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COROMANDEL WEALTH MANAGEMENT

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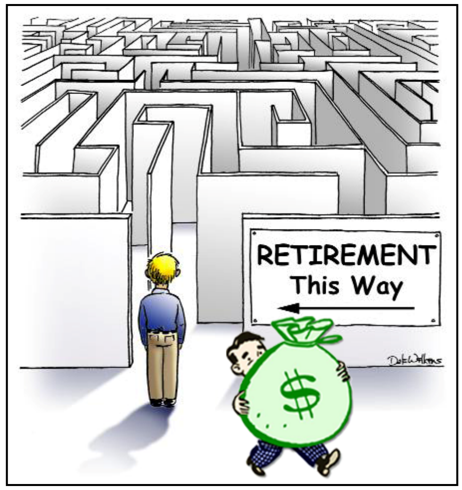
Offered a Lump Sum? Just Say"No"

Navigating the Retirement Maze



A recent trend in corporate America has been to offer retirees a lump sum payment in lieu of annuitized pension payouts in retirement. "A check in the hand" can seem a lot more attractive than a long-term stream of payments. Thus, it's no surprise that many "pension jackpot" recipients choose the immediate payout option rather than monthly checks. Yet it is important to recognize the implications, and responsibilities, of taking a lump sum retirement payout before making that decision. If offered this option by your current or former employer, the first question you should ask yourself is: "What's in it for them?"

Congratulations: You Now Own the Risk

When a company offers a "defined benefit" plan, more commonly called a pension, they are responsible for funding the future pension obligations, and making sure that they get an adequate return on the invested funds to cover the eventual pension payouts for the lifetimes of the plan participants. However, once an employee takes a lump sum payout, the risk completely transfers to the employee. The employee has traded the certainty of a regular lifetime check for the uncertainty of knowing whether the funds will last longer than he or she does.

So what determines whether you or your funds expire first? Several factors come into play:

- Your life expectancy – How many years do your funds need to last?
- Your investment returns – Can your funds grow sufficiently to meet your cash needs? What happens in the event of a significant drop in the market?
- Your withdrawal rate – 4%? 5%? $30K a year? Inflation-adjusted? Take out too much money too soon, and you may be forced to significantly cut back your withdrawals in later years.

Suddenly, that boring monthly check may start looking a lot more attractive. With both bonds and stocks projected to provide mediocre returns over the next five to seven years, it's no surprise that most employers would want to shed the responsibility of funding pension liabilities, and instead hand it off to their employees.

Other Lump Sum Payout Risks

Large cash payouts can have other associated problems, if not handled properly:

- Rollover risk – Forget to move the funds into an IRA within 60 days of receiving them, and you're stuck with paying income tax next year on the entire amount.
- Spending risk – The temptation to make a large purchase or to pay down debt with a large payout. Doing so removes that amount from future growth, not to mention the tax hit.

- Investment risk – Lump sum recipients are prime candidates for seductive pitches from investment and insurance salespersons. Are they offering sound investments? The only certainty here is the commission that the salesperson receives.

If you change your mind later on and decide to purchase an annuity, plan on receiving a lower payout than your original pension would have paid to you. Lower current rates of return and added fees will have you wishing that you had held on to your original lifetime payout plan.

When to Say "Yes"

There are some instances where it may make sense to take a lump sum payment in place of a pension. If you are not in particularly good health, and thus don't expect to live as long as the actuarial tables predict, you may be better off taking the cash up front. Similarly, if you have ample other assets with which to fund your retirement, and the pension is merely icing on the cake, you may want to invest the funds elsewhere, set up a trust for your children, or donate it to a charity.

It also pays to run the numbers on the equivalent rate of return for your pension payout as compared to the lump sum amount, based on your estimated life expectancy. In rare cases, you may find that you can do better investing the lump sum amount on your own. However, I have done this calculation for a number of clients, and have yet to find a case where I believe that I can generate better low-risk returns than those of the risk-free annuitized pensions.

The decision on how to handle the money that is going to fund your retirement is a big one. Don't let short-term desires interfere with your long-term needs.

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