***MAKING SENSE OF THE***
***LUMP SUM PENSION CALCULATIONS***
***Part Two***

In Part One, we learned that our Verizon/Idearc Pension may be a guaranteed annuity, but that the Lump Sum Cash Payout of that annuity is dependent on interest rates. In fact, it's so dependent on Interest Rates that our decision as to whether to take the Lump Sum or the Monthly Annuity hangs on the rates in effect at the time we must make that choice.

First, what is the GATT rate, and/or the PBGC Rate?

PBGC stands for the Pension Benefit Guarantee Corporation, and you can think of them like FDIC insurance for your Pension. If your employer goes broke, and the Pension Fund that backs up your Pension runs out of money, the PBGC will take over your Pension Plan and continue your monthly payments. This Government Agency sets standards for evaluating Pension Liabilities, and enforces rules on employers. Their Interest Rates and Mortality estimates are part of these standards, and are used for one calculation of your Verizon/Idearc Lump Sum amount.

GATT stands for General Agreement on Tariffs and Trade. Within that legislation, US employers were allowed to use the 30 year Treasury bond rates to evaluate their pension liabilities. So, the GATT rate is really the 30 year Treasury bond rate, and it gets paired with the (longer) Mortality Tables contained within your Pension documents to calculate your Lump Sum amount. Most often, the GATT rate-Plan Mortality combination produces the highest Lump Sum amount. With Plan Mortality fixed, the one moving part of this equation is the interest rate on the 30 year Treasury bond. (The GATT rate)

We have seen that a 1% rise in the GATT rate can result in about a 9% decrease in the Lump Sum amount for a 59 year old with about 22 years of life expectancy. So, what affects this rate, and what can we do about it?

The bad news is that a lot of global circumstances affect this rate, and most of them are not under our control, or even our Government's control. Although the rates on SHORT term Treasuries like 3 month Bills are essentially set by the Federal Reserve Bank, the rates on LONG term Treasuries like the GATT rate are set by supply and demand.

The supply of Long Term Treasuries is created by our country running a deficit. We hear about the deficit as the cost of the Federal Government being greater than the taxes we pay. It's the Government borrowing on its credit card. The more we borrow, the more Long Term Treasuries are issued. The demand for Long Term Treasuries depends on many factors, with the rates and creditworthiness of the US Government being paramount. Another is the expected inflation rate, and strength of the US Dollar against other currencies, such as the Euro. Higher Short Term Treasury rates (which are controlled by the Federal Reserve Bank) can have the somewhat confusing effect of lowering Long Term Treasury rates. By strengthening the Dollar, both against inflation, and against other currencies, higher Short Term rates make the Dollar more attractive, and lower the Interest Rate needed to attract money. As an example, one of the biggest buyers of US Long Term Treasury bonds is the Government of China. It currently sees the US Dollar as a safe haven for the cash it earns selling goods to the rest of the world.

If China were to stop buying US Treasury bonds, interest rates would presumably have to rise to attract new buyers. Conversely, if the US Government were to stop deficit spending, either by cutting spending or raising taxes, the supply of Treasury Bonds would decrease. This change would likely lower Long Term Treasury rates. So, it appears that among the global conditions that can have profound effects on the Lump Sum calculation of a Verizon/Idearc Pension payout are major changes in the fiscal policies of China and/or the United States.

The good news in all this is that within a 3 month window, we can look back and select which month's rate to use. At any given point, we can see the rates for the last three months. We can also select the date for our Lump Sum amount to be calculated. So, within limits, we can choose to cash out this month, next month or the month after.

While three months is better than nothing, it's quite short in the history of US interest rates. Over the last 25 years, the Long Term Treasury rates have been in the low 4% range and the high 16% range. Outside the three month window, predicting where the rate will go is all but impossible. Meanwhile, the decision to wait for a bigger Lump Sum coincides with the decision to forgo investment earnings or interest on the money where ever you would have deposited it. And, we must finally remember that every month we wait is monthly check we'll never see, and that won't get factored into the calculation of the Lump Sum amount. Our life expectancy inexorably decreases.

In Part Three, we'll explore the idea of earning Investment Income or interest on the Lump Sum when we get it. Our ability, skill and comfort with generating income have a lot to do with whether we take the Lump Sum in the first place. We've seen how the market for Global Interest Rates affects the Lump Sum we actually receive. Next time, we'll explore how the Investment Markets, be it Stocks, Bonds, CDs, Real Estate or Gold, etc. will determine our fate once we get it.