Episode 162: Retire with Style Live (not really) Q&A: Part 6

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SUMMARY KEYWORDS
Retirement income, financial personality, pensions, annuities, safe withdrawal rate, income protection, asset allocation, risk tolerance, legacy planning, pension freeze, lump sum, annuity options, Social Security, investment strategy, financial planning.

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

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.

Briana Corbin 00:41
Retirement Planning doesn't have to keep you up at night. Wade and Alex and our guests Jason Rizkallah are here to close out our Q and A series with expert advice on pensions, annuities and aligning your financial plan with your goals.

Wade Pfau 00:56
Hi everyone. Welcome to retire with style. I'm Wade. I'm here with my trusted co host, Alex, and we're joined today as well by Jason Rizkallah who's the Director of Financial Planning and McLean asset management. And we brought Jason in today. Well, first, hello, Jason. Welcome to the show. Thank you. Thank you for having me. I'm happy to be here. Absolutely. We brought you in today because this is the Q and A episode. It's actually the final Q and A episode, but with all the defined benefit based pension questions that we received, and we thought you'd be a great person to bring in and help us answer these questions. Given your background in the Washington DC area, you're able to work with a lot of clients who do have more on the federal side, but defined benefit pensions, they're a rare bird these days, but in Washington, DC area, I think you may see those a lot more than in the nation at large. Nonetheless, we had the questions that came in, so we thought you'd be a great person to help us out answering these absolutely

Jason Rizkallah 01:52
happy to provide any insight I can.

Wade Pfau 01:56

Absolutely thank you. And this is, if you are listening to last week's episode, you may have caught wind about it being recorded around Thanksgiving. So this is actually the first episode we're recording in 2025 so happy official New Year to everyone. We have made it to the year, and we're gonna finish off this Q A session. So, Alex, yeah, before you read the first question, do you have any any new year's resolutions. To share

Alex Murguia 02:21
any new year's resolutions, I don't know. Aid. It's about the small, the small, the small, progressive steps. That makes the difference. Resolutions. No another

Wade Pfau 02:36
innovation, at least for me, with the YouTube channel for retire with style we know their comments, and I didn't really know how to figure out how to reply to those comments, but I went through yesterday and replied to a bunch of comments. So one resolution on my side is to be more active responding to questions and comments that come in on the YouTube retire with Style channel.

Alex Murguia 02:59
Wow, Jason. Did you see what he did there? How he threw in, how he threw in, like his resolution is to be a better service to the listeners of Retire with Style and the YouTube channel. Oh, my goodness, take

Wade Pfau 03:21
care of those to protect your fragile psyche. Because

Alex Murguia 03:27
Wade does a lot of suppress, suppress. He knows I can't stand it.

Wade Pfau 03:34
A comment, someone wished that the podcast would just be me providing lectures. We don't need Alex as part of this. Yeah,

Alex Murguia 03:45
I gotta tell my mom to stop writing in you know, it is what it is. Man. Hey, this is, this is our style on retirement. I may be in retirement much sooner because of my but there it is. No no. Keep up the questions. Actually we're planning on being the truth is, when we do these podcasts, we've been very surprised with how popular they've become, and we're actually going to make this a huge focus for us in 2025 I don't know. Wade, is that a good thing that I said that for some of the readers. But no, no, we're really gonna we've got some cool ideas to really promote this out. So stay tuned, both for the podcast and for the YouTube channel. Right now, the YouTube channel has just been regurgitating the podcast, but with Wade's beautiful face, and now we're there some things during the course of the year that I think are going to be quite fun, but that being the case. The matter at hand is Wade. You have to start playing pickleball, man, because when we

Wade Pfau 05:05
were talking about that in the last episode, did someone comment that's now freezing cold outside, I don't

Alex Murguia 05:13
care. You got like, you know, they've made so many advancements now in athleisure wear. Yeah, and Jason, we may like bring you out on

Jason Rizkallah 05:29
some of these. So,

Alex Murguia 05:31
all right, so let's go to the questions, right? Let me pull it up, since I'm

Wade Pfau 05:37
like, a good idea.

Alex Murguia 05:41
All right, boss, okay, here we go. My question, this is the question. My question. It's one of lump sum versus annuity, but instead, my spouse's forward 3b is either annuity or yearly distributions based upon a safe withdrawal rate. I assume it's I can do one of these two, turn it into an annuity, or take a withdrawal from a standard 401 K portfolio using a safe withdrawal rate out of best practices that they determine they being that person in Illinois, the insurance guarantee fund only protects up to a quarter million dollars per company. What considerations are critical in deciding which way to go

Wade Pfau 06:23
action. That's a great question. Well, Jason, if you want to start, I don't give you an opportunity to share your insights. Sure,

Jason Rizkallah 06:33
sure. So I guess the first part of that question deciding on whether to take an annuity or lump sum, you know, option. I mean, that's an important decision that should be looked in the larger scheme of the picture on what the best do with the asset. And also kind of folds back into our resa, which helps lead you and essentially determine which avenue might be of most comfort to you, you know, in that regard. So deciding on to take the lump sum or the annuity, it comes down to, what do you want to do with the asset? Right? Do you prefer to have a reliable income stream coming in from it that you know and can count on no matter what the market conditions are? Are you comfortable taking the lump sum, investing it, and taking distributions as you need it, maintaining optionality and freedom of choice in the future, but subjecting it to sequence of returns risk, right? It's what value do you find the most? And with your plan, that's how I would look at how to answer the first part of the question on Should I take the annuity or the lump sum option,

Wade Pfau 07:36
and in this regard to when they talk about either an annuity or yearly distributions based on a safe withdrawal rate. Every plan is different. Some plans will allow you make discretionary withdrawals. I'm not sure if that's what's being described here, or maybe they even have like a managed payout Fund, which is a mutual fund that actually, in addition to investing the assets, also defines a distribution to try to maintain a sustainable level of distribution throughout the retirement so that could go either way, but it's still the same situation, though. If you're using that

sort of managed payout fund that tries to provide a safe withdrawal rate, in addition to the investment management, you still have the sequence of returns risk. There's no particular guarantee behind that.

Jason Rizkallah 08:23
Another consideration also, they mentioned the protections, you know, afforded to two annuities. In their case, $250,000 per company for the state of Illinois. I mean, you if you ultimately went the annuity route, you know one way to help protect yourself. You know, if that event were to occur and the insurer becomes insolvent, and therefore your annuity falls under the guarantee is to spread out across different providers of annuities, you know, diversify amongst insurers and pick up a few policies. Perhaps, maybe, if you have $500,000 you pick up two, $250,000 policies, or 750 you pick up three. You know, that's a way to help diversify away and protect yourself out of layer protection in there with

Wade Pfau 09:07
different companies. Now, you probably wouldn't be able to do that inside the 403 B plan, because they may just have one company provider. But also, related to this question, in general, if you're thinking an annuity is something that you'd be interested in. You want to compare the option inside your employer plan with options you could get if you did a rollover into an IRA and then opened up to a broader universe of annuity options. Some employer plans will have very competitive deals, and especially for women, because in an employer plan you have to use the same gender pricing in women tend to live longer than men. Sometimes women, especially, can get a better deal inside of an employer plan than in the broader competitive insurance markets outside of the employer plan. But you would want to compare options inside and outside, and to your point as well, if you're going to diversify to. Keep under those limits that would probably require at least part of those assets being rolled over into an IRA to be able to do that.

Alex Murguia 10:07
Yep, agreed. The only thing to add there is, you know, Jason hit up on the market risk the you know, there is no safe withdrawal rate. I mean, sorry, Wade did that initially. Then Jason brought up the risk protections from being in the guaranteed and the like. And then Wade also added that it's always on the table, the ability to take a lump sum and turn around and, you know, transfer it into an IRA and buy an annuity from it. So you have the menu of a universal menu really available to you. The other like balance that you want to find from a sensitivity standpoint, is longevity protection for yourself, you know, the back end, you know how, how much of an aversion you have to potentially running out of money, kind of thing. And so that's something that would, you know, you would want to consider from annuity versus an investment that will be geared for withdrawal rate strategy, regardless of what vehicle it's in, it's still going to be subject to the market variations no matter what. And then with that comes the control and flexibility around each of those positions. Which one of those do you value most? And so even going back to Jason's initial point, there's many ways to get these. None of these is more inherently better than the other. It's which one is the best fit for you. And yeah, I do feel the RESA factors really play into this really well.

Jason Rizkallah 11:35

And if I can just add one thing, sometimes it's not all or nothing. Sometimes you're doing a combination of both, you're taking a portion out in purchasing an annuity, and the other portion can

Alex Murguia 11:44
be like a bond allocation or something like that. And we'll talk about that later, because that's a question that comes up towards

Wade Pfau 11:52
the end. It's with your concern for the longevity risk aversion. That's something with the RESA, the retirement income style awareness, if your styles income protection or risk wrap, that tends to also correlate with more concern about outliving your money and everything else being the same, that can make that protected lifetime income more attractive and

Alex Murguia 12:12
and I'll say this just because Wade and I haven't spoken about this in a while, and we'll probably revisit this, the RESA and the like, if you want to learn more about it, it's our assessment tool retirement income style awareness, in which it'll identify how you want to source retirement income based on your your personal preferences. I encourage you to go to retirement researcher.com and within there, I'm sure there will be a link to take the reset if you want to explore it yourself, do this complimentary so retirement researcher.com and there'll be a link in there for the RESA, and we'll also put it in the show notes. Okay, let's see here the next question. But let me, let me do this. Wait. Even though we ordered it last, it was really more because how they came in, since we did sort of socialize a little bit right now, real quick, if I have a government pension and Social Security, can I be more aggressive in retirement and be 100% stocks through my retirement? The secondary question to that is, can I count my pension as a bond?

Wade Pfau 13:21
Alex is off the grid, absolutely. Broken Arrow.

Bob French 13:25
Broken Arrow.

Wade Pfau 13:28
Yeah. I mean, I can provide a few comments there, and then Jason, if you'd like to expand as well, but it's this is about when you're thinking about asset allocation. So this is a question like, should I be 100% stocks? You need to consider your risk tolerance, which is your ability to stomach short term market volatility, and then your risk capacity, which is, how much risk can you bear that without really disrupting your lifestyle, like, if there's a market downturn, would it negatively impact your standard of living in retirement? And this idea of being expressed here about if I have a government pension and Social Security, and I think the kind of implied reading between the lines this person may have enough reliable income to meet their essential expenses in retirement. So can I be more aggressive in retirement and potentially be 100% stocks, not my retirement and on the risk capacity side, yes, if your lifestyle not vulnerable to a market downturn because you have all this reliable income, your capacity tells you you could invest more aggressively. Now, whether you can stomach that is a separate consideration, but so I mean answering from the quantitative side, yes, risk capacity says you can invest more

aggressively. But Jason on the personal side, or the risk tolerance side, what kind of considerations would you add there?

Jason Rizkallah 14:46
Well, it oftentimes, when we when we come across a case where somebody does have sufficient, or sometimes in not so many cases, but more than enough reliable income to cover their essential expenses. So. Yeah, you know, we it can afford them the ability to be more aggressive on the investment side, because there's less reliance, or in some cases, no reliance, on a certain rate of return and on their assets providing the spending power, you know, throughout retirement. But it just because they could that just kind of touches on what you said wage should they right? There's a there's a difference between the could and the should in this case. And I mean, nobody is going to know your own personal you know how much risk you're willing to or can absorb, or willing to absorb, but you you know more than anybody else, because you've been investing your entire life and know what you can stomach and what you can't. Well,

Alex Murguia 15:36
Jason yassoway really is up to date on Wade's preferences. Wade, right? Doesn't she know like immediately, what your where your line is?

Wade Pfau 15:52
Maybe it's tolerance line, yeah,

Alex Murguia 15:54
yes, tolerance line, immediately,

Jason Rizkallah 15:59
but, but yeah, so could you be 100% stock Sure? Should you be that? That's a question that it needs to be answered and determined. And, you know, I mean, we can put out all the numbers that can say, Yeah, sure you can. You can be that way. But again, are you know only you're gonna really know, or you can only be able to stick with that strategy through good times and bad

Bob French 16:18
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Wade Pfau 16:44
If your income protection, the idea is, first you build a Florida protected, reliable income, and then you invest on top of that for discretionary goals, the diversified investment portfolio. And so you can have that bifurcation in terms of, yes, I've got my expenses covered, so the remain, even if I'm income protection, if I've got my income protected, those discretionary investment assets have the capacity to to be invested. And

Jason Rizkallah 17:13

another consideration is that you know, ultimately, if that's the case, are you looking at it more like a legacy? You know that you're leaving behind, and therefore, you know you're trying to maximize that legacy. That legacy. Okay, you know that can, that could be a valid point to be more aggressive in your investments too,

Alex Murguia 17:28
as well. Yeah, I'll flip it like this. What I what I don't subscribe to. I subscribe to everything you, you folks said right there. And you know what you're getting at, too, is the every fighter has a plan until they've been punched, you know, kind of thing. But what I don't subscribe to is, hey, I look at this chart, there. None of those apply. It's just a normal person, you know, has a $2 million portfolio and that's it, and they're going to take distributions from that, and they decide, I'm going to take 100 I'm going to do it 100% equity, because, technically, that would give you more growth, and because this is a portfolio for the next 35 years, not for the next 10 years, I believe over the long term, I'm fine. I think that's a flawed that not flawed because that's a tough thing. That's a tenuous thought process. You know that that may not hold up simply because the whole purpose is you have human capital to withstand spending shocks and things like that, while you're working. When you're retired, it's all your investment portfolio. So you don't know how those vagaries, vagaries will land, you know, early in retirement, and then you're up the creek, if you will, without a paddle. You know, when you when you can't afford that? And so I don't think you know it makes sense in those situations, simply because, oh, if I look at the Excel, I'm gonna be fine because over 30 years. But no, not when you're actively taking money from it, and you're not, you don't have that, that cushion like Wade was alluded to earlier from a financial capacity standpoint, then I don't think it makes much much sense,

Jason Rizkallah 19:01
and if I can add something just on that, Alex, actually, you know, when I work with clients in their financial planning engagements, one of the stress tests that we perform is like a 20% immediate market decline occurring, right? And more times than not, that takes a plan that that can that puts a lot of pressure on it, and then lessens the success rate down to an uncomfortable level. Yeah, when you see that number, it's like, wow. What

Alex Murguia 19:29
for a way to expand upon but I think we get too caught up in trying to maximize the Excel sheet upon death, upon death, so absent some sort of legacy position, which could be handled in many ways beyond just the investment portfolio, right? But let's just absent something like that. I haven't seen, you know, even you take Wade's book, where he kind of tried to do a battle of the bands on withdrawal rates and allocations and all that stuff, and see who wins. But. But there is not as much of a upside, I think, in my own economic analysis, between like a 70% equity portfolio for versus a 50% equity portfolio, when you're determining withdrawal rates, it's kind of more or less going to have very similar sustainable withdrawal rates. I'm not so sure it's worth the extra calories, if you will. I'm saying that in a roundabout way, but Wade Do you? What are your thoughts?

Wade Pfau 20:31
Yeah, it's so in terms of the safe withdrawal rate from an investment portfolio, there's a lot of evidence indicating the asset allocation if you're anywhere from, say, 35 to 80% stocks, it doesn't make a whole lot of difference. It can be a little bit less at either lower or higher stock

allocations, but it's all about the upside or the legacy at that point. So you're not worse off potentially, but you could be better off with the higher stock allocation

Alex Murguia 20:58
from a legacy sample. But if you're worried about anything and you're looking to mitigate your hassle, you know, as you age, you know, that kind of thing, you got to ask yourself, is the juice worth? Worth the squeeze here?

Wade Pfau 21:11
Right? Yeah, if legacy is not maximizing, legacy is not a primary consideration, you may sleep better at night with the and

Alex Murguia 21:20
I have to say, for many clients, unless you're talking with, like foundations, you know, somebody that you know you're talking like they're gonna I want to say 15 million plus kind of thing, right? It's weird, but a lot of folks are just, hey, look, I'm worried about my income. Whatever's left over for the kids or another generation is gravy. But that's not the main driver. That kind of thing. That's usually what I see, what I hear, Jason, you're, you're, you have feet. Your feet are on the ground. Much point in our careers? You want to disabuse me of that notion, or is that completely accurate?

Jason Rizkallah 21:55
You know, when I ask folks about their legacy plans, the majority, the vast majority of the time, is, hey, it's whatever's left over. I want to get through retirement, you know, and make sure that's successful first. Okay,

Alex Murguia 22:07
so there it is. So then the follow up to that question is, can I count my pension as a bond? And again, the reason I called an audible to begin with was because you had thrown in the pension, you know, the lump sum or pension, and you said you could do both, you know, that kind of thing. So it made me think we have that question. So let's just, you know, we're in that train of thought, can I count my pension as a bond? Wade,

Wade Pfau 22:32
yeah, I like to think of pensions and Social Security as bonds. Now they're not true bonds. In a sense, you can't rebalance in and out of your pension. Be defined benefit pension, and also you don't have the liquidity to draw from the future pension amounts to spend them today. But otherwise it behaves like a bond in terms of providing quote, unquote coupon payment your monthly pension benefit for as long as you live in a relatively safe and reliable manner. So in that regard, I do think you can in the funded ratio, there's a present value that pension, and I do think you can consider that as part of the bond allocation, which from an overall household balance sheet perspective, it's part of the same story of that would allow you to invest more aggressively with other assets in the investment portfolio, if you'd like, to

Alex Murguia 23:24
Jason, when you do this in a financial plan that you're presenting, you know, off of a funded racial result, and you sort of talk about this dynamic when their portfolio is going to include

components of investments and also insurance. How is that received? When you sort of say, well, you have this, you can be a little more aggressive with this,

Jason Rizkallah 23:46
sure so when we're making an asset allocation recommendation, that is all taken into account, right? So oftentimes, if there is a high degree of reliable income, or, you know, a decent amount, I should guess, I should say, and reliable

Alex Murguia 24:01
income is defined as contractual income, not paying stocks. I was gonna cut you mean specifically, like contractual income, okay, yeah, guaranteed income, not like rental income, or something like that, sure.

Jason Rizkallah 24:18
And so oftentimes we will increase the equity allocation as a result of having that, that reliable income, whether it's still a pension, whether it's through an annuity, you know, whatever it is that is generating it, a reverse mortgage, you know, even an example, could warrant an additional equity allocation. Then what you would normally invest in, should those, those income sources, not be there, you know. So it does affect, you know, ultimately, the the recommendations that we make to individuals on their asset allocation,

Alex Murguia 24:47
perfect. Okay, all right. So next question, drumroll please. If we agree on the 4% rule, that's a big that's a big ask,

Jason Rizkallah 24:58
cut it off right there. No, I.

Alex Murguia 25:02
If we agree on life on Mars right now, if we agree on the 4% rule, would you value a pension of 40,000 a year equal to a million dollars in an IRA, assuming the 40,000 increases with inflation? I

Wade Pfau 25:23
And the basic answer is yes. The if you wanted to spend $40,000 a year plus inflation, and you need, and you believe in the 4% really, you would need a million dollars to be able to fund that distribution so you could, quote, unquote, value it at that level. It's not quite the same as a present value because it has particular assumptions. Though, the 4% rule is based on you need a 1.3% real rate of return, assuming you have a 30 year time horizon in retirement. That's kind of what went into making up the 4% rule in the first place. So if your discount rate was 1.3% real, your time horizon was 30 years, then the present value of $40,000 a year plus inflation would be a million dollars. Now, if you actually price that out based actually, interest rates are higher than that, the tips yields are in the two and a half percent real range right now. So the it doesn't take a million dollars to fund $40,000 a year for 30 years. So actually, the present value could even be less than a million but I had simply yes, if you believe in the 4% rule, you could value a pension. Now, there's not a lot of pensions that give you the CPI adjustments, but if you had one paying $40,000 a year plus inflation, yeah, you can value it at a million dollars.

Alex Murguia 26:42
Jason, with that thought process, I'm thinking of the concept now of liquidity, weight, technical liquidity and true liquidity. For those of you scoring a home, we define technical liquidity as, okay, you have a million dollars, and you're going to take $40,000 a year, but that million dollars is earmarked for that 40,000 so it's not available for like, a kitchen remodeling, or anything like that, or, oh my God, I need a new car. That's true liquidity. Sorry, yeah, sorry. My bad, my bad. True liquidity. Technical liquidity is the fact that, sure it's liquid and you could execute the trade, but it's technically liquid, but you shouldn't be doing it. You know, that kind of thing. How do you do? You does this come up at all in your conversations with clients, where we do determine a safe withdrawal rate, because we are agnostic. You know, Jason is a advisor at McLean, and people get the RESA and if their total return, that's what we present, if you will, I would say a majority of our firm is that. And so does that concept play where you're saying, Okay, we're taking this distribution from the portfolio, but this is for distributions. How good are folks about leaving that money alone for distributions, as opposed to calling you for one off things, and they just use that pot of money, because it's very enticing to see, oh, there's $2,300,000 here. So of course, I can take 50,000 and payment on a car or something like that.

Jason Rizkallah 28:11
Yeah, I will tell I will say that the majority of folks are, are not good at making that distinction between those two. And what I mean by that is, let's say they say, okay, my portfolio is generating, you know, my Million Dollar Portfolio is generating 3% in dividends. So that's $30,000 a year in income, right? That I have coming in. Again, it's not being classified appropriately, but this is how typical investors look at it. And then they say, and I still have my million dollars there. But that's not how it works, right? Because if you have to then take money from that million dollars at 30,000 goes down. It decreases. Because now you don't have the million generating the 3% dividend anymore,

Alex Murguia 28:55
withdrawal increases exactly, but something, it's something getting tweaked exactly,

Jason Rizkallah 29:01
and so both sides are not there. You know, you kind of have to look at it one way or the other. I'm using this million to generate this 30,000 in income, and as long as I want that 30,000 income, I have to make sure a million stays there, right for that,

Bob French 29:14
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Bob French 29:29
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Alex Murguia 29:42

But what's the client reaction when these conversations happen and you submit it to them, is that, like, oh, I never thought of it that way. Or is that? Or is that? Like, I don't care, an extra percent this year, I more than make up for it. So let's, let's just stick with it. It

Jason Rizkallah 29:56
goes both ways. There's there's both sides occur. Whether they say, Oh, wow, yeah, I never did think of it that way. No, it's a good point or whatever. I'll roll with it, you know, type of thing. So it can happen either way. There's not one that favors the other.

Alex Murguia 30:11
Okay? I mean, at the end of the day, it's about capacity, right? How much does that reduce the probability of success for the plan, etc? I was just curious, anecdotally, what, what the reaction is when you convey this concept,

Jason Rizkallah 30:23
I'll tell you what, what we what we look at for folks, is one we as, as Alex even mentioned earlier, right? We don't consider dividends to be reliable income, right? So we take a total return approach, when we're looking at things, and say, okay, returns plus dividends equals this is going to be your growth, and that's what we're factoring in. And so, you know, we don't rely on dividends because they're not reliable, yeah,

Alex Murguia 30:44
or they're, they're more arbitrary on the company. It's just part of the total return. That's just part of the total return. It's a component, let me I guess, better say, okay, wait anything to add before the next question?

Wade Pfau 30:57
No, think we got that one covered. Excellent,

Alex Murguia 31:00
excellent. All right. Are there any addition? This is a two parter, so just bear with me. Are there any additional things to keep in mind, if your pension has been taken over by the PBGC, and

Wade Pfau 31:18
then there's another benefit guarantee corporation. There

Alex Murguia 31:20
you go, pension benefit guarantee corporation. I'll let, let's answer this one, and then we'll get to the second part of that one later. Fire, wage. Wade,

Wade Pfau 31:33
yes, there are things to think about you want to understand how your pension might change based on the rules that the pension benefit guarantee corporation uses, and they're the backstop to for private pensions. The employers pay into the insurance fund, and then if the employer is not able to pay the pension, it can be moved over. And the pension benefit guarantee corporation will cover up to certain levels, and they have a number of different rules. So different aspects, you may not have the cola anymore. If you have a large enough pension, you may not get the full pension. There may be different rules around if you claim early, you

might have less guaranteed pension through them than otherwise. So you can't necessarily game staying under some sort of maximum pension limit by just claiming at a younger age or something like that. You do want to make sure that you understand fully how the pension benefit guarantee corporation understands the rules of the pension you have and and what kind of benefit they would give you based on on how you claim under those rules. Okay,

Alex Murguia 32:44
let me just see my note. I have some notes here to think about. Yeah, some of the things that could be planned specific that they may not honor would be like the maybe your pension at cost of living adjustments, maybe there were early retirement subsidies, maybe there were certain other benefits. Those things are most likely going to be out the window when they reorg, since they're just concerned about, you know, giving you the income. And that's that, you know, from that standpoint. The other piece is the timing of the payments. They need to determine what the payment will actually be based on the new level set that they make. So there could be a little bit of time you'll be receiving payments, but you may not be knowing what this payment is going to be. The payment may not be finalized. May say like that for a while, until all of that stuff is figured out. So there's a little bit of amorphous direction, until that's that's more crystallized, and that could be unnerving. I would imagine, especially if you're trying to plan 1015, 20 years out. All right, then the second parter was, my pension does not allow taking a lump sum. It allows the annuity to start at any age after 55 but each year you wait, the annuity grows by around 8% I assume then that the good option is to wait as long as possible to start the annuity, since I guaranteed 8% would be difficult to beat, plus that would allow me time to read Wade's book. I parentheses, what are you talking about? You need, like, five years for that thing. Man, no, why don't you take it away?

Wade Pfau 34:43
Yeah, I could start with that one. And yeah, I mean, if your pension is going to increase, the monthly amount increases by 8% for each year that you delay that actually, it's very similar to what Social Security is doing where for between ages 62 and 70, i. Yeah, you get about an 8% increase. Now the question did express it, making it sound like that's an 8% guaranteed rate of return. I'm not sure if that's what the question intended, but to be clear, if your pension increases by 8% when you delay for a year, that's not an 8% investment return. You don't know the investment return you ultimately get until you know how long you live and how many payments you received to calculate the internal rate of return off of that. Nonetheless, an 8% increase for each year you wait is pretty attractive, so it does help boost the final return that you'll get if you do live a reasonable length of time into retirement. So I don't know. It seems unlikely that this 8% simply goes on forever, at some point you will want to claim but Yeah, certainly, I think you're thinking about the right way in terms of, you may want to delay for a while, but you also do want to understand, like we were talking about with the first part of this question, how does that 8% annual increase relate to what the pension benefit guarantee corporation has in mind for that 8% annual increase. There may be limits, or they may do that differently, or you might end up getting capped out on how much pension you can get. So just

Alex Murguia 36:14
make sure you understand you're gonna get. I would think you're gonna get capped

Wade Pfau 36:19
out to make sure you understand what they're going to do and how that would impact

Alex Murguia 36:23
but absent of the first part of the question, that's the mindset of how you would deal with that, you know, independent of, you know, a pension takeover, if you if you're faced with that decision, you'd have to look into that. I mean, some things you want to look into similar things that you would make with Social Security. Is your life expectancy? Do you have a medical condition, a chronic medical condition right now that that you get the sense that you're not going to be you're really not going to live till your 90s, early 90s, and then it's, what's the break even for waiting for not quality of life, etc. So there's, there's just non Excel factors to consider behind that, in addition to other income needs. I mean, sometimes, you know, people are very flipping about you have to delay Social Security. If not, you're an idiot, right? But the reality is, sometimes people have income needs right now that are current, and there's, you know, would we recommend taking the loan for the short term, so you can delay Social Security, you know, probably not you know, from that matter. So there's other things to take into consideration. Let's see here. Thanks for the episode on pensions. Mine was frozen in 2008 I retired from that company in 2015 age 52 after this episode, I realized I should have considered the lump sum in parentheses, $350,000 invested it and then bought an just invested and then bought an annuity. While at 52 I was happy with total return, I believe that a 70 plus year old, or for my widow, that safety first is best. So my question is, how to consider a pension that is frozen, and then do I do? It sounds like lump sum now or lifetime pension payment at a future date? I think real quick, what is a frozen pension? And then we can get into the the dynamic here. And for me, I'll answer it, and then you guys can get into it. A frozen pension is effectively a pension that stopped accruing benefits, you know? And so this person earned earned benefits up until the freeze and, oh, eight when it was locked in. And there are no new amounts being added based on salary or whatnot. For in general, that's what, when someone says a frozen pension. That's the thinking that goes through my mind. Now, uh, lump sum. Now pay. Now that being the case, frozen or not, lump sum or not, or take it all in kind or whatever. I think that's Risa related, but Wade, take it away.

Wade Pfau 39:06
Yeah, yeah. Well, you need to understand what the freezing does to the pension benefit, because historically, a lot of pensions were kind of created to motivate people staying at the same company over their lifetime, so that they would really reward you for having a long term of service, and if you have a shorter term of service, the pension might be somewhat paltry or minimal. Now, with it being frozen, that makes it look like you did not have a lengthy time of service. Do they compensate for the fact that they're freezing it? Maybe they do adjust the benefits compared to what they would have been. But this is back to that pension versus lump sum type of question that we were addressing at the beginning. What is the if you took the lump sum and purchased a deferred income annuity that would begin payments at the same date as the pension with that amount be more or less than the defined benefit pension? Uh, amount that you would receive, and that would just be sort of step one of thinking about, Do I want to take the lump sum versus waiting for that defined benefit pension?

Alex Murguia 40:15
Wait and Jason, to me, it stands to reason that of a pension is being frozen. There could be other corporate reasons for it, but that doesn't, that doesn't send me, that doesn't fill me up with a warm feeling about the prospects of the company that I, you know, that I would, I would even want to then take the pension instead of a lump sum for the next 30 years. Yeah. I mean, if they

already, like have quote, unquote issues. There could be many reasons why that are not necessarily danger zones, but they Yeah, it doesn't give me a good vibe.

Jason Rizkallah 40:51
Doesn't give you the warm and fuzzies.

Wade Pfau 40:55
Yeah. A lot of companies closed off the pensions to new employees, but they let the previous employees continue. So actually taking the step of freezing it is a stronger version of taking away the defined benefit pension. For

Alex Murguia 41:09
sure, it's just letting it sunset. So what they're doing is effectively just letting something like that sunset without being, you know, very onerous about it. All right, that's the pension question. Let me see here.

Wade Pfau 41:26
Oh, and that point about like saying that when I was younger, total returns made more sense. But as I get older, safety first or any on the safety first side might be better. It's not necessarily that your style changes. You might have been income protection your whole life. It's just when you're younger and further away from retirement, you're not purchasing reliable income at younger ages, necessarily. So it looks you may look like your total return in terms of your investment strategy, and it's as you get close to retirement that you actually put into place your income protection. I'm sorry, go

Alex Murguia 42:00
Jason. Oh, just that's very

Jason Rizkallah 42:02
common when we're, you know, looking at retirement plans for folks that retire at a relatively young age, it's, Hey, this, this is a good solution for you. Just not right now, right? Something for a future date. I

Alex Murguia 42:15
can't stress enough, though, for this person that I think they probably were income protection. They just didn't know it. Because the reality is, they took a job that had a pension, right? And when you do that, what you're implicitly accepting, and this is not bad or good, it's just what you're implicitly accepting is, I am going to probably cap my salary a little bit in exchange to have this pension. Why do I say that? Because usually you're not gonna see, like, VCs don't have pensions in there. I mean, like, high growth, high, or, you know, you know, high, high, extremely high ceiling salaries usually don't come with a pension, if you will, because the riskier this or that. And so I think this person implicitly took some sort of position that you could probably earn a salary that provides a nice standard of living, but probably nothing that's, you know, that's in the realm of, you know, craziness. Let me say it like that, and you do that because you're getting the stability of a pension. So I would say they were probably doing that along the way, implicitly, but that's, you know, that's my thing. Next question, I have a federal pension, and I must pay and I must put four and a half percent of myself, 4.4% of my salary, into it. Can I count that 4.4% towards my savings rate? Why? Or why not? Jason,

Jason Rizkallah 43:41
I mean, I would say yes, you can count it towards that, because it is money that you are saving. I mean, you're getting paid, you're tucking it away into a savings vehicle. So in my opinion, it can be viewed as a part of your overall savings, you know, for that. And also, I mean, when you're looking at like retirement, right, that's one expense that actually gets cut, right? If you I put that in quotes, because it's not, obviously it's a savings, not an expense, but you're no longer saving for retirement when you go into retirement. Now, you're using your assets. So in my opinion, it would be considered part of a savings rate.

Wade Pfau 44:16
Wait, yeah, yeah, you're building up a pension asset that will have a present value we talked about earlier in the episode. So it's an asset on your household balance sheet. There's a couple caveats. You just you don't have liquidity for those savings. And you'd want to consider, are you getting, like, a good money's worth? Like, is the pension amount consider reasonable relative to what you might obtain, having invested those funds on your own, but yeah, those are minor caveats, but otherwise, yes, you're building up an asset that will support retirement expenses, so it's part of your savings. So yes, you can count that as part of your savings, and

Alex Murguia 44:55
it's almost more consistent, if you will, because. As consistent as a trick, or it's there's a benefit to having it come in the form of a pension too, as opposed to if it was just a regular savings account. So it's almost like Savings Plus, if you will, at least from my vantage point, absent the comparison to a market portfolio or something like that. But I think your point is true about the liquidity piece. If you're doing this while you're you know you're working years, you want to make sure you're not susceptible to some sort of spending shock in which you don't have accessible cash, because you just push all your chips into something that could potentially be liquid and that can turn around and bite you sometimes later on, yeah,

Jason Rizkallah 45:38
like if you were to only be able to save 4.4% a year of your salary. I don't know if I would put the entire amount into that pension, right? Maybe you do half of it, and the other half you're saving in a different vehicle that allows you liquidity or or access to it. Well,

Wade Pfau 45:55
it sounds like this is required, but you would want to try to have an emergency fund or other savings, which

Alex Murguia 46:03
what you're getting at Jason at the end of the day. So yeah, and that's from a planning perspective, all right, if I have a government pension and Social Security? Oh, you. Oh yeah, yeah. I teleported. I waited, that's it. We got all the questions covered. It. There we go. All right, everyone? Jason, anything

Jason Rizkallah 46:32
to say? No. I mean, these are, these are great questions, taking the pension, or taking a lump sum, taking a payment, you know, option. I mean, these are all important decisions to make, and again, you know, I said it in the very beginning, but it's worth reiterating is they should be

made in the bigger context of your overall financial plan, right? Not, not a decision made in isolation, in and of itself, and that way, it can help lead you to what is ultimately the best decision that I'm comfortable with, and that works out best for me, you know, for what I have planned for retirement. So just keep that in mind when you're making these decisions. That you want to take a look at your big picture. You know when you're when you're ultimately determining which way

Alex Murguia 47:07
to go? Okay? And thank you everyone. I hope everyone took away one or two nuggets here that they can apply. And if you have questions from these, put them in the comments. We release these on YouTube as well. And so put them in the comments. As I said, we're we're attempting to be significantly more active here, so have at it.

Wade Pfau 47:29
Wade. Yeah, thanks everyone.

Jason Rizkallah 47:31
Thank you guys for allowing me to join. Thank you. Thank you,

Wade Pfau 47:35
Jason. We'll catch you next time on retire with style. Take care, everyone.

Bob French 47:42
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