James Wealth Management

Pensions

Over the years we have assisted many clients with countless financial questions. Our experience has exposed us to a wide range of unique questions, as well as those we receive frequently enough to proactively provide answers. Be sure to check out our other articles addressing some of the most common financial questions we receive. We begin our series with discussing pensions. Although for many, pensions are a thing of the past. Those who have one often have many questions about their choices and what would be best for them.

Some of the decisions we walk through with our clients when electing a pension option is whether to take it as a lump sum or monthly payment, as well as whether to add a survivors benefit for their spouse. Unfortunately, there is no universal answer to this question, as individual circumstances are a critical element of what is best. Factors such as retirement assets, relationship status, personal health, and cash requirements are all critical components to consider. Therefore, it is essential not to rely on the experiences of friends, coworkers, and acquaintances, but on the client's individual situation.

Many pension systems allow the pension to be taken as a monthly lifetime payment or a one-time full lump sum distribution, which is generally rolled over into an IRA. However, caution must be exercised when doing this independently, as improperly rolling it over could result in a significant tax bill. A direct rollover to an IRA is not a taxable event when done properly, and tax is only due as the client takes distributions.

There are pros and cons to both lump sum rollovers and monthly payments. With a lump sum rollover, the main benefits are access to funds and control over the investments. Clients can access the balance if they need more than the monthly payment amount, or leave it invested in the account to grow. With proper planning, distributions can also be taken in ways to help reduce lifetime taxes. A significant risk to taking a lump sum is overspending. Since the client has control over when to take out the money, they could do so too quickly. On the other hand, with monthly pension payments, the client receives a deposit each month without having to worry about stock market volatility, and payments are set to continue for the rest of their life. It is important to note that monthly pension payments are dependent on the stability of the pension system. Therefore, there is still an element of uncertainty whether the payments will continue for a lifetime.

Another risk to consider is the client could pass away unexpectedly and not receive many years of payments. Therefore, it is important to consider the client's health and life expectancy. A shorter life expectancy would mean less time to receive monthly payments, indicating it may be beneficial to take a lump sum. Conversely, choosing monthly payments may be more favorable due to the simplicity compared to taking a lump sum. When a client receives a set amount of income from a different source, choosing to add an additional monthly payment may not be the best option for the client to achieve their financials goals. In that case, a lump sum could be the better choice, which can be invested for future generations.

The next decision is whether to reduce the monthly pension payment amount to enable the client's spouse to receive a survivors benefit upon their passing. In this case, we would ask the client to view the monthly payment as insurance. A client would be reducing their monthly benefit, a "premium," for their spouse to receive a benefit when they are gone. Some think a survivorship payment isn't necessary due to the reduction of expenses upon the passing of one spouse. Therefore, it is essential to consider the health of both spouses.

When considering the life expectancy of both spouses, a survivorship benefit may not be advantageous if the surviving spouse has a short life expectancy. Conversely, if the spouse drawing the pension has a shorter life expectancy, it may indicate the need for a survivorship benefit. The availability of other sources of income for the surviving spouse can also alleviate the need for a survivorship benefit.

To properly assess the impact of longevity, it is crucial to analyze various scenarios. If a survivor benefit is chosen and the client lives for a long time, what will their financial situation be like? On the other hand, if they decide against the survivorship benefit and have a shorter life span, how does that affect their finances? By addressing these questions, clients can begin to determine the appropriate pension amount that would be sensible for their circumstances. Typically, pension systems offer different choices, such as joint and 50% to the surviving spouse or joint and 100% to the surviving, among others.

Choosing the right pension options can be challenging due to the multitude of factors involved for each individual. At James, we understand this complexity and begin working with our clients several years before retirement. This allows us to carefully plan, outline their objectives, and prepare portfolios that align with their cash needs during retirement.

If you would like to explore how we can assist you in making the appropriate pension elections, we encourage you to reach out to us at 937-426-7640. We offer a complimentary consultation phone call to help you get started on the path towards making informed decisions about your pension.

- The James Team