Episode 150 Lump Sum or Annuity What's Right for You

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SPEAKERS
Alex Murguia, Bob French, Wade Pfau, Jason Rizkallah

Bob French 00:00
The purpose of retire with style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to resaprofile.com/style and sign up to take the industry's first financial personality tool for retirement planning. Think taking your pension is as easy as signing on the dotted line. Well, today, Wade, Alex and Jason Rizkallah from McLean asset management are here to help you read that fine print.

Wade Pfau 00:52
Hi everyone. Welcome to retire with style. I'm Wade. I'm here with my trusty co host, Alex Marguerite, and we're joined today with a special guest from McLean asset management, Jason Rizkallah, Managing Director of Planning, and we're excited to dive into some of those practical issues, getting beyond just the theory. And Jason, we'd like to bring you in and reintroduce you to the audience, because you've got that experience. And we want to talk about part of the whole tax planning conversation as it relates to for those who have pension opportunities, whether to take the lump sum distribution from the pension, or to turn on that reliable lifetime income from the pension, and any number of issues related to those decisions, it's really what we're hoping to dive into with you today. So thanks for joining us again on the show, we've been here a multiple time guest. What's new in your world?

Jason Rizkallah 01:44
Absolutely, I'm happy to be here, and thanks for having me, and happy for the folks listening to this to get some information, and I'm happy to provide any information I can, you know, to help folks along their journey. But yeah, it's an important decision, ultimately, you know, whether or not, to take a pension lump sum, to take the income payment that it offers, and then figuring out which avenue is best for you and your specific plan, it's going to be very unique to your situation and your needs throughout retirement. So happy to share the information I can to help lead you to that decision. Great,

Wade Pfau 02:19
great. And so this is something that as each year passes, fewer Americans even have a choice that defined benefit pensions are slowly diminishing in terms of how often people have access to them. It's less common in the private sector, but still in the public sector, and with McLean Asset Management being in the Greater Washington, DC area, probably you do see more pensions coming up than across the nation as a whole. But yeah, if you have a traditional defined benefit pension, that is what we traditionally viewed pensions before the shift with the defined contribution, 401, K plan, investment version of all that you have an option, do you take a lump sum of the present value calculation of, here's the value you could receive as a lump sum investment account that you could then reinvest on your own? Or do you take the traditional defined benefit pension providing that reliable income? And so, yeah, that's really what we want to dive into. And you know, at a high level, just what? What do people need to be thinking about as a starting point for all that?

Jason Rizkallah 03:26
Yeah, absolutely Happy. Happy. Share my thoughts and my experiences with those I've spent my entire 18 year career in the DC region. So, you know, dealing with pensions and working with pensions and the clients, you know, has been a integral part of the planning I've always provided and the services I've always provided to clients that I've worked with. And you know, they can be complex at times too, to look at them, they can have different moving parts, very specific to certain types of positions even, you know, even within the federal government, there are certain departments that have different pension plans and others. You know, there's not just a vanilla type of plan that covers most folks on the more on the private sector. They can be a little bit less complex, but still, you know, it's going to be very specific to the offerings of your plan and what options are available to you. So what we'll be discussing today are ones that we hope cover the majority of plans. Right? There's always going to be specifics that should be analyzed, but we're looking to educate the mass so we want to provide as much information as we can that can help as many people you know as possible. Right for your specific situation, you want to look at it, though, as

Wade Pfau 04:33
part of that, make sure you do talk to the benefits coordinator at your company too, because there could be interactions with other employer benefits and things too, depending on the decisions you make. So absolutely, we can only speak in broad terms, and every company may have a slightly different or organization may have a slightly different set of rules for things.

Jason Rizkallah 04:51
100% yes, absolutely, you know whether or not you continue certain healthcare plans, things like this. You know can be contingent on those I've seen that happen. But. Not common, but it has, you know, occurred with that? Well, basically, there's, there's really, when you're looking at pensions, there's two main decisions. You come to a point in your life where you have to make a decision, how am I going to use this pension that I've been accumulating? And for most fans, again, they offer lump sum options, or they offer income payments to you. Again, the specifics of these can be very different from one plan to another, so again, we're going to take a broader kind of stroke to it, but when you're looking at taking making this decision, it honestly from a planning perspective, it should be made in the context of a comprehensive plan, right when you're looking at your big picture finances to see how best this component of your retirement resources can be used and utilized to fit your needs and what you need it to do. So that's the

first piece of advice, is you probably want to take a look at this, not in a vacuum, but when you kind of take a step back and look at the broader picture of your finances going into retirement. But with that said, you know, we're going to focus here on pensions, and the kind of decisions you can come across. The first would be, do I take a lump sum, or do I take what I will call an annuity payment from it? And there's pros and cons to each of these choices, right? And then there's a third option I'll bring up later on as well. But these two primary options within the pension itself, I can take a lump sum, or I can take an annuity payment. Clearly,

Wade Pfau 06:24
let's introduce that third option too, because I think this will be a lingering thought as well. If you have determined an annuity would be helpful as part of your plan, do you want the annuity through the defined benefit pension, or do you have a better opportunity externally, like to take the lump sum and then it's a commercial annuity outside of just

Alex Murguia 06:45
before you get into I think that's a great point. Wade, and there was a question I've been meaning to ask you, Jason, and maybe it's just better to ask it globally and for you to pepper it in when you're talking about your stories, largely because we're largely, you know, we're theory at this point, best practices, but nonetheless, you have the boots on the ground practical application, right? So as you're going through these, and especially, this is a perfect example that question that Wade just asked, because it comes up, you know, quite often. So I'd love to hear from you, you know, what are the biggest in the, in a, in a, in light of, you know why you're answering the questions, what is the biggest misconception that you have to debunk when someone walks in about this whole pension lump sum thing? It could be as easy as someone thinking, they just assume, in their assumptions, that they're going to get 12% every year. It could be something as simple as that. All right, but what's the biggest misconceptions that that, that you, that you have to touch upon here, you know, with and disabuse people of, and then the other one is, what's the biggest difference between theory? Because your sound, you know, you know all the theoretical Best Practices answers from a book, but you know, what do sometimes 100 sometimes, do you need to kind of bend that a little bit, you know, to practically apply, if you will. That being the case, those are two themes I'd like, I'd like to touch upon why you're answering, but again, Wade's question is great, where? Okay, what if you take the lump sum and then flip it into an annuity that you buy from a carrier?

Jason Rizkallah 08:20
Absolutely, that is the third option that I was referencing earlier, which is, I agree on, I agree that an annuity is the best choice for me, but is the pensions annuity the best choice for me? Right? So yet another decision to make once you've come to that conclusion, and we'll certainly, certainly go into details about that, how that thought process is, how you can approach that. Again, the pros and cons to making that kind of decision for that okay, yeah, I'd be happy to speak on those if I don't touch on them naturally, Alex, just bring them back up to me, you know, at the end, and I'll be sure to go through it. But when it comes to, let's just say, the first decision of a lump sum, right? Lump sum or annuity, you know, you think about it, okay, what is the lump sum going to provide to me? Just a windfall of cash, essentially to you, right? It's just going to dump a bunch of cash into your lap. And that can be a pro, and it could be a con. You have full control over the asset at that point, so you can do with it as you please, invest it, distribute it as needed, for income or for spending goals. You can designate it in certain accounts for certain beneficiaries to inherit at a given point in time. But it really you have full control over the entire

asset. You know, at that point, that's the benefit that you get from it, and then the flexibility to do with it as you wish when you wish to do that, which can add a lot of value for folks, just again, depending on the type of of retiree you are, kind of how you see yourself managing your finances to some that is very appealing to do that, to have this control and to integrate it into their plan the way that they see appropriate for for others. Who may not feel comfortable, you know, with that type of responsibility, that can be a con right, that can be a negative to doing something like that. All of a sudden you're given full control over this could be large sum of assets and a in a an important part of your financial plan, and you don't really know what to do with it or how to manage it appropriately. Or it can be intimidating, you know, for you. So do you take the lump sum and then do nothing with it, which can be dangerous, right? It's not growing. It's not going to provide anything to you. You don't know how to use it or distribute it appropriately. Do you take it the right way so that you can be sure to avoid, you know, unnecessary taxation on the asset? Should it be like the majority of pensions, which are pre tax, it's very you gotta be very careful about how you take that lump sum to not hurt you in a way in the long term with it. So again, when you're thinking of this lump sum, you gotta think of it. What do I wanna do with this asset? What am I gonna do with it once I get the lump sum and to make sure that you take it appropriately that matches your long term goals. Now, the taxation is a very important component of this, and I do want to you know just at least touch on this. Again, most, most pensions are pre tax, meaning that the money is accumulated, accumulated in there without any taxes being paid on it. So what does that mean? That means that when the money comes out, it's taxed, but how it comes out will determine the taxation of it. If you take the lump sum and you roll it over to an IRA, traditional IRA, it's not taxed at that point. It's a rollover. And then as you distribute it from the IRA, that's when you're going to pay taxes on the amount that's distributed. If you take it as a lump sum and put it in your bank account, you're going to pay taxes on that full amount as ordinary income that year, and that is usually not the best method for most folks. You probably want to avoid that. So making sure that if you do take the lump sum, that you take it in the appropriate way, and that the money is moved through the right channels, to ensure that you're not paying unnecessary taxes you know, on this lump sum, which could be a rather large amount for most folks, right,

Wade Pfau 12:05
right to just like, further compound that point, like, if you're taking the lump sum, you're creating for yourself, what we usually think of more in the 401, K, Ira world. And so now you're talking about, well, if you take the entire amount out, that'd be like emptying the balance of your 401, K, or your IRA in one tax year. And yeah, that could be a lot of taxable income. So generally it's as money comes out, it's taxed. But if you roll it over into an IRA, you maintain that tax Absolutely,

Jason Rizkallah 12:32
yep, and and again. You know, taking a lump sum can be the right choice, like, depending on what it is that you want to do with it. Some folks take it, put it into an IRA, and then start to convert it to a Roth as an example, you know, over years, and spread it out if it adds value, and if that's in their plan to do that. So, you know, again, having a plan of what to do with the lump sum is going to be very important if that's ultimately the choice that you make to take that, you know, for you. But also know it's a lot of responsibility at that point, right? You you're getting the lump sum, and you got to be prepared to be able to handle it, you know, and maneuver it appropriately.

Alex Murguia 13:07

And Jason, just quickly, because someone could be wondering the logistics of, okay, I have a 401 K, I cash it out, but I wanted to go to a 401 K. It doesn't have to happen instantaneously. I believe it's 60 days or something along those lines. Do you want to maybe touch upon that real quick? Does it work logistically?

Jason Rizkallah 13:28
Yes, I think Wade just mentioned that. So there's two different types of rollovers to be mindful. One is direct and one is indirect, right? Indirect means, if I can put it just in simple terms, indirect means it gets sent to you, right? It's in your hands at that point. And yes, Alex, there's a 60 day clock that starts to tick once that check is issued, that that has to be put back into an IRA to avoid being taxed on it. Okay? That's got a 60 day rollover or an indirect rollover. And these are terms for it. Direct rollovers are the cleanest way to remove the money and ensure that you're not going to have any kind of tax liability to it. And what a direct rollover is is from one custodian to another directly. Doesn't touch your hands. It's not payable to you or anything like that. So an example would be, let's say you have a pension through your employer. It's being held there. You would contact that provider or that custodian of that pension and say, Listen, I want to roll over these assets to my IRA. Normally, they'll have their own forms that you fill out right from them, and you're going to simply put there the information that it's asking. Where's this money going to? You know, XYZ custodian. I'll give an example. It could be Vanguard, Schwab, Fidel, whoever you know at the end of the day, those are that's the custodian. And this is the account number. This is where you send the money, and they will send the money directly to that custodian. That's why it's called a direct rollover. And that is the cleanest way, because it never touched your hands. There's a paper trade. Of how the money left and where the money arrived. A 1099, will be generated from the distributing custodian, but a 5498 will be generated from the receiving custodian. And those amounts should line up, you know, to the IRS, and they'll know, okay, wait, the money moved over. I'm

Alex Murguia 15:16
sorry. Is it a 5498 or 5765 Wait, What? What? Guys, I'd be you, Jason, hang on. A round of applause And ladies and gentlemen, he I, to my knowledge, he's not reading from a screen. He's

Jason Rizkallah 15:36
no, I'm not that out. That's right. That was not in my script. Wow, on that one. Yeah. So it's a very clean process, right? And that's the way you want to keep it as best you can. So the the advice would be set up an IRA at a custodian of your choice, contact the the custodian of your current pension and arrange for that movement to happen directly.

Bob French 15:59
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Wade Pfau 16:24
Yeah, that's the safest way to not get into trouble with forgetting about the 60 days and so forth. Yeah,

Jason Rizkallah 16:30
if it's 61 days that IRS is going to nail you with that tax, and it's not going to be pretty Yeah. And the ripple effect that can have on things, you know, down the line, if you're, you know, if you're in Medicare, if you're depending on where you're at in life with with your your medical insurance. So if you're age 65 or higher, and you have Medicare, or you're retired, you know that can affect that premium. You know, essentially. So you just got to be cognizant of this. And then the taxation on your other income sources you know that you have, it can definitely have a domino effect, if not done appropriately, so that, I mean, those are some considerations about the lump sum, right? It's, it's whether or not you want the entire amount in your control, and that's really going to be based off of your comfort with that, and what you want to do with the asset once it is in your control. That, I mean, that segues into the annuity options, you know, pretty, pretty cleanly. So within your pension, the annuity option, you know, what do I look at there? How do I determine if that's the appropriate method for me or not to take this, this asset? Well, again, that comes to the financial plan that hopefully you did that is leading you to the best avenue on how to use this asset or resource, and if it's determined that an annuity option is the best for you, well, you may have two choices, right? You have the internal annuity of the pension, and then you have, as Wade mentioned earlier, and that third option, and outside commercial annuity, you know, for it. So maybe the answer is, take a lump sum and then purchase an annuity, right? So it can be a little a, little b, but we'll focus on the internal annuity first, and then that that, you know, goes very nicely into the the outside one, because the benefits can can overlap with each other to some degree. So you know, when you're looking at the pension saying, hey, guess what? You can take a check for the rest of your life, if you like, right, rather than take the slump some and here are the amounts or the amount that you would receive based on different payout options. Some of those payout options you'll see will be single life, life with survivor benefits, whether it's 100% survivor, 75% 50% survivor, there's all these different kind of options you can choose from. Again, which one is best for you is going to be very specific to your situation, and what ultimately works out best Is there a large age gap between you and your spouse, right? And perhaps there's a high degree of probability that you're going to pass away much sooner than your surviving spouse. So maybe a survivor option is best. There. In that case, how much are you sacrificing, you know, to take a survivor option versus the single life. I'll tell you what something and this is happened yesterday, as I was reviewing documents with a client that I worked with the joint life with 50% survivor actually offered a higher payout to the to the main person than a single life did. I was like, shocked to see that. Yeah, it was, it was strange. But I'll give you an example. A single life payout was like, let's say, $3,000 but the joint with 50% survival was 3100 Yeah, it was very awkward, you know? So you'll see things like that sometimes happen. But it was there and I was reading it correctly. I read the document 18 times because I was like, Am I missing something here? Because this doesn't seem to align. Usually, when you add benefits, the payment comes down right when you add features to it.

Wade Pfau 19:59
Yeah, yeah. And you can see those anomalies in with commercial annuities, because company, a that has the best offer with one arrangement isn't offering a product with the other arrangement. But yeah, internally, I guess we should also just add to this point that single life usually does have a higher payout. So to discourage people from just jumping at that opportunity. If you are married, you are defaulted into the joint life, and your spouse is going to have to sign some paperwork if they're losing that joint life aspect of the That's right, yeah,

Alex Murguia 20:33

in some untimely death. Yeah, we don't, in

Wade Pfau 20:39
this case, you're saying the joint life did have a better payout anyway, it did. Yeah, it was, it

Jason Rizkallah 20:43
was pretty amazing. Yeah, right. They worth more alive than

Wade Pfau 20:50
that. Well, that because if, if that other spouse was older, then if they ended up passing away, first, that would lower the pension to what would have otherwise been a single person, so that was the spouse, older in that scenario,

Jason Rizkallah 21:03
no, was not okay. They were relative. They were born in the same year, so they were relatively calm, the same age, if you will. Yeah, it was, it was strange. Yes, it was strange to

Alex Murguia 21:13
see fascinated by this is because I work with Wade all the time. Is Wade's trying to crack the case. He's trying to figure, yeah. He's like,

Wade Pfau 21:22
Yeah. Relate to 50% survivor is a way like the expected lifetime payments at some point I'd have to really dig in more. But wouldn't they expect they can pay less when it drops to 50% after the death of one of the two individuals? Is that what it is? That what it is, I don't know what else it could be, or else, it's just the pricing and made a mistake. All right, that's

Alex Murguia 21:46
Jason's vote. My vote. I mean, that's, that's Wade's vote. All right, I'm gonna ask you to vote Jason. After this, I have my theory as well. The actuary who created this thing on a spreadsheet was using Excel, and you know how you do the decimal points on Excel, where you use the arrow to the left that points to the left or points to the right. And I always mess up the direction of the decimal points. I don't know about you guys, and I've done this like hundreds of times, like in a year, right? And I mess it up all the time. I bet you something like that happen. Jason, who wins me you

Jason Rizkallah 22:23
know it could be somewhere in between. I'll take a neutral stance, but I will tell you, maybe the actuarial is also privy to this policy.

Alex Murguia 22:35
His whole family owns them,

22:38
so he's like help out here.

Alex Murguia 22:41
He's no longer employed, by the way, that company, but he's got

Jason Rizkallah 22:47
worked out just fine for him. Yeah, I mean, it was, it was pretty amazing to see that, because that's usually not the case. You know, 99 out of 100 times. But this, that one out of 100 you know, it did work out. But you know, what are the benefits of doing this, right of taking an annuity payment? You know from it, one is that a reliable income stream is provided to you for life, and in your spouse's case, you know their life too, of course, a discounted amount, but still, nonetheless, a reliable income stream coming in, which can be a game changer for many folks is financial plan and kind of likelihood of success in retirement. So that's that's a benefit you get out of doing, taking the annuity payment and doing that kind of motion, you can never outlive the asset, right? So if you take a lump sum, there's the risk that you might deplete it. If you just draw on it too aggressively, don't invest it enough to have growth, and you're using it pretty aggressively, it can be depleted. Your annuity can't right, that income is going to come no matter what. For you, there's no need to manage the asset after that. It's said and done. You're just going to get checks for the rest of your lives. So there's no responsibility to that. There's no RMDs you have to worry about. There's no investment strategy you have to consider ongoingly in managing and monitoring or anything like that. Again, the decisions has been done, and it's just going to be there for the rest of your lives. Taxes are spread out according to the income payments, right? So as you're getting your income, you'll pay taxes on the income, but you're not paying taxes on any amount that you're not receiving, right? So it's as you receive it. You pay the taxes on it, and by doing that, by setting up this kind of reliable income source depending, again, on your age and what your plan looks like. But you know that can often allow you the ability to defer, like Social Security as an example, and allow that to continue to accumulate, you know, down the line, and add greater value there, maybe put less pressure on your portfolio to provide certain spending in the beginning of retirement, and give you an income stream that you can help, if not, live off of, at least help help you to live off of there

Wade Pfau 24:52
and on that. Social Security point is most people need some level of reliable income. Yes, Social Security, if. If part of the reason you have this pension is because you're not part of Social Security, this may be your only reliable income, and so sacrificing that could be a consideration as well that you may not want to waiver

Jason Rizkallah 25:13
is a wonderful point there 100% Yeah, is that? You know there, there are certain pensions that don't then allow you to participate in social security, right? So, yeah, it's not even there as an option, and this essentially becomes it. So you got to make sure that you know the timing and how you take it is important, but that's the importance of taking the income too, for that. Now, you know, what are some of the negatives? You know, are cons to it? One, liquidity, right? I mean, the asset is gone, essentially in exchange for these income payments, right? So if you needed more than what the income is providing to you at any given point in time, there's no access, you know, to the principal there. That principal was used to essentially provide you this income stream for life. So the liquidity, you know, goes away once you do that. Also, there are certain pensions that I've come across that are life only meaning there is no spousal, you know, option available. It only covers for your lives. I've seen those a lot of times in like, military type pensions, things like that. And so, you know, again, if you take this pension payment, it will be set to you ahead of time, whether or not you know you're when you're when you're given your options, it'll tell you, Hey, do you have survivor options or not on it? So you know going into it,

but that can help in your determination, right? Do Is it important that my spouse continue to get some income from this upon me passing away or not? If, if your spouse's ability to be successful in retirement, should that event happen be determined by receiving income from this. Maybe you then want to take the lump sum and purchase an outside annuity, which is the third option that we'll talk to there. So there are ways around it, perhaps that you can work if the option is available to you, but that being a negative that could apply to some folks. It's more of a niche, you know, set of folks. But still, some folks may encounter that they only have a life, only option, no survivor option available under the annuity plan that their pension offers. And that sort of you know, that leads us into the third option, which is, well, you know, I'm going to take the lump sum and purchase an outside annuity, or should I do that? Is that an option? What does that look like? And now, before

Alex Murguia 27:25
you get into the details of that, because if I'm listening, I want to get to the conclusion right away with one question, and then I can listen to the rest much with more calm, which is, are they competitive with pension with a in in company pension, you know, directionally, are they competitive?

Jason Rizkallah 27:44
Yes, yes, they are.

Alex Murguia 27:46
I didn't want you to talk about all of this, and then at the end those 10

Jason Rizkallah 27:56
minutes back, yeah, no. Fair enough. Good question. I'm glad, glad that is, yes, they are competitive. How competitive is determined on the market, right? And what's going on, but they are competitive. Um, and as a matter of fact, what we saw with the whole rising interest rate environment, and actually has held up, even though we went through a slight decrease. You know, recently, the commercial annuities we've seen, again, from a majority standpoint, pay out better offer, better income payments than their pension counterparts, you know, on the pension side. So it's worth looking into. If you're going to take the annuity option, you should look at, can I get a commercial annuity that's going to give me a better deal? And what we mean by better deal is for the same premium, get a higher income amount guaranteed to me,

Alex Murguia 28:39
so for the so if you're deciding, I'm gonna assume a financial plan has been done, and if everyone knows the math, the break evens, etc, etc. So if someone is in a plan, is in a company, and they have a decision to make, hey, do I take the company pension or lump sum? If they do decide to take the company pension, they shouldn't just reflexively just say, I'm going to take the company pension, because if a lump sum is available, then in their calculation, they have to also consider what's an open market annuity, because an annuity is nothing more than effectively, you're getting your own private pension from an insurance carrier, as opposed to from your company. Wade, Did I say anything there that's off in that decision making?

Wade Pfau 29:28

No, no, yeah, if you decide you want income you should compare. Should I take that defined benefit pension, or would I be able to get more monthly income by taking that lump sum and purchasing

Alex Murguia 29:40
avoid the laziness factor of just being like, I'll just take the company pension because it's already there. They it's an opt in. It's almost like a negative consent kind of thing, as opposed to proactively looking for something. I'll leave it at that.

Jason Rizkallah 29:53
Yeah, no, that's exactly right. If ultimately your decision is to take the annuity from your pension, you. Do owe it to yourself to look at what you can get outside of that you know as an option. So you know this these commercial annuities, as Alex, you know, was saying earlier and I confirmed, there can be periods in time where commercial annuities pay out a comparable or higher income rate for the same premium that your pensions offering. There could be times where that's not the case, right? It ebbs and flows with the environment that we're in. As I said earlier, what I had seen over the past, I would call it year and a half, even up till today, is that I have been seeing that the commercial annuity side is offering a richer benefit than their pension counterparts, right? So how long that holds up for and to what degree is all to be determined, but nonetheless, it is there, so that

Wade Pfau 30:46
can fluctuate just because it's yeah, the pension, they're deciding what discount rate, what interest rate, to use to calculate the lump sum, and very small differences in their choice can lead to big differences in the lump sum amount, which means it could go either way when you start comparing that lump sum and what that could buy on the commercial annuity market. So yeah, really, it can fluctuate over time about where the better deal could potentially come from. If

Bob French 31:12
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Jason Rizkallah 31:39
So what may be some reasons that you want to consider an outside annuity versus what the pensions offer? Well, we've mentioned one a few times, which is the level of income that you're going to receive, but also the structure of the income can matter too. So when you go into the commercial annuity space, you have vast offerings available to you with all kinds of bells and whistles, features, things like this, and that world kind of opens up. You working with a planner or on your own research, you can determine which one is ultimately the best for you. You know which type of annuity. But if you cast kind of a net out there, you'll start seeing a lot of offerings. So let's say, I'll go back to my more extreme example of when I had worked with a client that was in the military, and he has a life only annuity, but he has a lump sum option, right? But he's married, and he would like his spouse to get some income from this if and when he passes away before her. So his option would be take a lump sum and go purchase a commercial annuity that has the ability to pay for a survivor benefit on the income. So he would roll that

pension over to an IRA, take that asset purchase a commercial annuity, which then covers two lives. Okay? So he that was his way of working around not getting a survivor benefit through his current offering. You know, through the through the pension itself. But also, you know, when we look at joint lives through the commercial annuities. Typically, we're looking at 100% income being maintained through both lives while you're while on the pension side again, typically you're going to be taking some kind of discount on, you know, that income from the survivor, whether it's 50% 75% something like that, is what the survivor will get on the commercial annuity side, we will lean towards getting that 100% survivor benefit. Yeah,

Wade Pfau 33:24
joint and 100% survivor Correct? Simply means the same amount continues to be paid, regardless of whether one or two individuals is still alive. Whereas, say, joint and 50% survivors is after the death of the first individual, the pension would drop to 50% of its initial amount, absolutely,

Jason Rizkallah 33:42
and being that we, you know, we're not privy to when that day comes where, you know, we pass away, and for how long into the future that is, and for how long will the surviving spouse be alive for, you know, for the remaining of their retirement. You know, some folks will say, Well, you know, the pension gives me a, you know, a payment and then a 75% survivor benefit, but I'm not here, so there's less expenses, right? So that's fine. You know, that can be okay, that they only get 75% of the check because there's less expenses. Oh, maybe, maybe not, right? I mean, we don't know what the expense environment is going to look like in the future. I mean, look at where we're at today versus three years ago and inflation and the effects it had on prices. You know, things can change quickly. You know, to where more income can certainly be useful, you know, in somebody's plan for that. So, you know, again, as it only comes to analyzing and looking at the options that are available to you, all options available where it can lead you to the best decision that you can make. And when you make your decision, you know, go into it with confidence, knowing, hey, you know, I made this, knowing that I turned over all the stones, looked at all the numbers, and this made the most sense, you know, for today to take. But you know, what are some of the negatives to using a commercial annuity? One is you have to go find. A commercial annuity to use, and with so many options available, as I mentioned earlier, with bells and whistles, knowing which one to use that's ultimately the best for you can can not I mean, can be a difficult decision and not easily, something that you can come to very quickly. You know that decision on which annuity should I use? I would advise working with a professional that is experienced with annuities to help decide on which one is ultimately the best, because there can be very slight differences between them that should be considered and ultimately to ensure that you get into the best option that that is for your situation. So finding the right annuity can be a challenge you know the specific one to use for that, and then ensuring, as we had said earlier, with the lump sum, that that movement of funds from that pension to the commercial annuity is done appropriately, right, to ensure that there's no taxation occurring there. Now, it's a similar process to, as I explained earlier, moving it to an IRA investment account, like at a custodian under the lump sum option. It's the same movement that happens to an annuity, and it's held in what they call a qualified annuity, which is like an IRA at the insurance company. So it is going to remain under that tax deferred status, and there's not going to be a tax implication for doing that movement from your pension to that commercial annuity. Okay,

Wade Pfau 36:18
and on this decision too. Could you talk a little bit about credit risk issues between the defined benefit pension and its credit risk versus what you may be looking at with insurance companies and potentially diversifying between insurance companies? Sure.

Jason Rizkallah 36:32
So you know, the old expression, you know, don't keep all your eggs in one basket can certainly apply to when it comes to insurance products and annuities. Now insurance companies, right? You would expect them to be some of the most solvent and strong, financially strong companies that are in in our nation and in the marketplace. And yes, that's true for many of them, but you know, it's still risk nonetheless, the solvency of your of the insurance company that is issuing your annuity, whether it's through your pension or whether it's through, you know, you buying it commercially. So being aware of, you know, how is that pension annuity going to be backed up? You know, what? What protections Do you have? Is going to be very important. I don't like to speak specific numbers, because I know, you know, they can change, and things can change around that. But there are protections that apply to pensions that you know you want to be very specific on and look at what applies to yours. And then there are certain protections that are applied to annuities. You know that I'm very state specific. So again, whatever state you're in will have specific kind of guidelines of what protections are available there. Comparing those is going to be very important in your decision, because, again, this income is for your lifetime, and oftentimes for another lifetime, right your spouse's lifetime as well. So it's for a long period of time you want to make sure that whichever choice you're deciding on, that you're doing the best you can to ensure that that income payment is going to continue on. Now there are no guarantees right in life, and as such, with annuities, right, there's always something that could happen, but you do the best you can to protect yourself against it. I'll give you an example on the commercial side. You know, by practice, we like to stay at what we call a minus or higher rated insurance companies. But even on a lifetime type of annuity, I preferably like to stay in the a or higher rated. That's it's a preference. They're all excellent rated, you know, if you will. They all fall into an excellent category at a minus or higher. But a is really, really, really where I feel comfortable for the lifetime income. You know, annuities, if we're looking at other types of annuities that are more like CDs. They're called multi year guarantee annuities. A minus might be okay because you're only holding them for a short period of time, but for lifetime annuities, I like to be in that a space for my clients. So you know, doing again the research, what is backing up that pension versus what could be backing up your annuity? And Wade brings up a good point. Right under your pension, you don't have the option to diversify the insurer, right? They're telling you, hey, you're going to get X number of dollars per month. And you don't have the option to say, Well, can I split it between different things here? Right? To add some levels of insurance. You can do that on the commercial side. If you have a million dollar lump sum pension, you know, available to you, you can buy two, $500,000 commercial annuities, or four, $250,000 commercial annuities if you want to and diversify. You know that risk out

Alex Murguia 39:31
someone, that's a lot of work. I'm not discounting to do that or not, but I'm like, it's worth it, don't get me wrong, but someone's listening is like, four, oh, my goodness, I can't even drink four glasses of water a day. You want me to get four annuities? You know, that kind of like, Jason, what

Wade Pfau 39:49

have you seen there, too, with like, Could you take, like, use part of the take a defined benefit pension for part, and then get a lump sum for the other part to can that sort of diversification happen? Or? That mostly all or nothing on the I can

Jason Rizkallah 40:02
tell you, from my experience, it's been all or nothing. Some, some allow, again, that's very specific. I have come across some that allow for partial rollovers and things like this. Most that I come across the majority. And I wouldn't, I wouldn't even say it's the vast majority, right? I'd say maybe 6040 if I were to put percentages on them. 60% don't allow for a split. Maybe 40% do that. I've seen. But yes, it's usually an all or nothing decision. You either take the annuity or you take the entire lump sum.

Alex Murguia 40:33
But another way of asking another thing, what's the source of that? Of that yes or no? Is it usually the company that doesn't allow it, I picked up on, or the person, where do you find

Jason Rizkallah 40:46
it? It's how the plan was established, you know, essentially, so it could be by the employer, in conjunction with the plan administrator, you know, it could be, that's how it was determined. It wasn't, you know, it's not that. It's a certain type of thing. Yeah, I

Alex Murguia 41:00
would think Wade nowadays, a company would, unless there's some obviously, I'm not a corporate finance guy, but you would think a company would want to get people off their books as quickly as possible from a liability perspective, huh?

Wade Pfau 41:14
DB, right?

Alex Murguia 41:17
The company? Yeah, I would like encourage it. If I'm like a company, buy it in the private sector. You know what? That's their forte. We make widgets, not like some

Jason Rizkallah 41:26
do. Some do. I've seen some where the decision was very clear, take the lump sum and go buy a commercial like they were, like, we're not gonna give you much here. You know,

Alex Murguia 41:40
we already bled you dry for your work, you know,

Jason Rizkallah 41:45
that's it. Yeah, that's it, you know. But, yeah, it's it. You know, diversifying out is more work, right? Because now you're not only identifying one annuity, but you're identifying two, three, however many you think you know anyone

Alex Murguia 41:59
that could help perhaps no kidding.

Jason Rizkallah 42:06
Honestly, financial planning, that's exactly what we do for folks, and usually the recommended course of action. Now there is a sacrifice to that, right? So if you're doing a search the kind of the appropriate way, starting off with a rated companies and then throwing out casting that net of I have this much in premium. I want to start income at this date. What can I get, you know, and then you'll get the numbers back that. Say this company is willing to offer this much income, and this one that much, and that one that much. So there's clearly a list right the top. Let's call it four or five insurers in your area that meet these credentials, these search criteria criteria. Excuse me. Now you're going to sacrifice something when you diversify, right? There's no free lunches, you know, ever with this, and so you can put it all into the top one and get the most income with with the highest credit quality that you're comfortable with. But when you start to diversify, usually going now with the second and third and fourth best, right? Which means, usually a lower income amount. So you're going to sacrifice some on the income amount to diversify. Is what we found. It's virtually, I have not seen where you have two or three times, given exactly

Alex Murguia 43:14
it's on the credit side. Could you get four A rated companies and they're they're paying different prices, and that satisfies your need. Practically, you're gonna have to work your way down the alphabet,

Jason Rizkallah 43:26
so no you can stay within that a or higher credit rating and find it enough diversification there, typically, to satisfy your need. So you're not having to sacrifice the credit quality. It's you're sacrificing the income that you're receiving, or some feature that one may have, that the other does, they're

Alex Murguia 43:44
not always gonna pay the other piece, if you're doing this, how quickly do you need to do this analysis? Simply because rate change even across companies, and we're talking about off this podcast, Jason and I were just simply speaking about somebody that got quoted, I don't know, three months ago, and then versus now, it's completely different. And so you need to really clear out your schedule for for what's the timeline in which the reasonably do this analysis? Because you can't do one every month, and then six months later make a decision, because you almost have to redo it again, especially

Jason Rizkallah 44:21
on this environment right where we're at a flat to declining, you know, kind of thing. It might have paid off for you a year and a half ago, when we were on the upline. Those days are behind us. So basically, there's some protections that you have, you know, afforded to you as a person purchasing an annuity to help lessen the risk of these movements that could happen. But if we're just looking at numbers, right, just looking at the annuity options available, depending on the type of annuity will depend on kind of how quickly you need to move in order to lock in certain things that you're seeing today. So like with single, premium, immediate annuities, the. Those things move essentially daily, you know, is what I've seen, especially when we're in this kind of environment where interest rates are moving, you know, I could draw an illustration today and then tomorrow, it'd be different, you know. And that literally is what I've seen happen

so you have less time. What it is is you see something you like in that kind of arena, and you got to move on it rather quickly to either try to lock in that or get as close to that number as you can

Alex Murguia 45:25
do. A quote, if you get a quote, is there a time where you haven't bought it, but you know, when you're getting a mortgage and they lock you in before? I just for the benefit of everyone listening, can you talk about, yes, lock in, that kind of thing? What? What it takes? Etc.

Jason Rizkallah 45:38
Most companies offer a rate lock period, especially if you're moving money from, like, an employer plan, or there's some kind of transfer involved, which is what qualified money is. You know, they realize, hey, you might fill out the application, get everything today, but we're not gonna get the money for a month, because paperwork has to be submitted to that distributing company. Then the money has to be

Alex Murguia 45:57
sent over and go through the process, like high pressure. You don't want that, yeah, you don't want that either.

Jason Rizkallah 46:02
So, but, but what that rate lock period is, and what it takes to get that rate lock is very company specific. Okay, so some companies offer very generous rate lock procedures, meaning, if you fill an application today, we'll, we'll lock this in for 30 days or 60 days, or even 90 days I've seen so plenty of time, right? And submitting an application is a is telling that insurance company, yes, I want to purchase your annuity, but you could stop that at any point, you know, like you can say, I no longer want this annuity, and then cut off the application. And no money moved. You're fine, you know? I mean, so some people lock it in and then take some a month or so to make their decision on whether or not they want to keep it or not. But others, no, there is no rate lock. The rate lock happens when you when they receive the money, and then they rate lock it in, you know? So it's going to be very specific to the product in the company that you're using to purchase your annuity on what their procedure is with it on the on the fixed index annuity side, which is something that we're often comparing when we're looking at options for folks with the with the single premium immediate annuities, they're a little bit more, I should say, stable when it comes to their features. We noticed that, like the spias, can adjust daily, and sometimes do adjust daily. The FIAs fixed index annuities, they're less they move less frequent. Doesn't mean they don't move. But, you know, I don't see them moving daily, and I don't even see them moving weekly. You know, for the most part, you know, maybe this month versus next month or last month might be different. I would say as frequent as I seen, the move is about monthly. Now, they could change at any time these insurance companies, right? They can come up tomorrow and say, We're changing this and doing this, and if you don't have an app in and it's not locked in, you're subject to that change. But they're a little bit more easier to deal with, a little bit more relaxed when it comes to that rate lock and kind of keeping steady with what you're seeing in the market meaning. And what that means is, if I were to generate an illustration for for a fixed index annuity today, there's a high probability that it'll remain pretty consistent with that for the next month, you know, or something of that nature. Just to give an example, rather than I generate illustration today and tomorrow, it's different. So it's product specific, and again, carrier specific on other

Alex Murguia 48:20
logistics and the practical. Like, okay, you can make the math decision, but now you need to make the actual wet signature decision. Yeah,

Jason Rizkallah 48:30
absolutely. Now being mindful when you take either annuity option, whether it's from the pension, whether it's from a commercial, whether your plan allows for some hybrid of the two, perhaps right, like, if it's one of those unique plans that allow for a partial you know, you want to be mindful of when that income is going to be received, when you're going to start it the impact. It's going to have to, let's say, Medicare premiums, because it is income coming in, so it is going to have an impact to those other again, Wade had mentioned earlier, sometimes there are continued benefits available under your employer, but it's contingent on you taking the pension, right? So they can deduct those costs and everything directly from it and things like this. So you have to know, what are the repercussions of taking the lump sum or the outside annuity option as compared to what it is, and ask your provider that, I mean, they'll tell you, Hey, if you don't do this, this, you know, you're going to lose these things, you know, or this is what will be jeopardized as a result. So ask them, just ask the questions you know about that, what happens if I take the lump sum, you know, what does that have any impact to me? You know, with anything else I'm receiving, you know, in retirement from here, and they'll tell you if it's yes or no, you know to that

Alex Murguia 49:40
makes sense?

Wade Pfau 49:42
Great. Yeah. Thank you. Jason and Alex alluded to this before, but again, if anyone listening does have questions about pensions versus lump sum or really any aspect of retirement and financial planning, how can they best reach out and arrange to have a conversation? In with you. Jason, absolutely.

Jason Rizkallah 50:00
If you go to the McLean website, McLean Asset Management website, it's just WW, dot McLean am.com and you go to the standalone planning you can hit get started, and it will shoot a message over to me or request to speak. And then we start to communicate there. We'll schedule a time where I get introduced to you, get to know your situation and see if there's any way we can help you with these decisions at the end of the day,

Alex Murguia 50:26
what? What I would thanks Wade and Jason for that. What I would say is just because this is something we didn't realize until we started have more of a national reach, how difficult McLean is to spell. To McLean, Virginia, which is greater DC. It's Northern Virginia. It's right next to the CIA. Everyone knows Tyson's mall is like, right around there, right? And so McLean is m c, L, E, A, N. And then another thing I would have done differently 20 years ago is after McLean the you then have the initials am, so it's McLean am.com, and retrospect, yes, mistakes for me,

Wade Pfau 51:13
link in the show notes as well.

Alex Murguia 51:14
Yeah, we'll put a link in the show notes. Actually, that reminds me Wade and for our listeners, we're gearing up to the final like the quarter end push, and we wanted to lean into answering questions. We had a lot of success with that at the beginning, and it's a good, organic way to engage with folks. So what I read, what I really suggest for everyone listening in who have quite who has questions about this and other ones, please go to retirement researcher.com retirement, researcher.com forward slash ask. And we're going to have a page there where you enter your your your name, you know, your your information, and a question that way we can go through and we're going to do our best to answer every question. Obviously, some questions will be similar, I'm sure, and so we'll collapse them, but for the most part, please retirement researcher.com, forward slash, ask, and putting your question there that helps us tremendously, frankly, determining what topics. But we kind of Wade and I like just brown bagging it and doing Q and A's, we enjoyed those the last few times. So please do that as well, and know that we'll have more advisors on the show to really talk about the practical stuff on the tax planning, as Jason did with us today. So thank you very much, Jason as always, good buddy. Wait. Thank you very much for humoring me for the last uh, 50 minutes on the dot. Thank you.

Wade Pfau 52:51
Got your pin stripes. Thanks everyone for listening on retire with style. Take care.

Bob French 53:00
Wade and Alex are both principals of McLean Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tysons, Virginia. The opinions expressed in this program are for general informational and educational purposes only, and are not intended to provide specific advice or recommendations for any individual or on any specific securities to determine which investments may be appropriate for you consult your financial advisor. All investing comes with risk, including Risk of Loss past performance does not guarantee future results. You