Lump Sum or Annuity: which payout works best for you?

hooker & holcombe

Every defined benefit pension plan offers a retiring employee a form of benefit payout at retirement. When it comes time to retire, there are two types of payouts an employee can choose: a lump sum or an annuity payment. In order to know which payout option is the best for your situation, you need to know the advantages and disadvantages of each.

Lump sum versus an annuity

A lump sum payout will give you immediate access to the entire value of your retirement benefit and you can choose to use the funds as you wish. However, you risk being subject to market volatility and poor investment returns, which will increase the likelihood of less money over the course of your retirement years. But if the market performs well, you would receive a greater return. Keep in mind that a lump sum is a one-time distribution which means the plan has satisfied its obligation to you, the employee.

With an annuity, you have the advantage of not out-living your retirement benefit. This is known as longevity risk. All annuities are payable for the life of the retiree with a possible continuation of the benefit to a beneficiary or spouse if the retiree dies first. However, it is important to know that most annuities do not include cost of living adjustments, so your monthly check could lose purchasing power over time.

Annuities come in a variety of forms offering different coverage levels. Some of the more common annuities are summarized below:

Annuity type	Benefit to retiree	Benefit to beneficiary
Single Life	Payable for life	No benefit
Joint and Survivor (commonly 50%, 75% or 100%)	Reduced benefit payable for life	Payable for life after the death of the retiree
Period Certain (commonly 5, 10 or 15 years)	Reduced benefit payable for a pre-determined amount of time	Payable for the remainder of the guaranteed period

Keep in mind that a Single Life annuity typically provides the largest payment to the retiree. For Joint/Survivor and Period Certain, the larger the payment is to the beneficiary, the smaller the payment will be for the retiree.

How do I decide?

There is no right or wrong answer when making your decision. When it's time to retire, you should use your best judgment based on your own situation and the information that you have. Additional items to consider should be family history (longevity), other personal savings, Social Security benefits (if applicable), monthly bills you will have in retirement, and how your spouse or other dependents will manage after your death. Aligning your benefit with those items is often the best way to determine which payout option to choose.

The Department of Labor publishes several guides on retirement planning that can be useful tools in helping you make the right decision for you and your unique situation: https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/publications/retirement-savings-toolkit