Miller Wealth Advisors

CASE STUDY | VOLUME 110

SHOULD YOU TAKE THAT PENSION BUYOUT?

Companies are increasingly offering their current and former employees a critical choice: Take a lump-sum payment now or keep their pension.

SITUATION

Robert Smith retired three years ago from a major corporation after a long and successful career. He and his wife, Marsha, have been receiving an annual pension of $50,000 from the company since his retirement. Last month, Robert was offered a lump sum buyout from the company and needs to decide whether to keep his pension or take the offer and invest it on his own.

BACKGROUND

A recent notice from the IRS and the Department of Treasury has prompted an increasing number of companies to offer lump sum pension buyouts. Before Notice 2019-18 was published on March 6, 2019, the IRS prohibited companies from offering buyouts to former employees who had already started receiving their pensions. Since the ruling, companies have begun offering these buyouts as a way to shrink the size of future pension obligations, which ultimately reduces the impact of that pension on the company's financials.

IMPORTANT CONSIDERATIONS

- Life expectancy: How is Robert's health? What is his family history and longevity?
- Joint payout reductions: Will his pension continue to be paid in full to Marsha or will it be reduced?
- Opportunity cost: What is the interest rate environment? Is Robert comfortable investing on his own?
- Solvency of company: Will Robert's former employer be around to fulfill all pension payments?
- Estate planning: What are Robert's and Marsha's legacy goals?

OUTCOME

After careful consideration, Robert chose to stay with his pension and forego the buyout. We analyzed the equivalent rate of return he would need to earn if he took the buyout and invested it on his own. The rate was 6.5% every year for the rest of his life. In the end, Robert favored the security of his lifetime pension over the chance that his lump sum payout would exceed this hurdle rate in the face of volatile financial markets.

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