ONE LUMP OR MANY? CONSIDER PENSION PAYOUT OPTIONS CAREFULLY

The U.S. Treasury Department recently proposed rules to make it easier for employees to decide which payout option is better for them: a lump sum or an annuity. But the rules, if formally adopted, won't take effect for another year, so workers retiring before then should take matters in their own hands.

For many years, workers whose employer offered a traditional pension plan didn't have to make the decision. The plan simply paid out monthly checks based primarily on a worker's age, salary and years worked. But in the 1990s, employers began offering retiring workers the choice between a lump sum and monthly annuity payments. According to the Department of Labor Statistics, approximately one in four employers offer a lump sum option, and that percentage is growing. That's because employers find lump sums cheaper to pay out than annuities, and experts say about 90 percent of workers choose the lump sum option.

Yet a lump sum is often not the best choice, say many CERTIFIED FINANCIAL PLANNER™ professionals. Part of the problem is that the lifetime value of a lump sum payout typically is worth less than the lifetime value of an annuity—sometimes as much as 50 percent less, assuming the worker lives to his or her life expectancy. (Also, usually you should roll the lump sum into an individual retirement account in a custodian-to-custodian rollover so the lump sum isn't immediately taxable.)

Currently, employers are required to provide the worker with only two numbers: the monthly annuity payout and the lump sum amount. The Treasury proposal would require employers to make an apples-to-apples comparison of the relative lifetime values of these options.

Let's say the employer gives you two options: take $1,400 a month starting at age 65 or take a lump sum of $150,000. Which would you choose if this is all the information you had? Running the numbers through an online commercial annuity calculator shows that a $150,000 lump sum (for a male) would be the equivalent of a monthly annuity payout of only $1,058, versus $1,400. Conversely, the $1,400 monthly annuity would be the equivalent of a lump sum worth $198,413.

That's why workers faced with these choices soon shouldn't wait for the proposed regulations to take effect. They can run the numbers through online annuity calculators for a ballpark estimate or have their financial planner run the numbers.

But even these comparison numbers don't take into account all the factors to consider when making the lump sum-versus-annuity decision, which is another reason to discuss the options with your financial planner. For example,

- Workers with expected shorter-than-normal lifespans due to current health habits or perhaps genetics may find the lump sum the better option. That's because they are less likely to live a full life expectancy to collect the full value of the annuity payments, which often end when the worker dies.

- Workers with full or longer-than-average life expectancies may prefer annuities in order to lessen the risk of running out of money.

- You're responsible for investing a lump sum. In theory, you could end up earning more than if you'd take the straight annuity—but you also could lose money or suffer anemic returns due to poor investment decisions or a poor market climate.

- A lump sum offers more flexibility than an annuity because you can take out extra money if needed for emergencies.

- You can leave any remaining lump sum to your heirs. An annuity usually ends when the worker dies or, in the case of a joint and survivor annuity, when the worker's spouse dies.

- A lump-sum payout rolled over into an IRA can stretch out the required minimum payments if properly planned.

- Most annuity payments aren't adjusted for inflation, which means the level payments buy less and less over the years.

- The decision may depend in part on what other financial resources you have. If you already own substantial assets in individual retirement accounts or a 401(k), for example, you might take the pension annuity in order to cover living costs and save the other accounts for extras or emergencies.

Whatever choice you make, have as much information as possible and choose carefully. Once you select an option, you can't change your mind.