Important information for you about The Total Lump-sum Option

Impact of a longer life

According to current census data, Americans who retire in their early 60s can easily live another 25 to 30 years. Many Americans will live even longer. This added longevity is both a blessing and a potential problem. Although modern medicine can prolong our lives, it cannot guarantee those lives will be healthy. Neither can it guarantee we will have the financial resources to maintain our desired standard of living, much less cover the costs of a catastrophic illness.

The total (double) lump-sum option

The 2001 Oregon Legislature mandated an option which allows retiring members to take their member accounts in a lump sum which is then matched by an equal lump-sum distribution from their employers. This option presents an unprecedented opportunity for PERS members, but it also includes a substantial risk.

The importance of PERS benefits

In a survey conducted several years ago, PERS retirees revealed that for a majority of them, PERS benefits represent the largest part of their retirement income. For most PERS retirees, an income stream from their PERS account is a necessity, not a luxury.

Therefore, members who are considering a total lump sum need to be aware of what that decision means. Retirees who take the total lump sum lose three very important financial benefits of PERS annuities.

A lifetime benefit

First, the monthly benefit from PERS is paid for the member's lifetime. Depending on the benefit option, it can also be paid for a beneficiary's lifetime. You can purchase lifetime annuities in the private sector, but if your investments are simply in stocks, including mutual funds, the retirement benefit from those investments lasts as long as the principle and interest. Bad markets or poor investments may mean your money will be gone while you still need it.

Cost-of-living adjustment

Second, monthly benefits are subject to an automatic 2 percent cost-of-living adjustment (COLA) each August when the Consumer Price Index increases at least 2 percent the previous year. COLAs are rarely included in payouts from private investments.

8 percent increase built in

Third, PERS monthly benefit calculations assume an 8 percent annual increase on investment returns. That is, it is assumed that the money left in the Benefits-in-Force Reserve, which funds benefit payments, will earn 8 percent annually. That assumed 8 percent earnings rate is built into the monthly benefit. (Money left in the variable at retirement is subject to investment gains and losses. Refer to *Questions and Answers About the Variable Annuity Program*.)

That means that if you take a total lump sum, whatever investment you make with that money must generate enough return to equal the 8 percent earnings rate that funds PERS monthly benefits, plus the 2 percent COLA, to equal the income you would have received from PERS.

Federal and state taxes

A fourth consideration is that PERS benefits are subject to both federal and state taxes when they are paid unless they are rolled over to traditional or Roth IRAs or eligible employer plans. A lump-sum payment that is not rolled over is taxed in the year you receive it. Depending on your tax bracket and the state in which you live, your total benefit could be immediately reduced by as much as 30 to 50 percent. People who take a total lump sum may find themselves in a higher tax bracket than they have previously been in depending on the amount in their member account.

Handling your own investments

If you believe you can do better by investing your benefit yourself than by leaving your account with PERS, the following guidelines could help you. PERS staff are not financial planners or tax advisors and do not give investment advice, but some basic principles of managing retirement assets are consistently cited by financial planning experts:

- **Plan early,**
- **Understand your strengths and limitations,**
- **Know your risk tolerance,**
- **Invest your time before you invest your money, and**
- **Get help.**

Plan early

You can't begin planning too soon for retirement. Can you reasonably anticipate your needs for the retirement years? What contingencies must you cover - children still at home or in college? A non-working spouse or partner? Mortgage payments still needing to be made? Health issues, including long-term care, covered? Depending on your circumstances, you may need to answer many other questions. Waiting until it is time to retire to ask the questions may lead to disappointment. Early planning is clearly related to the principles which follow.

Understand your strengths and weaknesses

How much do you really know about financial markets? How much time are you willing to devote to active management of your financial assets? Are you willing - and able - to manage your investments yourself? Are you comfortable turning them over to someone else so you can devote yourself to more traditional retirement activities? If you do not already have investment experience, after you take your total lump sum is not the time to discover you have neither the skill nor the interest to actively manage your largest retirement asset.

Know your risk tolerance

After you take a total lump sum is also not the time to discover that reading a stock market report when your mortgage payment is due makes you break out in a cold sweat. Risk tolerance is a personal characteristic and what works for your neighbors or co-workers may be unworkable for you. How do you know how much risk you can tolerate? If you have kept all or most of your member contributions in the regular account rather than the variable, it would be a sign that high risk is not your strong suit.

Invest your time before you invest your money

This is a consistent theme in articles and books on money management. If you have not taken the time to conduct research into investment strategies, to attend PERS group counseling or other financial planning workshops, to carefully analyze your retirement needs, to consider the demands that will be placed on your money and time in retirement, to learn how to select appropriate financial and tax advisors, then you may not be ready to manage a financial portfolio.

Even if you decide to let a professional handle your money for you, you will be way ahead if you already know what kinds of investments are available, what they are designed to do, and the fee structure associated with those investments.

Get help

This may be the most important principle of all. It does not indicate weakness or personal deficiency to recognize that successful money management is a learned skill. Few of us who are not in the profession have had the opportunity to become genuinely knowledgeable investors.

Deciding to get help is just the first step. How do you choose the individual who represents the best match for you and your goals? The following suggestions are consistently offered by professional money managers.

- *Ask questions.* Remember, it's your money, and you have the right to be completely comfortable with your financial and tax advisors. Don't allow yourself to be intimidated into hearing only what a potential advisor wants you to hear. Insist on answers to the questions *you* want to ask.
- *Include your spouse or partner.* Chances are your income will be used for household expenses, so everyone who benefits should be comfortable with your financial advisor(s). Also, the other members of your household will probably think of questions or issues that do not occur to you.
- *Check for professional credentials.* Anyone can become a personal corporation (PC), so those initials are not very instructive. The use of CPA (Certified Public Accountant), PFS (Personal Financial Specialist), CLU (Chartered Life Underwriter), CRC (Certified retirement Counselor), CFP (Certified Financial Planner) or the more demanding CFA (Chartered Financial Analyst) or ChFC (Chartered Financial Consultant), means people so designated have at least successfully completed a course of instruction approved by their professional organizations. You can also look for someone who is a member of the International Association for Financial Planning (IAFP).
- *Consider more than one candidate.* Professionals are willing to be initially interviewed by phone to be sure you fit their client profile. Some advisors also suggest that a professional who won't do a free, 30-minute in-person interview should be put last on your list of candidates.
- *Check reputations.* Some places where you can check are state regulatory agencies and professional associations, most of which track customer complaints. Some potential problems can be avoided by taking the time to find out if your candidate has a record of questionable activities. Also, get the names of current clients. If other people in similar circumstances have been satisfied with the advisor's services, it suggests you will, too.
- *Know exactly how the advisor generate income.* Does the person make a commission on products sold, charge a percentage of assets under management, charge an hourly rate for advising? Most consultants recommend against people on commission, but norms vary by industry. Commissions are standard, for example, in the insurance industry.
- *Remember: if it sounds too good to be true, it probably is.* This is classic advice, but many people still ignore it. Avoid advisors who guarantee they can beat the market. Real professionals will carefully describe both the benefits and the risks of an investment.

Where do you look for both information and financial professionals? Try the following organizational websites:

For financial advisors:

The Financial Planning Association; www.fpanet.org

The National Association of Personal Financial Advisors; www.napfa.org

For accountants or tax preparers:

American Institute of Certified Public Accountants; www.aicpa.org/index.htm
Accreditation Council for Accountancy and Taxation; www.acatcredentials.org

National Association of Enrolled Agents; www.naea.org

For insurance agents:

Society of Financial Service Professionals; www.financialpro.org

Also check the front pages of telephone directories for a listing of professional associations and their local affiliates.

This Q&A is for general informational purposes only and is not intended to provide legal advice. If there is any conflict between this brochure and federal law, Oregon law, or administrative rules, the law and administrative rules shall prevail.

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