3 Pension

You have a pension, congratulations! Only 4% of employers offer a pension. Pensions are an endangered species compared to the 1980's when 60% of private sector workers had pensions.

The pension decision is the biggest decision affecting your retirement income because it structures your income for the rest of your life. Most people want to solve this decision the way you would solve a math equation, assuming there is only one equation and one answer. The problem is, when it comes to pension decisions, there are multiple equations.

What Equation Are You Solving?

- *Highest payout rate*
- *Best inflation protection*
- *Greatest withdrawal flexibility*
- *Largest inheritance*
- *Lowest market risk*

Each one of these equations may lead you to a different pension decision. Before we discuss math:

Let's talk about the deal breakers.

4 Major Deal Breakers

Reflect on your personal experiences as you consider these topics:

- Inheritance
- Nervous About Investing
- Cut Ties With Employer
- Spendthrift

DEAL BREAKER #1

INHERITANCE

"If my spouse and I die, I would HATE to not pass anything on to my kids."

Retiree Inclination: Lump Sum Benefit

For many, the lack of a death benefit will trump all factors. They cannot accept the possibility of not passing assets to the next generation in the event of an early death. Other retirees would like their last check to bounce as they lay down in the coffin.

DEAL BREAKER #2

NERVOUS ABOUT INVESTING

"I am so scared of investing. If I took the lump sum, it would be under my mattress."

Retiree Inclination: Monthly Benefit

There is no shame in wanting conservative investments. The problem ultra-conservative investors who take the lump sum benefit face, is they don't make enough interest to match the monthly benefit they gave up. You need to be realistic about your risk tolerance before taking a lump sum.

DEAL BREAKER #3

CUT TIES WITH EMPLOYER

"I am done depending on my employer for my income."

Retiree Inclination: Lump Sum Benefit

You don't always leave your employer on the best of terms. This is especially true if you wanted to work longer and were forced out. A retiree may be less confident in their previous employer's ability to provide a lifetime income. Some want to avoid any affiliation whatsoever.

DEAL BREAKER #4

SPENDTHRIFT

“I worry I’ll spend through the lump sum too quickly.”

Retiree Inclination: Monthly Benefit

A spendthrift individual may benefit from the rigidity of the monthly pension. Conversely, we have found the lack of flexibility can inhibit some tax strategies.

If you don't have strong deal breakers, you'll want to consider the math.
Here is an example of a retiree's pension, of course, using a fake name, Rochelle.

Age at Pension Start
65

Lump Sum Amount
$356,000

Monthly Benefit
$1,800.00

Let's assume Rochelle chose to roll the $356,000 to an IRA. She would pay no taxes upon the rollover, only when she takes withdrawals. How would the lump sum do if Rochelle chooses to withdraw exactly $1,800 per month (the same as her pension would have paid)?

Here are two common math mistakes:

Bad Math No. 1

If you calculate the number of months left simply by dividing $1,800 into $356,000, you are missing the effect of growth on your lump sum.

$356,000	Lump Sum
÷ 1,800	Monthly Payment
=198	Months
÷ 12	Months
16.5	Years

Bad Math No. 2

If you divide one year's worth of payments ($21,600) by the lump sum ($356,000) this is a 6.1% payout rate, but some of that is your principal and some is interest.

$1,800	Monthly Payment
x 12	Months
$21,600	Annual Payment
÷ $356,000	Lump Sum
= 6.07%	Payout Rate

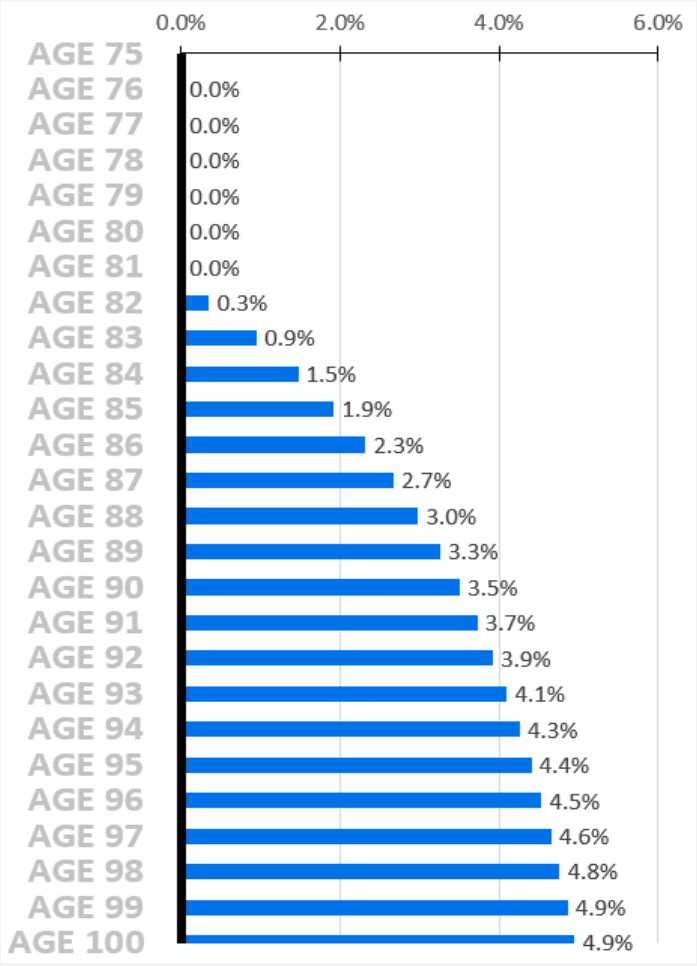
Required Rate of Return

The required rate of return – which will be called RRR from here on out – is what Rochelle really needs to know. In other words, what investment growth is needed on her lump sum to match the monthly benefit? She needs to know the date she will die. Conveniently, financial planners are notorious for providing the exact day. Rochelle will die exactly at age 90. S0, her RRR is 3.5%. If she earns 3.5% on the $356,000 lump sum, her $1,800 per month will last exactly to 90 years old.

CHOSEN LIFE EXPECTANCY - AGE 90 **3.5%**

The following chart shows the RRR for Rochelle if she passed away at any age between 75 & 100. If she passed away at 85, she only needs to earn 1.9% on her lump sum balance to match the $1,800 monthly benefit. If she lives to 100, she needs to guarantee she will earn 4.9%, just to break even. Each pension benefit is different. Your RRR will likely be different than Rochelle's. If you are interested in seeing these charts adapted to your personal pension figures, contact Capita for a free personalized pension analysis report.

INVESTMENT RETURN REQUIRED TO MATCH MONTHLY BENEFIT



Summary

Consider the math and the emotions. Not all decisions can be made through solving a math problem. You might decide you relate to a deal breaker and none of these charts matter. The pension decision is important and personal. Visit with a Capita advisor to discuss your pension benefit.