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Understanding Your Pension Options

A difficult choice for employees
Just before retiring, many employees must choose among a sometimes dazzling array of confusing pension options. An employee's choice of option determines how his or her retirement benefits will be received. Moreover, whatever choice is made usually cannot be changed once retirement and the payment of benefits begin. This puts a lot of pressure on employees to choose well.

Common pension options
The most common options offered under many company pension plans include:

- Option 1. A maximum lifetime monthly benefit that provides the highest monthly payment available to the employee under the terms of the retirement plan.
- Option 2. A reduced lifetime monthly benefit for the employee and continuation of this benefit, or a portion thereof, upon the death of the employee for the life of the employee's spouse or named beneficiary.
- Option 3. A reduced monthly benefit for a specific number of years for the employee or, in the event of the employee's death, for the employee's spouse, beneficiary or estate.
- Option 4. A reduced lifetime monthly benefit for the employee plus a lump-sum return of all or a portion of the employee's contributions to the retirement plan.

Guidelines for choosing best option
Following are some guidelines to consider in determining what pension option might be best for you.

Determine your priorities first. For instance, if you have a spouse or dependent beneficiary that will need your pension income to continue in the event of your death, it makes sense to consider option two carefully. Choosing this option may mean that the lifetime monthly benefit for yourself will be reduced by as much as 6%–12%, but this reduction will ensure that your pension income will continue for your spouse or other beneficiary. Remember, when you die your own personal expenses will cease but your spouse's essential household expenses will continue and inflation will continue to increase these costs.

Don't let greed affect your decision. Pension plans are designed to provide employees with income during their retirement. They are not designed to make sure you get the most out of what you have paid into the plan or to provide a windfall for your beneficiaries. Option three provides certainty of return on your investment and may be most attractive to employees who know or suspect they have a short life expectancy and want their family or estate to benefit from the plan. Fortunately or unfortunately, many people outlive their life expectancy, making this option rather dangerous for anyone who could end up needing a source of monthly income beyond the period selected.

Choose security over aggressiveness. If you need the maximum monthly benefit for the rest of your life, option one is the obvious choice. If you do not need the maximum benefit but do need or want access to larger lump sums to invest yourself or use for larger expenses, you might consider option four. This option may provide a significantly reduced monthly benefit, but it will give you access to your own money if you want to invest it yourself or if you want to draw on it for trips, home repairs, medical emergencies and other expenses that smaller monthly payments could not afford. But before choosing any lump-sum distribution, be sure to investigate the tax consequences involved and carefully consider the comparative compensations and security offered by each of your pension plan options.

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