The Pension Decision: Monthly Check or Lump Sum?

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VIRBUS WEALTH MANAGEMENT & PARTNERS℠

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For most people with a defined-benefit pension, the choice between a monthly check and a lump sum is the single largest financial decision of their working life. It is usually made once, on a deadline, and it can't be taken back. This paper walks through how that choice works, what drives the numbers, and the questions worth answering before you sign the election form.

The short version

There is no universally "right" answer. The better choice depends on your health, your spouse, your other savings, and how much you value a guaranteed paycheck.

- **The monthly pension** is a paycheck for life. You don't manage it, and it can't run out. In exchange, it usually stops (or shrinks) when you and your spouse are gone, and most private pensions don't rise with inflation.
- **The lump sum** gives you control and flexibility, and anything left over can pass to your kids. In exchange, you take on the job of making it last, including market swings and the risk of living longer than expected.
- **Interest rates move lump sums.** When rates rise, lump-sum offers generally shrink. When rates fall, they generally grow. Timing your retirement date around this can matter by tens of thousands of dollars.
- **Your spouse has a say.** Federal law generally requires your spouse's written, notarized consent to give up a survivor benefit.
- **It's not always all-or-nothing.** Some plans allow a partial lump sum or have separate benefit pieces. Read your plan's options carefully.

Why this decision deserves real attention

Once you pick a payout option and the first payment goes out, the choice is almost always permanent. You can't trade a lump sum back for a pension, and you can't cash out a pension you've started collecting.

We see it come up most often with workers at the refinery, in the trades, and in public-sector roles across the Wabash Valley. Many have spent 25 or 30 years earning that benefit. It deserves more than a weekend of thought before an HR deadline.

Here is the trade-off in one table.

	Monthly pension	Lump sum
Income	Guaranteed for life	Depends on how it's invested and withdrawn
Who manages it	The plan	You (and your advisor)
Market risk	Carried by the plan	Carried by you
Longevity risk	Carried by the plan	Carried by you
Inflation	Usually no increases in private plans	Can be invested for growth

	Monthly pension	Lump sum
What's left for heirs	Usually nothing after survivor benefits end	Whatever remains in the account
Taxes	Taxed as income as you receive it	Tax-deferred if rolled to an IRA; taxed when withdrawn
Plan or employer risk	Backed by PBGC up to legal limits	Removed once rolled out

A quick word on that last row. Most private pensions are insured by the Pension Benefit Guaranty Corporation (PBGC) up to annual limits. For most workers at large, well-funded employers, that limit is well above their benefit. It's still worth knowing.

How your lump-sum offer is calculated

Your lump sum is the plan's estimate of what your lifetime of monthly checks is worth in today's dollars. Two inputs drive almost all of it: interest rates and life expectancy.

Interest rates. Federal rules (Internal Revenue Code Section 417(e)) set the minimum interest rates plans use, based on corporate bond yields. Higher rates mean the plan assumes your money can earn more, so it needs to hand you less today. Lower rates mean a bigger check.

Mortality tables. The IRS publishes life-expectancy tables that plans must use. When those tables assume people live longer, lump sums go up a little.

The "lookback" timing trap. Most plans lock in rates from a specific earlier month and hold them for a year or a quarter. That means you can often see next year's rate change coming. If rates have climbed during the year, retiring before the new rates kick in may preserve a larger lump sum. If rates have fallen, waiting may help. Your plan's Summary Plan Description spells out its exact timing.

A hypothetical example. Consider a 62-year-old with a $2,500 monthly pension. Under one interest-rate environment, the lump-sum offer might be around $400,000. If rates were about one percentage point higher, that same pension might be offered at roughly $360,000. Nothing about the worker changed, only the calendar.

This example is hypothetical, for illustration only, and does not represent any specific plan or client. Actual figures depend on your plan's terms and the rates in effect.

Two quick gut-checks we use with clients:

1. **The payback test.** Divide the lump sum by the annual pension. In the example above, $400,000 ÷ $30,000 is about 13 years. If you'd need to live beyond about age 75 for the pension to "win" on a straight dollar basis, compare that to your health and family history.
2. **The replacement test.** Ask what it would cost to buy the same guaranteed income from an insurance company. If the lump sum can't buy back a comparable income, the pension may be the better value.

Survivor options: the spouse question

If you're married, the payout option you choose decides what your spouse receives after you're gone. This is where we see the most regret, so it's worth slowing down.

Most plans offer some version of these choices:

- **Single life:** the highest monthly check, but payments stop at your death. Nothing continues to your spouse.
- **Joint and 50% survivor:** a smaller check while you're alive; your spouse receives half for the rest of their life.
- **Joint and 75% or 100% survivor:** a smaller check still, with more continuing to your spouse.
- **Period certain:** payments guaranteed for a set number of years (often 10 or 15) even if you pass away early.

Federal law generally requires a joint-and-survivor option as the default for married participants. Choosing anything else, including the lump sum, usually requires your spouse's signed, notarized consent.

A common shortcut to be careful with. Some people choose the single-life option and buy life insurance to protect their spouse instead (sometimes called "pension maximization"). It can work, but only if the policy is affordable, you qualify medically, and it stays in force. We run the numbers both ways before anyone goes down that road.

Don't forget the lump-sum spouse. If you take the lump sum, your spouse's protection comes from the account itself and your beneficiary designations. Those designations need to be set up correctly on day one.

Your pre-decision checklist

Before you sign anything, you should be able to answer each of these. Check them off as you go.

- [ ] Have I requested my official benefit estimate showing every payout option, including the lump sum?
- [ ] Do I know which month's interest rates my plan uses, and when they reset?
- [ ] Do I understand whether my pension has any cost-of-living increases (most private plans don't)?
- [ ] Have my spouse and I talked through what each option means for them if I die first?
- [ ] How does my health and family history compare to the "payback" age for my numbers?
- [ ] Do I have enough other guaranteed income (Social Security, a spouse's pension) to cover basic bills?
- [ ] If I take the lump sum, am I comfortable with market ups and downs, and do I have a written plan for withdrawals?
- [ ] Will a lump sum go by direct rollover to an IRA so I avoid the mandatory 20% tax withholding?
- [ ] If I'm leaving between 55 and 59½, have I considered keeping some money in the 401(k) to use the Rule of 55?
- [ ] Have I coordinated with my CPA on the tax side and updated my beneficiary designations?

How Viribus can help

We've sat at a lot of kitchen tables with this exact decision. Our job is to lay both options side by side in plain English, with your real numbers, so you can choose with confidence.

A pension review with us typically includes a side-by-side comparison of every payout option in your plan, a look at how the lump sum stacks up against what it would cost to replace that income, survivor scenarios for your spouse, and coordination with your CPA and attorney on taxes and estate details. We'll explain the reasons behind our recommendation and what it costs, every time.

Next step: Call our Terre Haute office at (812) 232-0304 or visit viribuswm.com to schedule a no-obligation pension review. Bring your most recent benefit estimate and Summary Plan Description if you have them.

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