



# Financial Concepts Inc.

"Wealth Management"

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Tune in to Jeffrey's podcast, *Financial Focus*, by visiting  
<http://financialconceptsmesquite.com/podcast/>

## INGREDIENTS

- 2 cups whole milk
- 2 cups heavy cream
- 1 cup white sugar
- ¼ teaspoon salt
- 2 teaspoons vanilla extract
- 2 cups mashed fresh strawberries
- 2 drops red food coloring (Optional)

## DIRECTIONS

1. | In a large bowl, combine the milk, cream, sugar, salt, vanilla, strawberries, and food coloring.
2. | Pour the mixture into the freezer bowl of an ice cream maker, and freeze according to manufacturer's directions.

<https://www.allrecipes.com/recipe/140877/easy-eggless-strawberry-ice-cream/>

STRAWBERRY ICE CREAM



Jeffrey Bird-RICP®

# Financial Focus

A Monthly Insight Into Your Finances

July 2021

## Pension or Lump Sum: Which Should You Choose?

Traditional pensions, which promise lifetime income payments in retirement, have become less common in the private sector, with only about 10% of workers currently participating in a traditional pension plan. However, pensions are still widely offered in federal, state and local government employment, and 61% of workers expect a pension to be a major or minor source of retirement income.<sup>1</sup>

About half of pension plan participants can choose to take their money in a lump sum when they retire.<sup>2</sup> In addition, companies may offer pension buyouts to vested former employees who are working elsewhere, and even to retirees who are already receiving pension payments.

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## Fruit Fit For A King

The pineapple made its way to England in the 17th century and by the 18th century, being seen with one was an instant indicator of wealth — a single pineapple could cost the equivalent of \$8,000 today. In fact, the fruit was so desirable and rare that consumers often rented a pineapple for the night to show off to fellow party-goers.

<https://www.foodbeast.com/news/till-people-used-to-rent-pineapples/>

# PENION OR LUMP SUM ...

By shrinking the size of a pension plan, the company can reduce the associated risks and costs, and limit the impact of future retirement obligations on current financial performance. However, what's good for a corporation's bottom line may or may not be in the best interests of plan participants and their families.

## A Critical Decision

For many workers, there are clear mathematical and psychological advantages to keeping the pension. However, a lump sum could provide financial flexibility that may benefit some families. The prospect of a large check might be tempting, but cashing out a pension could have costly repercussions for your retirement. One study found that one out of five people who took a lump sum depleted the money within five and a half years, and an additional 35% were concerned that the money would run out.<sup>3</sup>

Given the risks, it's important to have a long-term perspective and consider the following factors when a sizable lump-sum offer is on the table.

## Terms of the Offer

The amount of a lump sum is based on the discounted present value of an employee's future pension, set by the IRS formula based on current bond interest rates and average life expectancies. Keep in mind that a pension's lifetime income may be more valuable for women than for men because women tend to live longer, but gender is not considered when calculating lump sums. In addition, companies may not include the value of subsidies for early retirement or spousal benefits in their buyout offers, the latter of which could be a major disadvantage for married couples.

## Taxes and Potential Penalties

Pension payments (monthly or lump sum) are taxed in the year in which they are received. Cashing out a pension before age 59½ may trigger a 10% federal income tax penalty, unless the lump sum is rolled into an IRA or to an employer-sponsored retirement plan (if allowed), which postpones taxes until withdrawals taken prior to age 59½ are subject to the 10% federal income tax penalty, with certain exceptions. Annual minimum distributions are required starting at age 72 (70½ if born before July 1, 1949).

## Financial Resources

A lump sum might be helpful for someone with little cash in the bank for emergencies or with debts to pay off. Those who are able to live comfortably on other sources of retirement income might also benefit from a lump sum.

## Risk Tolerance

A lump-sum payout transfers the risk from the pension plan sponsor to the participant. Individuals who opt for a lump sum must then manage that money and determine for themselves how much risk to take in the financial markets. Often the amount is not enough to replace the pension income given up, unless the investor can tolerate exposure to stock market risk and is able to achieve equivalent returns over time.

## Health Status

A lump-sum payment might make sense for a participant with potentially life-threatening medical issues, because pension payments end when the plan participant (or a surviving spouse) dies. Money held in an IRA could be withdrawn and spent as needed on health-related costs and/or custodial care. Any IRA funds that are preserved can be passed down to heirs.

## Pension's Prospects

A pension plan's "funded status" is a measure of its assets and liabilities that must be reported annually; a plan funded at 80% or less may be struggling. Most pensions are backstopped by the Pension Benefit Guaranty Corporation (PBGC), but retirees could lose a portion of the "promised" benefits if their plan fails. For single-employer plans, which are most common, the PBGC annual maximum is \$69,750. However, for a multi-employer plan (created between employers and a union), the guarantee is much lower at \$12,870.<sup>2</sup>

1) [https://www.ebri.org/docs/default-source/rcs/2020-rcs/2020-rcs-summary-report.pdf?sfvrsn=84bc3d2f\\_7](https://www.ebri.org/docs/default-source/rcs/2020-rcs/2020-rcs-summary-report.pdf?sfvrsn=84bc3d2f_7)

2) <https://www.kiplinger.com/retirement/annuities/601077/pension-or-lump-sum-compare-payouts-and-options-before-you-decide>

3) <https://www.aarp.org/retirement/planning-for-retirement/info-2020/monthly-pension-vs-lump-sum-payout.html>

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# A Backup Plan for Your Paycheck

Your ability to earn a paycheck may be your most valuable asset. In a 2020 survey, two out of three people said it would take six months or less for their household to face a financial impact if the primary wage earner became disabled. Half said they would use their personal savings, and many would have to ask for help from their families, take out loans, or tap retirement accounts.<sup>1</sup>

Social Security offers some disability protection, but qualifying is difficult — only one out of three applications is approved — and it typically takes three to five months for initial approval and longer for an appeal.<sup>2</sup> The average monthly Social Security Disability Insurance payment of \$1,278 would not meet the needs of most families.<sup>3</sup>

## Portable Individual Coverage

If you're concerned about the potential effect of losing your paycheck due to sickness or injury, you might consider an individual disability income insurance policy. Your employer may offer long-term disability coverage, but group plans typically don't replace as large a percentage of income as an individual plan could, and benefits from employer-paid plans are taxable to the employee if the premiums were paid by the employer. Of course, if you change jobs, you might lose your subsidized employer-based coverage.

An individual disability income insurance policy could help replace a percentage of your income, up to the policy limits, if you're unable to work due to illness or an injury. Benefits may be paid for a specified number of years or until you reach retirement age. If you pay the premiums yourself with after-tax dollars, benefits are usually free of income tax. An individual policy will stay in force regardless of your employment situation as long as you pay the premiums.

## Customizing Coverage

Unlike group policies, an individual policy can generally be customized to meet your specific needs. Here are some common riders. All benefits are up to the policy limits.

**Residual benefits.** May help replace lost earnings after you return to work part-time or at a lower-paying job.

**Own occupation.** Determines a disability by your inability to perform the duties of your specific occupation or profession, as opposed to being unable to work in any occupation.

**Automatic benefit enhancement.** Provides an annual benefit increase each year for a predetermined period of years to help keep up with increased earnings. Your premium will also increase.

**Future increase option.** Allows you to increase benefits (for a higher premium) without medical underwriting.

**Cost-of-living adjustment.** Adjusts the amount of monthly disability benefits each year during disability.

Disability premiums are based on your age, gender, occupation, and the amount of potential lost income you are trying to protect, as well as the specifics of the policy and any additional benefits that are added. A complete statement of coverage, including exclusions, exceptions, and limitations, is found only in the policy. It should be noted that carriers have the discretion to raise their rates and remove their products from the marketplace.

1) <https://www.limra.com/siteassets/newsroom/industry-trends/2020-images/DIAM2020factsheet.pdf>

2) <https://www.disability-benefits-help.org/blog/top-5-reasons-why-social-security-disability-claims-are-denied>

3) <https://www.ssa.gov/disabilityfacts/facts.html>

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