum distribution" is a **one-time** payment from your pension administrator. This is obviously very different from receiving regular ongoing payments, and has its own sets of pros and cons:

## PROS

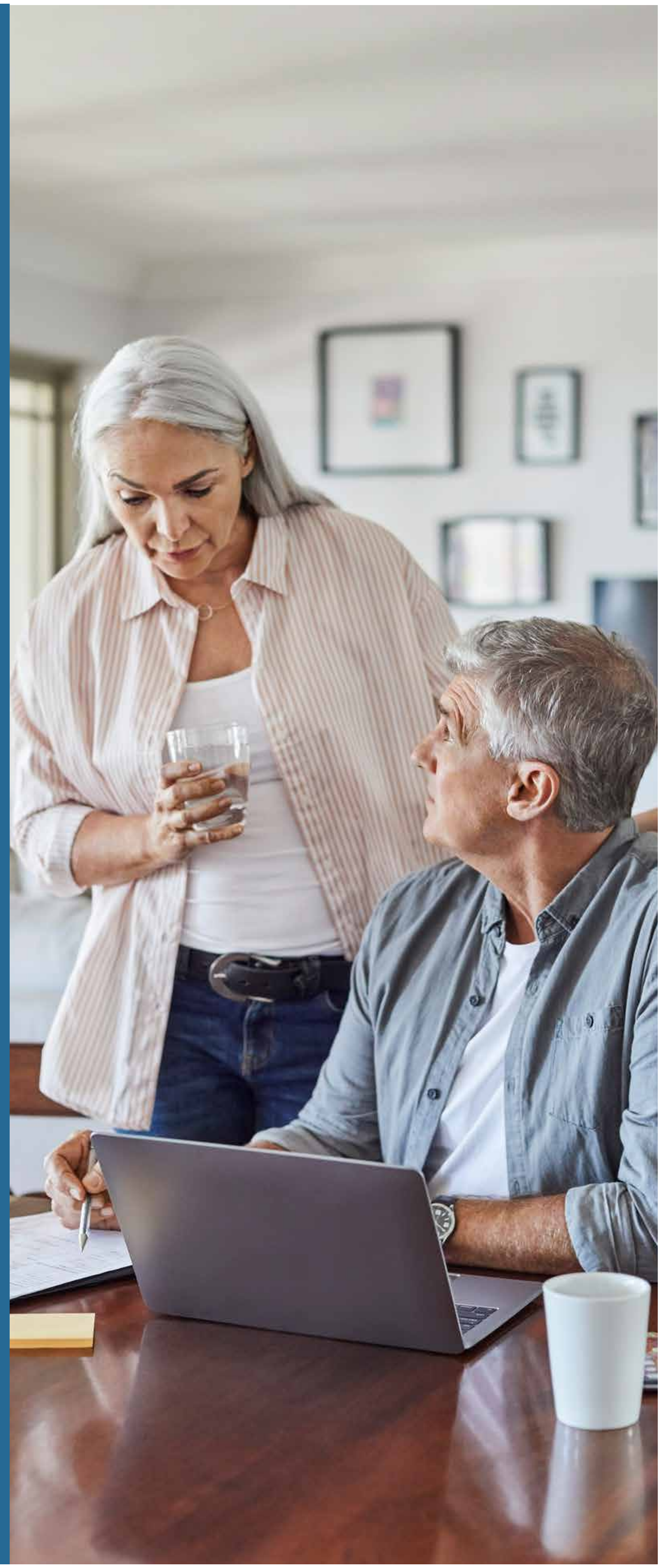
- You gain access to a large sum of money right away.
- Lump-sum payment gives you more control and flexibility over your money, allowing you to spend or invest it, however you see fit.
- The amount you withdraw from investments is your decision and can be changed based on your retirement lifestyle needs.
- The lump sum amount you receive (after taxes are deducted) can be reinvested.
- If you pass away earlier than expected, there could be funds left over to be used as inheritance along with your estate.
- Once you and your spouse pass away, the pension payments might stop if you are on a regular pension payout; however, with the lump-sum distribution option, you could instead name a beneficiary to receive any money that is left.

- If you have debt going into retirement, a portion of the lump sum could be used to pay all or some of it off, thereby reducing your monthly expenses and avoiding interest payments associated with the debt.

## LUMP-SUM PENSION PAYMENT, CONTINUED

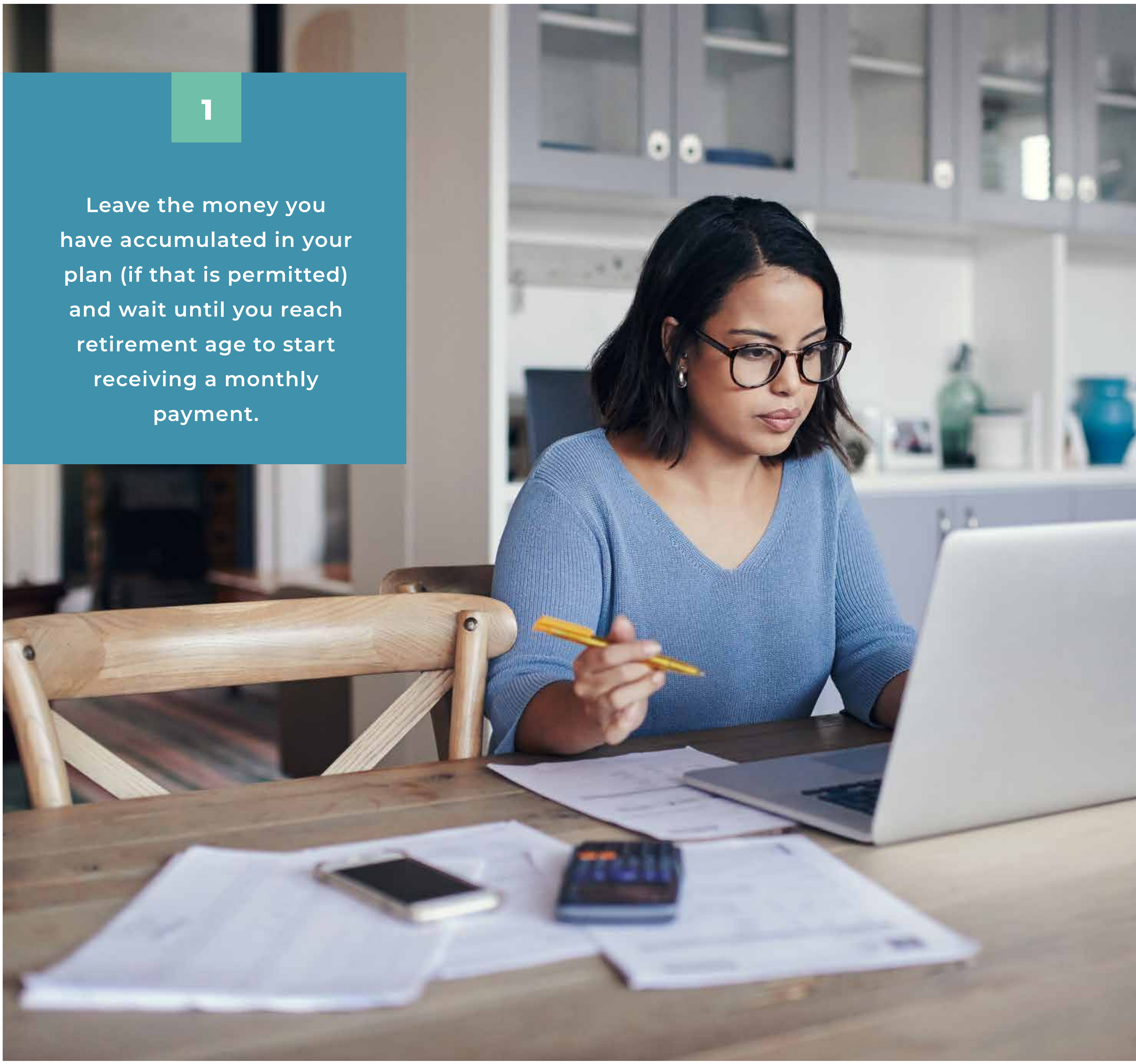
### CONS

- Your pension is no longer guaranteed to last for life, because investment volatility could impact growth. This is why it's vitally important to find an experienced financial professional who can handle your investments for you, to help ensure you have enough to live on for the rest of your life.
- Flexibility is great, but can also be a negative. With so much money being accessible to suddenly spend, it can invite **overspending.** Once the money is spent, it is gone for good, which is another reason it's crucial to have a trusted financial professional to guide you.
- Your health insurance coverage may be affected. A few companies that continue health coverage to their retired employees stop coverage if an employee takes the lump-sum payout.



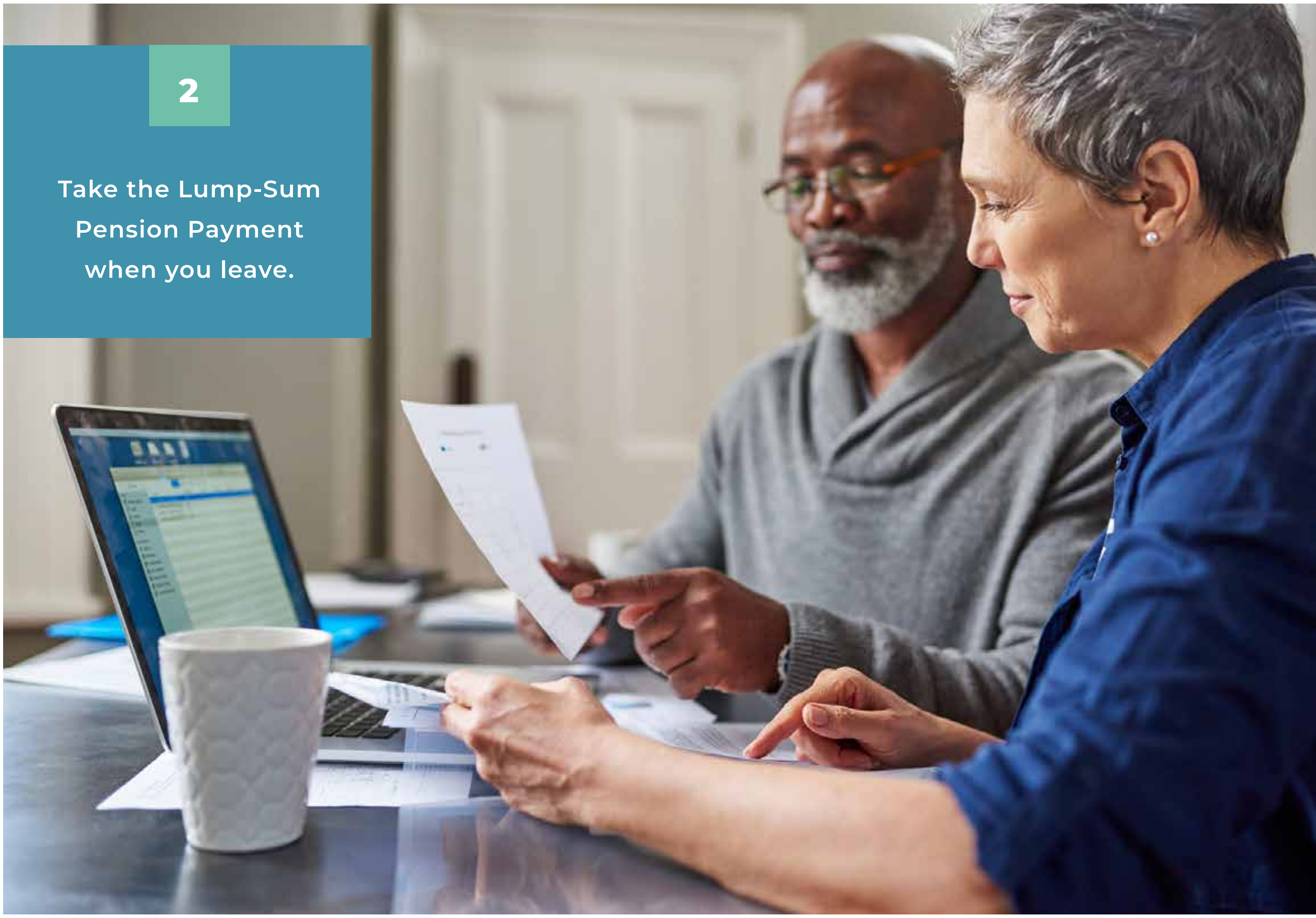
# CHANGING JOBS

The pension choices and the relative pros and cons described under retirement are, for the most part, also applicable to anyone who is changing employers. When you leave your employer, you essentially have two choices:



**1**

**Leave the money you have accumulated in your plan (if that is permitted) and wait until you reach retirement age to start receiving a monthly payment.**



## 2

## Take the Lump-Sum Pension Payment when you leave.

The pros and cons of the lump-sum pension payment option have already been discussed, but the “leave the money” option requires further analysis.

If you choose to leave the money with your former employer, you are entrusting that company to manage your money for you (for potentially the next 20 – 40 years) with your best interests in mind. Unfortunately, this may not be the most advantageous option.

A DB plan is focused on ensuring the company has enough cashflow to make their fixed monthly obligations, and as such, they adopt a very low investment risk level. This low risk level is more in line with someone who is already in retirement rather than someone who is still in their wealth accumulation stage.

If a DC plan gives you the option to remain with them after you leave the company, you would be limited to the investment choices (usually mutual funds) that they have on their approved list.

## WHAT'S THE RIGHT DECISION FOR YOU?

When you're retiring or leaving a job with a pension plan you must decide how you'll get your payment(s). You need to consider:

1. **WHAT TYPE OF PENSION PLAN YOU CURRENTLY HAVE**
2. **IMPLICATIONS OF REGULAR PENSION PAYMENTS/LIFE ANNUITY**
3. **IMPLICATIONS OF A LUMP-SUM PENSION PAYMENT**
4. **PROS AND CONS FOR BOTH OPTIONS**
5. **WHAT DECISION IS BEST FOR YOUR FINANCIAL FUTURE**

Let the investment professionals at Assurican Private Wealth help you navigate your way through your critical pension decision by providing you with a free, fact-based analysis of your options and opportunities.

Improve your financial position now by working with the investment experts at Assurican Private Wealth. Contact us today at inquiries@assurican.com to get started.