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Are GM-Like Pension Offers a Good Deal?

By Linda Stern (excerpt)
June 7, 2012

Over the next few weeks some 42,000 white-collar General Motors retirees will take a crash course in actuarial math.

The company is ending their pension plan, forcing a decision on whether to take a lump sum or accept a private group annuity from Prudential that would replace GM's monthly pension benefits dollar for dollar.

With that, they are facing the same question that retirees and near-retirees encounter every day: Do I want an annuity?

There are a few special wrinkles to the GM plan, and talk that other companies could follow this precedent; the market for pension transfers from employers to insurance companies could increase in the next few years. ...

...On the other hand, those retirees now get a second chance to decide how they want to take their retirement benefits. Here are some questions they - and anyone weighing a lump sum buyout or a private annuity - should ask:

-- What number do I have to beat? There is an interest rate at the heart of the lump sum calculation determined by Internal Revenue Service's rules and tables. GM is not saying what interest rate it is using. Company spokesman Dave Roman says that the average rate among all the offers would depend on how many retirees take their lumps and whether there is a pattern to those who do.

But last year, GM used 4.15% when it calculated the current value of its pension for its public accounting statements. Right now, the range of rates supported by IRS tables is roughly 3.5% to 5%, says David Kudla, a Grand Blanc, Michigan, financial adviser with many GM retirees as clients.

In a hypothetical calculation based on average life expectancy (these are not GM figures), a 65-year-old retiree receiving $40,000 a year may be offered a lump sum of $430,000 if the rate was 5%, and $485,000 if the discount rate was 3.5%, Kudla calculated.

"That is not a significant hurdle to surpass," Kudla says. He - and most likely many private money managers - believe they can get better returns than that for their clients.

-- What would be my monthly take? Now and later? Of course, if a private financial adviser took $485,000 and invested it for the long haul, it's unlikely he would let a client pull $40,000 out the first year. For long-term safety, a starting withdrawal rate of 4% or 4.5% is a general rule of thumb, meaning that someone who decided to take the lump sum probably should not withdraw more than about $22,000 the first year. ...

...-- What if I die on Tuesday - or not until I'm 115 years old? Retirees who go for the lump sum will have to be conservative about their withdrawals if they want that money to last a lifetime. On the other hand, they will be able to pass the remainder to their heirs. With the GM deal and most annuities, only spouses can keep the pension tap on, and only if spousal benefits are elected. ...

... -- What about taxes? Taking the lump sum offers retirees more opportunities for tax management, because the money would reside in a tax-deferred IRA. Assuming they had other investments and funds to live on, they could withdraw more money during low-tax-bracket years, and less money during more taxing years. After age 70 1/2, they would have to take mandatory minimum distributions. ...