Pension Plan Guidebook for EMC Employees

EMCretirement.com

a service of Halley Hill Wealth Management LLC

Zack Purvis, CFA
President, Halley Hill Wealth Management LLC
zpurvis@halleyhill.com
478-235-2674

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Zack Purvis, CFA
zpurvis@halleyhill.com
(478) 235-2674

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You can contact the author of this guidebook, Zack Purvis, at zpurvis@halleyhill.com or (478) 235-2674.

Introduction

This guidebook provides information for the NRECA Retirement Security Plan. To keep it simple, we'll just call this your "pension plan". You may also be eligible for another form of pension plan through your EMC, a 401(k) plan. This guidebook does not cover the 401(k) plan and you should contact your HR department for details on that plan.

The NRECA Retirement Security Plan is a Defined Benefit plan. Defined benefit plans are employer-sponsored retirement plans that use a formula to calculate the benefits employees may receive from the plan. The employer (your EMC or NRECA) is responsible for investment decisions and assumes all investment and planning risks. This is in contrast to a defined contribution plan, such as a 401(k), where the employee is responsible for investment decisions and the related risks and benefits.

Resources

Your HR department can provide details on your benefits and help you determine if you're eligible for the pension plan. Most EMC pension plans are administered by the National Rural Electric Cooperative Association (NRECA) and you can find information for this organization at www.electric.coop. You can also request a copy of the Summary Plan Description (SPD) for your pension plan to review benefits and details of the plan. We highly recommend you review the SPD as it will provide much more detail about your specific pension plan and cover a number of topics that may apply to you but are not covered in this guidebook.

You should receive an Annual Benefit Statement with information about your benefits under the pension plan. If you believe you are eligible for benefits from the pension plan but have not received these annual statements, you should contact your HR department.

We are also available to discuss your individual situation and can be reached at (478) 235-2674 or zpurvis@halleyhill.com. We have worked with employees of many EMCs and have copies of the Summary Plan Description for these cooperatives. If we don't already have a copy, we will request one from you to provide the best service possible.

How Are Benefits Calculated?

Each EMC employer can customize certain elements of the pension plan to meet their needs and can also change the plan provisions over time. But generally your benefits will be based on these three factors:

- ✓ Final Average Effective (FAE) Salary
- ✓ Years of Eligible Service
- ✓ Benefit Level %

These factors are used to calculate your benefit in the form of an annuity, generally a 50% Joint and Spouse Annuity (more details on this later).

FAE Salary x **Years of Eligible Service** x **Benefit Level %** = **Annual Annuity Payment**

Final Average Effective (FAE) Salary – This is a calculation based on your salary. For instance, many EMCs use the average of your highest five base salary amounts during your last ten years in the plan.

Years of Eligible Service – This will be the number of years you have accrued benefits under the pension plan. There are a number of factors that could affect this number and you should contact your HR department and/or review your SPD.

Benefit Level Percentage - This is the amount of benefit that accrues during each year of eligible service. For instance, if your co-op's benefit level percentage is 1% and you have 10 years of eligible service, you could be eligible for a benefit equal to 10% of your Final Average Effective Salary.

The calculations for your accrued benefit can be very complicated, so you should review your Annual Benefit Statement, your SPD, and consult with your EMC's HR department.

Your HR department and/or the SPD will also provide information on any age requirements for receiving benefits under the plan and any other factors that will affect your benefits.

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zpurvis@halleyhill.com
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Forms of Benefit Payment

There are three general forms of benefit payment for the pension plan: monthly annuity; lump sum cash payment; or a combination of these two options.

Lump Sum Cash Payment – Your benefit is received in a single payment. Oftentimes, retirees choose to invest this payment in an Individual Retirement Account (IRA) to continue the deferral of income taxes on the benefit and allow the opportunity for growth in the balance.

Life Only Annuity – This form of benefit pays a fixed monthly amount for the retiree's life.

10-year Certain and Life Annuity – The retiree receives a fixed monthly amount for life. If the retiree passes away prior to 10 years of payments being received, a beneficiary would receive the monthly payment for the remainder of the 10 year period.

Joint and Spouse Annuity – The retiree receives a fixed monthly amount for life, and if your spouse outlives you, they would continue to receive the payment. Generally, you are able to select for the spouse to receive 100%, 75%, or 50% of the benefit payment. (The higher the percentage of spousal benefit you select, the lower the monthly payment amount will be.)

Survivorship Annuity – This is similar to the Joint and Spouse Annuity, but the payments after your death would go to someone other than your spouse.

Other Options:
Cost of Living Adjustment (COLA) – Many plans offer the retiree the ability to receive an annual increase in benefit payment based on a consumer price index. Choosing this option will decrease your initial monthly benefit, but this amount could increase over time and allow your retirement income to potentially keep pace with inflation.

Cash Refund – This option may be available if you select the Joint and Spouse, Life Only, or Survivorship annuity option. This option would pay a single payment to your beneficiary if the value of your lump sum cash payment at retirement exceeds the total amount of monthly payments you actually received.

Combination – You can also choose to receive a portion of your benefits as a lump sum cash payment and a portion as a monthly annuity. This cash and annuity option is generally paid in 10% increments.

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Lump Sum vs. Annuity

The most common question we receive from EMC employees about their pension benefits is: Should I choose the lump sum payment or the annuity? This is a great question, and like most great questions the answer is "it depends". You should carefully consider the pros and cons of each option, including the seven factors we discuss below. And we highly encourage you to seek advice and information prior to making this very important decision.

These are seven items you should consider before making your decision:

Safety of Principal – Pension plans typically have several layers of protection to ensure your monthly payments continue as scheduled. This "guarantee" is helpful as you'll know exactly what your monthly payment will be for your entire time in retirement. Investments made with a lump sum payment are generally not insured and will fluctuate in value (up and down). You may choose to use Social Security as your "guaranteed" base income and investing a lump sum payment in an IRA or private annuity.

Inflation – We all know the "stuff" we buy tends to increase in price over time. And over 20+ years in retirement inflation really adds up. At an average 2.5% inflation level, your "purchasing power" will decrease nearly 40% over 20 years. That means if you want to keep your lifestyle the same, you'll need additional income to offset the effect of inflation on a fixed monthly annuity payment. You can consider choosing one of the COLA options if your plan offers this or taking the lump sum and investing these funds for growth and income.

Income Needs – Budgeting is not really a fun task for most folks, but it's extremely important as you prepare for retirement. Determine the level of income you'll need to support the lifestyle you want (and don't forget about inflation). Then consider your sources of income, including Social Security, pension annuity payments, other private annuities, investments, and any part-time employment or other income. We help clients build out a simple budget and then analyze different scenarios to determine which option for your pension benefit makes the most sense in your unique situation. But you can definitely do all this on your own if you're a "do-it-yourselfer" and are willing to put in the time and energy. If you'd like a template budget worksheet to get started, just let us know!

Taxes – Distributions from a pension plan are generally taxable to the recipient when received. This would include the full annuity payment (if you choose a monthly annuity)

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even if it's not needed to cover current expenses. Lump sum distributions are typically deposited/rolled over to a tax-deferred account (e.g. IRA or qualified private annuity). You then generally won't pay taxes until you actually withdraw money from the account.

Health and Family History – Consider your current health and your family's history of longevity. Annuity payments (whether from NRECA or a private annuity) typically last your entire life and potentially the life of your spouse. The longer you live and receive the annuity payments, the better this option stacks up against the benefits of a lump sum distribution.

Estate Planning – Would you like to leave an inheritance to a family member or a bequest to charity? Make sure to consider these plans when you decide how to receive your EMC pension benefit. Three common choices EMC retirees make when they want to leave money after they pass: cash refund option on a pension monthly annuity; invest proceeds from a lump sum distribution in an IRA; or choose a private annuity with a death benefit included.

Discount Rate at Retirement – When you request a pension estimate from your HR department or NRECA, they will use a "discount rate" to convert your annuity estimate into an amount that could be distributed as a single lump sum. The lower the discount rate, the higher the lump sum amount. And vice versa – the higher the discount rate, the lower the lump sum amount. Consider the current plan discount rate (based on IRS-mandated rates that track the overall interest rate environment). Generally, lower current interest rates make the lump sum option more attractive as a choice for you.

Quasi-Retirement

Quasi-retirement is an option offered by some EMC's pension plan. This option will allow you to receive your pension benefit while you're still employed but after you've reached your Normal Retirement Age (NRA). The NRA varies between co-ops and you should check with your HR department to learn the NRA for your plan.

If you elect quasi-retirement, you'll continue to earn benefits under the pension plan until you actually retire. The benefits earned between your quasi-retirement date and your actual retirement date will be available to you when you actually retire from your co-op. Also, you may actually be able to elect quasi-retirement twice. Once after you've reached your NRA, and then again after your reach 70.5 years old if you're still employed.

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In general, electing quasi-retirement may be a good decision if you're planning to choose the lump sum distribution option. Typically, this option would not be beneficial if you plan to receive 100% of your pension benefit as an annuity from NRECA.

The reasons for these general rules lie in the details of how your benefits are calculated. The lump sum is calculated as the present value of your monthly annuity as of a certain date. This is a little bit of a morbid thought, but it's true that as each year goes by there is one less year that you'll be retired. With less projected annuity payments being paid to you by the pension plan, the lump sum will decrease. As discussed earlier, changes in interest rates will also affect the lump sum amount. So unless you believe that your salary will increase substantially between your NRA and actual retirement date, electing quasi-retirement for lump sum distributions may be a good option to consider.

The best way to analyze this option is to request multiple benefit estimates from your HR department. For instance, you could request an estimate for quasi-retirement as of your NRA and another as of your expected retirement date. These estimates will help you compare the pros and cons of selecting quasi-retirement.

The decisions you make related to your pension benefits are extremely important ones. Be sure to seek guidance and advice from qualified and experienced sources before making your decision.

Questions?

We hope this primer on the NRECA Retirement Security Plan has been helpful. If you have any questions at all, or if you'd like to discuss the personalized services we offer to EMC employees and retirees, please contact us at:

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