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BAILEY FINANCIAL GROUP

OF OXFORD HARRIMAN & CO.

LUMP SUM MISTAKE

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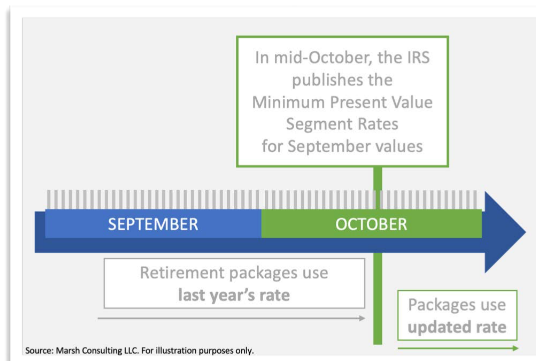
Thinking about the lump sum? 3 do's and 1 don't

Fall may be the season of pumpkin spice lattes for some people, but for others it's the season of "lump sum retirement" conversations – that time of year when employers with defined-benefit retirement plans are updating their official present value interest rate, potentially changing the value of employee retirement packages by thousands of dollars instantaneously. It's about as much excitement as an interest rate can generate.

The retirement package represents one of the biggest financial decisions of an employee's life, for people whose employer offers such an option, so this lump-sum value change is understandably big news. We work with clients on this decision every single year, so we want to take a minute to talk through the three biggest considerations that we think would-be retirees should keep in mind – and the mistake they should look to avoid!



Do: Get your arms around the timeline.

First, you have to understand the timeline of these events. The interest rate update for 2024 is based on the average daily values of the September 2023 readings for the IRS's Minimum Present Value Segment Rates.[1] These will be published in mid-October of 2023. Until then, retirement package values are based on the September 2022 value.

This year's official interest rate is expected to be slightly higher than last year's, so lump-sum values are expected to go down somewhat (there is an inverse relationship).

If you are hoping to lock in 2022's rate for a lump-sum retirement package, in other words, you often have until mid-October to request your retirement package.

[1] https://www.irs.gov/retirement-plans/minimum-present-value-segment-rates (PM/CAR#-04022025-5989701.1.1)

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Do: Make sure you know why you are NOT among the 90% who should consider taking the annuity.

"… for most people, the annuity is the best option. When people take a lump sum, they immediately face a problem: what do I invest this in and how do I turn this into lifetime income?…"

When you read about financial options, you'll always see both sides – here are the pros and cons of each option. You'll also hear the lore of that one retiree who struck gold with the greatest lump sum deal of all time! It can be very difficult to anchor your expectations about what's appropriate for *most* people and for *this* kind of investment market.

Here's our wealth planning opinion: for most people, the annuity is the best option. When people take a lump sum, they immediately face a problem: what do I invest this in and how do I turn this into lifetime income? Those who have an employer with a defined-benefit plan are actually given that option in the form of a lifetime annuity! Taking the lump sum is just a way of creating a new problem for which they were previously given a solution.

The monthly annuity also gives most people a lot of comfort. They can start to make their plans and look at their lifestyle with a level of security. They can only get themselves into "trouble" a month at a time. It's a way of life that is just like planning around a paycheck. Retirement introduces all kinds of other changes to people's lives, and the continuity of cash flow is something that many people really value.

"… The monthly annuity also gives most people a lot of comfort. They can start to make their plans and look at their lifestyle with a level of security…"

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Now, remember that we are an investment team. It's actually in our interest to tell people to take lump sums so we can make money investing it for them! But we do not believe the lump sum is the best choice for *most* people. So if you are seriously considering a lump sum package, think very carefully about why your circumstances warrant a different choice than most people.

You can also consider an option that offers a combination of lump sum/lifetime income. That may be the best of both worlds, if there is a good reason for you to pursue a lump sum but the lifetime income also appeals to you.

"do not rush into taking a lump sum just because there is a lot of chatter at work about the lump sum value being at a peak and a window of opportunity closing."

Do: If you are a 'lump sum candidate,' think about how the timing works for you.

If you are still convinced that a lump sum is right for you, then you need to think about the timing. If you are absolutely sure that you are retiring in the next few months, the upcoming interest rate change really does have an impact on your decision. You could capture a higher lump sum by locking in your retirement package before the rate change takes effect in mid-October.

In this case, it may make sense to make use of the cancellation option. It's possible to file retirement paperwork now to lock in the 2022 rate – but you can generally cancel as late as five business days before your actual retirement start date, if you later decide not to retire then after all.

"…the upcoming interest rate change really does have an impact on your decision"

However, if you take that cancellation-option route, be sure to confirm the cancellation policy in writing with your HR team when you file.

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Don't: Take a lump sum of regret.

No matter what, do not rush into taking a lump sum just because there is a lot of chatter at work about the lump sum value being at a peak and a window of opportunity closing.

"do not rush into taking a lump sum just because there is a lot of chatter at work about the lump sum value being at a peak and a window of opportunity closing."

Think of the housing market. If someone told you your house was at peak value, sure, you might gain something from selling it right this second – but you would also be left without a place to live and a host of new problems to solve.

Last year's interest rate change was a huge jump. From 2021 to 2022, the IRS Segment Rate went from 2.1% to 4.94%.[2] and that change had an especially large impact on lump-sum retirement packages. The 2023 update will probably see the IRS Segment Rate climbing again, up into the mid-5% range, and that will pressure lump-sum packages downward again.

But that is just one of many factors going into retirement decisions. Next year, interest rates could be even higher – or they might be lower! Both options are feasible. If you are considering working one more year, you may see a scenario where you have accumulated another year of benefits plus you see a gain from a better Segment Rate

Thinking about your situation? Call us.

Call us anytime to discuss your own financial picture, including retirement and other big financial decisions you may be considering.

~Ginger Baker.

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[2] https://www.irs.gov/retirement-plans/minimum-present-value-segment-rates (PM-04122025-6017488.1.1)