



Krosnowski & Scott LLC

Investment & Retirement Planning Specialists

Pension Lump Sum or Annuity, which option should I select upon retirement?

You are approaching retirement. Your employer provides employees with the ability to choose from pension lump sum, annuity, or a lump sum/annuity combination.

When reviewing pension options it is important to assess your comfort level with a variety of factors. Being aware of your investor temperament can be very useful in this process. How sensitive are you to fluctuations in the value of your investment portfolio? What percentage of your retirement income do you wish to generate from fixed sources (such as pension annuity and Social Security) and variable sources (such as investment balances)? What is your investment priority? Is it to provide retirement cash flow or to pass assets on to your beneficiaries? How much income do you need to live comfortably in retirement? What percentage income distribution rate on your investment assets will this require? What are your retirement income funding sources?

In general, if you tend to be a more risk averse investor and leaving a financial legacy to your heirs is not a priority then the pension annuity may be the option for you. If you can tolerate financial market fluctuations and you would like to have the ability to pass on assets to your heirs then the pension lump sum may be the choice for you.

We generate a free initial report for corporate employees who are approaching retirement called a retirement income analysis. The report is designed to measure your potential to retire by answering two questions. How long will my retirement assets last? And can I afford to retire? We can run different versions of the report which illustrate selecting the pension lump sum or the annuity.

Below we discuss the pros and cons of these pension alternatives.

The pension annuity provides guaranteed income payments for the life of the retiree or the retiree and their spouse if they choose a joint and survivor or annuity option as long as the pension provider is solvent. The pension lump sum provides the retiree with the ability to a) defer taxes if their balance is rolled over directly into an IRA, b) the potential to protect the assets against inflation (depending on how they are invested), c) receive flexible income distributions, d) have access to principal, e) have investment control over the assets, e) have access to special tax methods on IRA distributions (such as I.R.S. code 72(t) IRA income distributions prior to age 59 ½ penalty free) and f) pass on assets to their heirs.

We believe that the larger your investment portfolio, the more it may make sense to take the lump sum pension option. We encourage retirees to distribute five percent or less of their assets to try to avoid asset depletion. An income distribution rate of three to four percent is ideal. If you wish to take the lump sum pension option but your income distribution rate would be greater than five percent, then we believe that you and or your spouse should remain employed. Having a larger retirement plan balance may enable you to be able to live off of a lower retirement plan balance income distribution rate. Continuing to earn income may enable you to lower your income distribution rate. Below is a summary of the various pension options.

Summary of Options – Pension: Annuity vs. Lump Sum

FEATURE	Employer Pension Annuity (EPA)	Pension Lump Sum (PLS)	Employer Pension: 50% Annuity/50% Lump Sum	100% Pension Lump Sum Invest *part IFA & part PLS
Payments Guaranteed for Life	Yes	No	EPA = Yes PLS = No	IFA = Yes PLS = No
Tax Deferral	Maybe	Yes	EPA = No PLS = Yes	IFA = Maybe PLS = Yes
Inflation-Hedge Protection	Maybe	Yes	EPA = No PLS = Yes	IFA = Maybe PLS = Yes
Income Flexibility	No	Yes	EPA = No PLS = Yes	IFA = Maybe PLS = Yes
Access to Principal	No	Yes	EPA = No PLS = Yes	IFA = Maybe PLS = Yes
Investment Control	No	Yes	EPA = No PLS = Yes	IFA = No PLS = Yes
Special Tax Methods	No	Yes	EPA = No PLS = Yes	IFA = Maybe PLS = Yes
Assets for Heirs	No	Yes	EPA = No PLS = Yes	IFA = Maybe PLS = Yes

*IFA = Insurance company fixed annuity

We hope that you have found this essay to be of use in your retirement planning efforts. Please feel free to contact us if you have any questions or if you would be interested in having us generate a retirement income analysis report for you.

Sincerely,

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