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Lump Sums Vs. Pensions
Transcript

Chris Schildz: Welcome to another episode of Conversations with Commerce Trust. I'm Chris Schildz and I'm with David Stubblefield today, a certified financial planner at Commerce Trust Company. David, welcome.

David Stubblefield: Thank you for having me, Chris.

Chris Schildz: Today we're going to talk about a main event. We're going to talk about the choice when you're confronted with the option of a pension versus a lump sum. But before we get there, let's set the table for just a second. Financial Planning is a very big field in the industry today. Tell us what you do so our audience can have an idea of what to expect.

David Stubblefield: I do the long-range planning for clients and prospects of the Commerce Trust Company. A lot of the times that's focused around retirement or solving for financial independence and then touching base on other aspects of their financial life underneath that umbrella, right. The goal is to give you guideposts is a word I use a lot to make financial decisions as you transition from one phase of your life to the next.

Chris Schildz: Well David, that brings us up to the point where you have the choice for some fortunate retirees as they head into their, maybe their last five years of their runway of making a pension choice or making a lump sum choice for what to do with their proceeds in their retirement accounts. Is there a rule of thumb that a that you tell people? Can you help us with the front end of this choice?

David Stubblefield: Sure, absolutely. So there are several breakeven calculators available on the internet. If you like to use Excel, or if you like to use your calculator, you can kind of figure out with a certain rate of return how long this lump sum will last me if I take the dollar amount of the pension out, and you can decide if you're comfortable with that. That's one way to look at it.

David Stubblefield: I tend to take a more, I'll kind of call it a simplistic approach that I think can be applied very quickly. And then the philosophy behind this, is this lump sum, and I'm putting my hands up here in air quotes, a good offer? So am I getting, as I said earlier, the pension is the apple with the income stream you can't outlive and the lump sum is the orange where you have full control and all the investment risk. How do we equate these two to something that we can understand? You know, am I getting a good offer? You know, if they're offering me the orange or are they giving me a big enough orange for the apple, I'm going to give up, right? So one way I tend to do that is I want to just take some basic math and you take the lump sum amount, and then you take the payment stream that you would take.

David Stubblefield: All right, so this is very important because they make calculated the lump sum on just a single annuity life. But maybe you're not going to do that. You're going to take 100% joint survivor. So both you and your spouse are covered for your joint lifetime. You take that annual amount, you divide that by the lump sum. So then whatever that interest rate is, then you say to yourself, is that a reasonable rate of return I can expect if I invest this money a certain way? And I'm just going to pick an interest rate number here. Let's say if it's six 6% is the, is the number you get there, right? So I'll invest this money and 50 to 60% stocks in a diversified stock and bond portfolio. It's probably perfectly reasonable I'll get 6% on average, which means that theoretically whenever I am not needing this money anymore, that lump sum is leftover, right?

David Stubblefield: So that's a good, that's a good value, right? Relative that income stream, right? So the orange and the apple are fairly even at that point in time, right? So let's say that interest rate is 10%. Well, okay, so that means you've got to really earn a lot of, have super outsize, very aggressive returns on that money to keep up with the income stream would give you. So maybe a little out of balance towards keeping the, keeping the pension at that kind of interest rate point. And let's go the opposite way, and let's say the interest rate is lower than six. They say it's three or four, and then you're like, well my opportunity to, if I have this lump sum out run that then is pretty high, right? So may maybe the lump sum tilts more in that in that regard.

David Stubblefield: These things are calculated through a current interest rate environment and actuarial tables and things like that to theoretically be actuarially the same. But their set of fact patterns may not necessarily match what you needed to apply to your financial life, and that's where I kind of use this kind of just general rule of thumb about is that a good offer or not? So can I reasonably expect to get the interest rate in which that calculates to? And if the answer is yes, I'm indifferent. Right? And then if it skewed one way or the other, you can one leans one way versus the other. Right? So if you're indifferent than, that's a good offer. That's a fair offer, right? The apple and the orange are fairly equal for what they are.

Chris Schildz: If the offer is good, and the math seems to work out to one side or the other, let's go down the pension stream side choice. Tell us what the advantages are, maybe the pros and cons.

David Stubblefield: So the pros of taking the pension would be the longevity pretension, money you can't outlive. And also then if you have a greater portion of your assets, your expenses, your core expenses are covered through money you can't outlive. That gives you flexibility with your remaining asset to perhaps increase your market exposure and grow those assets more in retirement.

Chris Schildz: Are there things to be concerned about on the pension side?

David Stubblefield: So, the health of the pension plan is certainly a concern. You want to make sure it's a good viable pension plan is fully funded. You know, there's that situation. That's probably the biggest one. You know, it's usually as a permanent decision, right? If you take the pension plan, although they are offering lump sums as I think I said earlier, they are offering lump sums now kind of retroactively, so it's becoming more of an active decision than it ever has been. But still, you should probably think of it as a permanent decision.

Chris Schildz: Now for married couples on this side of the fence, there's some spousal options as well too. Can you run through some of those choices?

David Stubblefield: So typically speaking, if you were married, you will have some alternate annuity stream options that you can take with your pension, or a pension screen option. So usually those are going to run from, you almost always have a 50% joint survivor. By law you have to have that if you're married. And then a lot of plans will then offer variations of 50% joint survivor up to 100% joint and survivor. And just to make sure we understand what we're saying there, let's say my pension is $20,000 a year, right? As a 100% joint survivor, well that means if I'm alive, if we're both alive, we get $20,000 a year. If I pass away, my spouse gets $20,000 a year, as opposed to the 50% joint and survivor where if I'm alive, we're getting $20,000 a year. But if I pass away, my spouse only gets $10,000 a year. That's typically what that means.

Chris Schildz: Let's go back to the other side of the fence. Pros and cons on the lump sum option.

David Stubblefield: So, the pros would be you have full control of that money. It is yours to do with what you will, right? So, you can hopefully grow it over time and then possibly leave it to your heirs. So, you have full liquidity and full power over that. So, the con there is with full power comes full responsibility, and the investment risk is all yours.

Chris Schildz: And so one would have to take those proceeds and invest it. It's not always the best choice for do it yourself investors, but it could be what. How do you handle that part of it? How did they make the decision of whether hey, I can do this or I probably can't?

David Stubblefield: So, we tend to, through our financial planning process, we will look at both sides of the coin for you. So you can tell, you can see if one decision is dramatically better on your financial life versus the other.

Chris Schildz:	This is an emotional decision for folks, and well it should be. This is something that's going to determine the financial course maybe for the rest of your lives, or for the couple's lives. What do you tell them in the last meeting when you're coming up to the decision, and how do you get them over the hill?
David Stubblefield:	So, I think the first thing we have to do, we have to have people acknowledge that even if you're financial independence is strong and you have a good understanding of that, to shift from accumulating money to using your money is always a moment of trepidation. I don't care what your net worth is. That is true. I've, I've been in planning for over 14 years. I vicariously retired over 650 times. I have seen that more often than not, that people always have this moment of pause when you walk away from earning money and you have to shift to using the money you've been saving and use that to support your lifestyle then going forward.
David Stubblefield:	So good planning where you can kind of look at their whole financial life, hopefully it puts them at ease. You know, I sometimes say, even if they take academically know they're okay, we can take them from academically knowing they're okay, to knowing that they're okay emotionally. And once they know that, then then they have the ability to then make decisions and move forward.
Chris Schildz:	That was David Stubblefield in Conversations with Commerce Trust. David, thank you for joining us today.
David Stubblefield:	Thank you.
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