PharmaWealth Report: All Science and No Finance

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Layoffs are continuing to plague the pharmaceutical industry at a feverish pace and across all job functions. Individuals who have spent their entire careers in the industry are waking up each day to find that their jobs have been eliminated. Along with the pink slips, employees are offered severance packages that offer anywhere from a few weeks to two years of salary continuation. Major decisions have to be made at that time and many executives are just simply not ready to make those decisions.

One executive, who was a recipient of such a package recently, confided in me, saying "I'm a scientist. All I worry about is my job." Sound familiar? While her attitude and focus on her work is admirable, the sad truth is that she was not prepared for what was coming; the sudden loss of employment. While there are constant rumors swirling around the water coolers at many pharmaceutical companies, most people aren't proactive when it comes to their own personal planning. It's all science and no finance.

When presented with a nudge out the door, people are generally focused on two things: how long they'll continue to get paid, and when they can get their hands on their retirement money. A lot of pharmaceutical companies today still offer defined benefit pension plans with the option of taking a choice of annuity payments or a lump sum. In my experience as a wealth manager, the vast majority of the people immediately snatch the lump sum distribution without giving the annuity options a second thought. That may or may not be the right path to take. While this discussion is not designed to be a hard and fast recommendation, I hope to plant a few seeds for additional thought before my pharma friends blindly make an irrevocable election that can affect a family's livelihood.

Here is one major reason why pharmaceutical executives should seriously consider an annuity option. In my opinion, pharmaceutical executives generally are poor investors. Science and finance go together slightly better than oil and water. I can't count how many times I've reviewed an executive's investment holdings only to find between one-half to three quarters of their portfolio is invested in their company's stock. These people are exposed to far more risk than they can even imagine. This is usually the result of stock options that have been exercised and held over a period of many years as well as the accumulation of company shares in the 401(k) plan. This type of overconcentration in one company's stock in the pharmaceutical industry is more common that you'd believe. Despite some of the severe downturns we've experienced recently, especially at some companies, the overconcentration persists. Fortunately for these executives, the employer is responsible for ensuring the pension lump sum or annuity payments are available when needed. Remember: the company bears the investment risk on the lump sum and annuity payments -

not the executive.

When electing the annuity option, an executive is trading the investment risk and potential upside for a guaranteed stream of income. All of the risk lies with the employer to make good on its promise to provide that stream of income. Company pension plans offer multiple payout elections, offering a steady stream of income, not just over the life of the executive, but over his or her spouse's life as well. The same can't be said about taking the lump sum.

In electing to take a lump sum, assuming the balance is rolled over into an IRA to maintain its tax-deferred status, the executive is assuming all of the investment risk in trying to replace the stream of income that would otherwise have been provided. Most executives are not investment savvy enough to replicate the income generating capabilities without taking on too much or too little risk in their investment selections. As a result, they run the risk of taking a large hit on their assets, thereby reducing the amount of income that can be generated over an individual or a couple's lifetime. Investing too conservatively, as in an all bond portfolio, can result in ignoring the impact of inflation and, in effect, going broke safely.

So this begs the questions: Why do so many people automatically elect the lump sum payment, only to take on the risk and forego a predictable and guaranteed monthly cash flow? Do pharmaceutical executives – PhDs, engineers, and the like—really have the ability to invest as well or better than their company pension administrators who are responsible for managing billions of dollars? Why are so many people willing to assume that risk?

I hope these thoughts gives rise to some serious deliberation should you or a colleague suddenly be faced with having to make the decision to elect either a lump sum or an annuity. While the lump sum seems like the obvious choice, and many times it is, that is not always the case.

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