Lump Sum vs. Annuity: A Decision Guide for EMC Employees

EMCretirement.com

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You can contact the author of this guidebook, Zack Purvis, at zpurvis@halleyhill.com or (478) 235-2674.

Introduction

This decision guide was developed for EMC employees that are eligible for the defined benefit pension plan. If you're not sure if you're eligible for the pension plan, you should contact the HR department at your EMC.

The most important decision you'll likely make regarding your pension benefits is how to receive your benefits. For an explanation of the various options you can check out our other guidebooks or contact your EMC's HR department.

Lump Sum vs. Annuity

The most common question we receive from EMC employees about their pension benefits is: Should I choose the lump sum payment or the annuity? This is a great question, and like most great questions the answer is "it depends". You should carefully consider the pros and cons of each option, including the seven factors we discuss below. And we highly encourage you to seek advice and information prior to making this very important decision.

These are seven items you should consider before making your decision:

Safety of Principal – Pension plans typically have several layers of protection to ensure your monthly payments continue as scheduled. This "guarantee" is helpful as you'll know exactly what your monthly payment will be for your entire time in retirement. Investments made with a lump sum payment are generally not insured and will fluctuate in value (up and down). You may choose to use Social Security as your "guaranteed" base income and investing a lump sum payment in an IRA or private annuity.

Inflation – We all know the "stuff" we buy tends to increase in price over time. And over 20+ years in retirement inflation really adds up. At an average 2.5% inflation level, your

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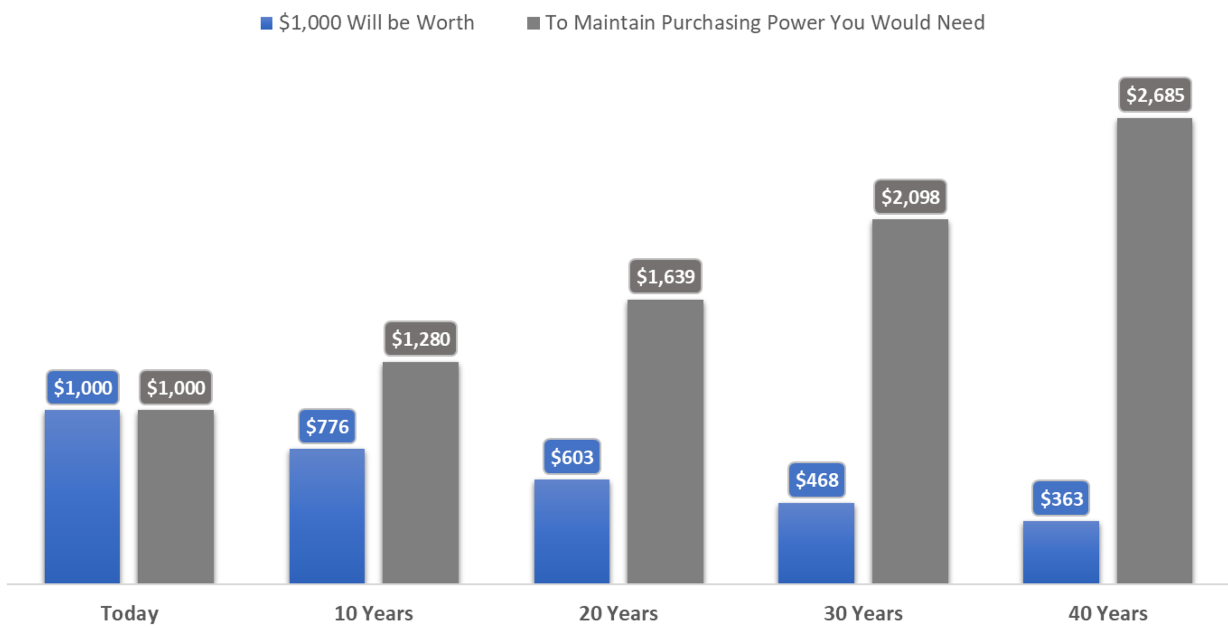
"purchasing power" will decrease nearly 40% over 20 years. That means if you want to keep your lifestyle the same, you'll need additional income to offset the effect of inflation on a fixed monthly annuity payment. You can consider choosing one of the COLA options if your plan offers this or taking the lump sum and investing these funds for growth and income.



Income Needs – Budgeting is not really a fun task for most folks, but it's extremely important as you prepare for retirement. Determine the level of income you'll need to support the lifestyle you want (and don't forget about inflation). Then consider your sources of income, including Social Security, pension annuity payments, other private annuities, investments, and any part-time employment or other income. We help clients build out a simple budget and then analyze different scenarios to determine which option for your pension benefit makes the most sense in your unique situation. But you can definitely do all this on your own if you're a "do-it-yourselfer" and are willing to put in the time and energy. If you'd like a template budget worksheet to get started, just let us know!

Taxes – Distributions from a pension plan are generally taxable to the recipient when received. This would include the full annuity payment (if you choose a monthly annuity) even if it's not needed to cover current expenses. Lump sum distributions are typically deposited/rolled over to a tax-deferred account (e.g. IRA or qualified private annuity). You then generally won't pay taxes until you actually withdraw money from the account.

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Health and Family History – Consider your current health and your family's history of longevity. Annuity payments (whether from NRECA or a private annuity) typically last your entire life and potentially the life of your spouse. The longer you live and receive the annuity payments, the better this option stacks up against the benefits of a lump sum distribution.

Estate Planning – Would you like to leave an inheritance to a family member or a bequest to your favorite charity or church? Make sure to consider these plans when you decide how to receive your EMC pension benefit. Three common choices EMC retirees make when they want to leave money after they pass: cash refund option on a pension monthly annuity; invest proceeds from a lump sum distribution in an IRA; or choose a private annuity with a death benefit included.

Discount Rate at Retirement – When you request a pension estimate from your HR department or NRECA, they will use a "discount rate" to convert your annuity estimate into an amount that could be distributed as a single lump sum. The lower the discount rate, the higher the lump sum amount. And vice versa – the higher the discount rate, the lower the lump sum amount. Consider the current plan discount rate (based on IRS-mandated rates that track the overall interest rate environment). Generally, lower current interest rates make the lump sum option more attractive as a choice for you.

The decisions you make related to your pension benefits are extremely important ones. Be sure to seek guidance and advice from qualified and experienced sources before making your decision.

Questions?

We hope this decision guide has been helpful. **If you have any questions at all, or if you'd like to discuss the personalized services we offer to EMC employees and retirees, please contact us at:**

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