Should You Retire Early to Get a Larger Lump Sum on Your Pension?

High interest rates are changing the math on pension lump sums

By Anne Tergesen

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The math on when and how to retire is shifting for millions of workers with pension plans. Blame the steep rise in interest rates.

When workers retire with a pension, many are given a choice between receiving a monthly income for life or taking a lump-sum payment. Many pick the lump sum, and those payout amounts have generally increased in recent years. But now, as interest rates rise, lump-sum payouts are dropping by as much as 30%, financial advisers say, sparking a wave of early retirements.

Rising interest rates can be a boon for pension plans, since their bonds can earn more interest, making it less expensive to fund future benefits. Unfortunately for those nearing retirement, lump-sum payouts fall, because they are calculated based on what future benefits cost today. Monthly pension checks don't change with interest rates.

The situation has created a dilemma for employees: retire soon to lock in a lump sum, or remain on the job and risk reduced payouts if interest rates continue to rise.

"For a lot of people, it's one of the biggest financial decisions they will make, since usually the pension represents a good chunk of their money," said Larry Pershing, a financial adviser in Chicago.

According to a 2022 survey by the U.S. Bureau of Labor Statistics, 15% of private sector workers have access to a pension plan. U.S. Census Bureau data shows that 16% of Americans age 65 and older receive income from a private-sector pension plan.

Workers in pension plans that update their lump sums annually may still be able to get 2021's higher lump sums, but only if they retire soon.

Ford Motor Co. recently told potential retirees they have until the end of November to notify the company if they want to retire by Dec. 1, the deadline to cash out pensions before higher interest rates reduce the plan's payouts.

At KFC, three top executives, including the U.S. chief operating officer, recently told parent company, Yum Brands Inc., that they will leave at the end of November due to rising interest rates' impact on the pension plan.

Advisers say clients at a wide range of companies, including Honda Development & Manufacturing of America LLC, Constellation Energy Corp. and Exelon Corp., have grappled with this decision.

Retiring early to grab a higher lump sum may make sense for people who had planned to leave their jobs soon and are financially and emotionally prepared, advisers say.

But others may be better off remaining on the payroll to bolster their finances, including 401(k) accounts that have lost ground this year.

Because the decision to retire requires financial planning and an analysis of priorities, "I wouldn't accelerate my retirement just for this situation," said Steve Vernon, a former pension actuary and president of Rest-of-Life Communications, which provides webinars and workshops on retirement planning.

"A lot of people see their lump sum and think, 'Wow, I'm rich,' but that's the extent of their thinking," said Mr. Vernon.

Here are some key questions to consider.

Should I take the lump sum or stick with pension payments?

The first step is to find out how much you'd receive with each option.

Most pension plans offer online calculators that provide data. Ask your plan's administrator or human resources department when your pension plan updates the interest rates it uses to calculate lump sums and how the change will affect your projected

payout. Also ask when you'd need to notify the company if you want to retire to secure a higher lump sum, said Lou Mazawey, a Washington-based principal at Groom Law Group, who advises companies on benefits.

Then consider whether you'd be better off with the pension, which provides a retiree a monthly payment until death that's typically based on factors including tenure and salary. Retirees can elect to continue their pension over a spouse's lifetime too, a benefit that typically reduces the amount of the monthly income.

Many retirees feel more secure having an income that doesn't fluctuate with the markets. Because pensions protect retirees from running out of money, they can make sense for those who expect to live long lives.

About 50% to 80% of workers choose the lump sum, depending on factors including the company and industry, according to consulting firm Willis Towers Watson. For some, the attraction is that it provides flexibility with a pot of money to leave to heirs or draw on in emergencies.

Many retirees feel they are likely to earn a higher return by investing a lump sum than they'd get with a monthly income.

Which pays more over your lifetime?

Brian Tegtmeyer, an adviser in Columbus, Ohio, recently performed an analysis for a 58-year-old client with the option to take a $540,000 lump sum or a pension that pays $2,150 a month.

Assuming the client or his spouse live to age 85, they'd need to earn an average of 2.4% a year on the lump sum to equal the cumulative income they'd receive from the pension, Mr. Tegtmeyer said. If either lives to 95, the lump sum would have to earn closer to 4% a year to keep up with the pension, he said.

If the couple were to invest the money in an even split of stocks and bonds, Mr. Tegtmeyer said they'd have high odds of earning more than an average of 2.4% a year over time. "And if he's willing to take a little more risk by putting more in stocks, he might be able to grow the lump sum to exceed the pension by a significant amount," said Mr. Tegtmeyer.

He said his clients may instead use some or all of their lump sum to purchase an annuity. At

current interest rates, an immediate annuity would pay the couple about $2,600 a month, versus $2,150 for the pension. The gap between the annuity and monthly pension payment is likely to narrow once the client's pension plan updates the lump sums, and payouts decline.

Should I retire early to get a higher lump sum?

To get the $540,000 lump sum before the payout falls, Mr. Tegtmeyer's client would have to retire in the next few months, about a year sooner than he had planned.

If he were to work another year, he'd earn his $70,000 salary. But his lump sum is likely to fall by as much as 20%, or $108,000, and he would also see some of a $30,000 early retirement incentive reduced based on the new interest rates.

"In his case, working another year financially doesn't make sense," said Mr. Tegtmeyer, who said his client is in good financial shape to retire.

For others, the calculation is less clear-cut, depending on the impact on expenses and income. Retiring earlier may mean higher health-insurance premiums, or it could mean skipping out on coming bonus payments and 401(k) contributions.

Early retirees who claim Social Security before they had planned could receive a smaller monthly check, since payments rise for every year in which a person delays claiming between ages 62 and 70.

Early retirees often tap their nest eggs sooner, which means they have to make the money last more years.

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