SHOULD I ACCEPT A LUMP SUM BUYOUT OFFER?

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With economic uncertainty increasing, more companies with defined benefit (DB) pension plans will likely attempt to improve their bottom line by offering lump sum buyouts. A lump sum buyout is a limited opportunity for DB plan participants to elect a one-time cash payment in exchange for giving up future periodic payments. Some buyouts are offered to participants who are near retirement age, while others target those already receiving benefits.

Deciding whether to accept a lump sum buyout is an important choice that you shouldn't make without consulting with a knowledgeable financial advisor. Here are several factors you and your advisor should be looking at:

What is the effect of interest rates?

The lump sum amount is calculated by taking into account several factors, including an assumption about interest rates. The lower the interest rate assumption, the higher the lump sum. With interest rates rising fast, this may be a good time to seriously consider locking in a lump sum, instead of waiting for a later buyout window to open when rates may be even higher.

How is your health?

The amount of the lump sum is also based on average life expectancies. If you expect to live longer than an average person of your age, you may want to consider passing up the lump sum. However, if you are facing medical issues, taking the buyout offer may be the way to go.

How financially secure is your employer and your plan?

If your employer goes out of business with a pension plan that doesn't have enough funds to pay benefits, your existing or future payments could be reduced. That would be a factor favoring a buyout. The Pension Benefit Guaranty Corporation (PBGC) does insure pension benefits up to a certain amount. However, even though the PBGC's financial picture has improved somewhat, it might be risky to count on that lifeline.

Will your spouse agree?

If you are married, your spouse must consent before you can receive a lump sum.

How tempting will a lump sum be?

Be honest with yourself. You may be the type of person who wouldn't be able to resist spending a large check instead of putting it away for retirement. If you are, taking a lump sum now may jeopardize your financial well-being in later years.

Know the tax rules

DB monthly payments are typically fully taxable in the year received, and you can't roll them over. But a lump sum payment is eligible for rollover to an IRA. Once rolled over, your funds become subject to required minimum distribution (RMD) rules. But aside from that, you have lots of flexibility with IRA withdrawals.

These are some of the important issues that should be part of any consideration about accepting a lump sum buyout offer. Remember: Don't make this crucial decision without getting help from an expert.