

Get the Most Out of Your Pension

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Most people who are nearing retirement and have an employer pension are looking forward to a monthly paycheck. Unfortunately, many of those people are fuzzy on the details. More than 44 million workers from a variety of industries (including teachers, state and federal employees, construction and manufacturing workers, financial services employees, and many more) can expect pension income during retirement. Each person's benefits will be different depending on

- ✓ The employer's formula for determining benefits
- ✓ Whether cost of living adjustments are included
- ✓ Which distribution option is selected
- ✓ When benefits begin for the retiree

During times of economic uncertainty, understanding and protecting your pension income are doubly important, because during hard times, many companies lay off workers or force workers into early retirement. If you're prematurely forced out of your job along with many others, replacement jobs can be scarce. You may have to take your pension earlier than you want to or earlier than is optimal.

Take a Look at Your Pension

Answer *yes* or *no* to the following questions to see how much you know about your personal pension:

- ✓ I have a recent pension benefit statement and I understand what it says.
- ✓ I know whether my pension includes cost of living adjustments.
- ✓ I know what distribution (payment) options are available.
- ✓ I know how soon/late I can begin drawing my pension.
- ✓ I know whether my pension provides a disability payment.
- ✓ I know my pension's survivor benefits.

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If you answered *no* to any of these questions, don't just sit there — talk to your employer to find out what your pension will do for you.

Meanwhile, read on for the basics to understand why knowing your options is so important, especially in difficult times.

Determine Your Benefits

Somewhere in all those documents you glanced at and then filed (or possibly threw away) when you were hired, you can find a formula for calculating your estimated pension benefit. If you can't find this paperwork (called a *summary plan description*), request a copy from your human resources department for your records. One of the most common benefit formulas is based on the total number of years of service multiplied by a percentage of an average of your final years of earnings. Usually, the longer you work at the same company, the larger your current income and the larger your pension income during retirement.

Before you get too excited about this pension income, keep in mind that employers usually design pension benefits to replace about 40 to 60 percent of income, anticipating that Social Security benefits and private savings will cover the difference.



Ask for a pension benefit statement from your employer if you haven't received one in the last year. This statement should be provided annually and should summarize your pension benefit.

Consider Cost of Living Adjustments (COLA)

Receiving a regular income for the rest of your life sounds like a good deal. But does the dollar amount increase each year to compensate for inflation? If it does, stand up and cheer. You have a pension that should keep up with the rising costs of goods and services. Table 73-1 shows the increasing value of a pension with a cost of living adjustment (COLA). As you can see, a little COLA in your pension makes a big difference over time.

Table 73-1 The Effects of COLA on Pension Benefits

<i>Age</i>	<i>Pension (No COLA)</i>	<i>Pension (3% COLA)</i>
65	\$3,000/month	\$3,000/month
75	\$3,000/month	\$4,032/month
85	\$3,000/month	\$5,418/month



If you don't already know, find out whether your pension includes cost of living adjustments. This has grave implications on how much money you need to save outside of pension plans for your future retirement. If your expenses already outweigh the combined expected income from your pension and Social Security, and if your pension doesn't have a COLA, the disparity between income and expenses is going to grow rapidly over time. You'll have to make up for that disparity with your savings and other assets.

Know Your Distribution Options (How Much Money and for How Long?)

When you're ready to retire, you may have several pension payment options to consider. Here are the most common:

- ✓ **Single life annuity:** You receive monthly income payments for your life only. So if you're married and you die shortly after you retire, your dearly beloved gets to deal with the loss of you *and* your pension unless you have a hefty life insurance policy to make up the difference. This is the largest payment option available. With some pension plans, this is the only option available.
- ✓ **Single life period certain:** Payments continue at least for your lifespan or a set number of years (usually 10 or 20 years), whichever is longer. The amount of this payment is less than for the single life annuity because of the guaranteed payment stream for a set number of years.
- ✓ **Joint and survivor annuity:** You receive reduced monthly income payments for life. When you die, your spouse receives a survivor benefit for life (usually 50, 75, or 100 percent of your payment).
- ✓ **Lump sum payout:** Your employer converts your monthly retirement benefit into a single lump sum payment. If this is an option, you may even get to choose between a full lump sum payment and a partial lump sum combined with a reduced annuity option. Here are some additional issues to ponder:

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- You should roll this lump sum into an IRA to defer taxes. If you don't roll your lump sum into an IRA, you pay taxes on the entire amount paid out to you. And if you're younger than 59^½ and you don't roll the funds into an IRA, you'll likely pay a 10-percent penalty in addition to regular income taxes on the lump sum amount. (Exceptions include retiring at age 55 or later, disability, certain medical expenses, and more — consult IRS publication 575, an accountant, or a financial planner for details.)
- If you choose the lump sum, make sure your retiree health insurance coverage (if any) won't change.
- Your lump sum rollover to an IRA must be invested just like all your other financial assets.
- You can purchase your own low-cost annuity with all or part of this money, but make sure that any annuity you pick is at least as good as the pension annuity you've turned down, especially if your pension has a COLA. However, it's highly unlikely that a commercial annuity can compete with your company pension regarding the size of monthly payments and the Pension Benefit Guarantee Corporation (PBGC) guarantee that's available for qualified pension plans.
- Don't even be tempted to go on a crazy spending spree and deplete your nest egg.

So which distribution option should you take? This decision requires you to evaluate your entire retirement income picture. At least consider the following:

- ✓ How much Social Security income you'll receive
- ✓ When to begin your Social Security payments
- ✓ How much, if any, your pension will offset some of your Social Security benefit
- ✓ How much you've accumulated in your personal savings and investment accounts
- ✓ Your estimate of your retirement living expenses
- ✓ If you die, how dependent your spouse will be on your pension



Your choice of payment options is permanent (no pressure!). If these choices make your head spin, consult with a financial planner or two for some pension planning advice. See Strategies #54 and #55 for more information on accumulating money for retirement and making sure it lasts a lifetime (or two).

Get Your Money at the Right Time

Although many pensions are designed to begin paying at age 65, some plans give you a range of choices. Pension benefits may be available as early as age 55 or any time after you retire. Early pension payments will be smaller than if you wait until your normal retirement age (much like early Social Security benefits are reduced). Sometimes you may have great reasons to take advantage of an early payout; examples include locking in healthcare benefits or ensuring a larger survivor benefit.

Some pensions allow you to delay taking payment until long after your retirement. You may find this hard to believe, but some people actually decide to delay their pension payments. People who delay are usually still in the workforce and have earnings pushing them into a higher tax bracket than their future retirement tax bracket. They may wait until they're fully retired because they don't need the pension income while they're still working, and they don't want to pay the higher taxes. Plus, the monthly pension benefit increases with age.



Find out when your pension is available to you. Check with your employer or read the summary plan document to see when you can start your pension payments.

Other pieces of the pension puzzle

The following issues may crop up depending on your situation:

- ✓ **Incapacitation:** Find out what the rules are if you become disabled before retirement. Some pensions, including Social Security, provide a benefit usually up until age 65, when the regular pension benefit begins.
- ✓ **Survivorship:** What happens to your pension if you die just *before* you retire? Will your spouse have a pension benefit? How much? If your personal retirement plan is dependent on your pension income, the survivorship question is crucial! If your plan doesn't have decent pre-retirement survivor benefits, you may need to increase your life insurance to cover this risk.