PRIVATE WEALTH MANAGEMENT

Considering your pension options when leaving an employer?

There are generally three options to choose from when members of a defined benefit pension plan have the option to commute their pension:

01 **Take the pension** and commence monthly payments on a date allowed by the plan (usually between age 55 and 65).

02 **Transfer the pension's commuted value to another registered pension plan** (if the new employer's plan permits a transfer).

03 **Transfer the pension's commuted value to a locked-in account**, where the commuted value of a defined benefit pension represents the present value of the lifetime pension payments as calculated under the plan's benefit formula. This benefit is usually comprised of an amount that can be transferred to a locked-in account (under provincial or federal pension legislation) on a tax-deferred basis and an excess amount that is subject to immediate taxation.

Considering the options

01 02 Pension options

- Is there a reduction of the pension benefit if the payments start prior to the normal retirement date?
- Is the pension indexed to inflation before and after retirement? If so, is there a cap on the annual pension increase?
- What is the amount of the pension benefit that will be paid to the surviving spouse?
- Does the plan provide for a guarantee period where the remaining monthly pension payments in the period will be made to the estate or beneficiaries if the plan member and spouse dies? How long is the guarantee period?
- Does the plan provide for a bridging benefit, for example, a supplemental pension paid only to age 65?
- Is the pension plan in a significant deficit position that could create a significant risk to the client if the sponsor becomes bankrupt?
- Are there benefits that will be stopped if the Pension Option is not elected? If so, what would it cost to fund these benefits independently? (i.e., group life, extended health care, dental, vision care plans).
- Are there health concerns that could shorten life expectancy?

ADVANTAGES

- Retirement benefits are guaranteed for life
- Pension may provide inflation protection with indexation
- Possible bridging benefits and enhanced survivor benefits
- No investment risk or investment decisions
- Payments from the pension plan are eligible for pension income splitting at any age

DISADVANTAGES

- Payment amounts cannot be increased or decreased
- Payments could be less than the actuarial value of the benefits earned if normal life expectancy is not attained
- No estate value
- No investment control

03 Transfer the commuted value to a locked-in account

- Does the commuted value have an excess amount that would be subject to immediate taxation? If so, is there RRSP carry-forward room to shelter some of this amount?
- What is the required minimum rate of return to produce a sustainable payment from the investment assets that is equal to the retirement income the Pension Option will provide?
- What asset mix is reasonable to generate this minimum rate of return and is this consistent with your risk tolerance?
- What other current and post-retirement income sources are available?
- Is re-employment, which could delay the start of withdrawals, a consideration?

ADVANTAGES	DISADVANTAGES
• Control of the investments • Flexibility when payments can start and amount of payments • Potential for enhanced estate value • Possible unlocking of 50% of the assets • Conversion to a life annuity at any time	• Long-term investment performance of the locked-in assets could be lower than anticipated and therefore payment amounts are not guaranteed • Significant portion of the transferred assets may be subject to immediate taxation • Future payments from a Life Income Fund (LIF) are subject to maximum annual payout restrictions • Payments from a LIF, LRIF or PRIF will not be eligible for pension income splitting until age 65 • Other Employer benefits such as group life and health coverage may be discontinued

Types of risk

Mortality Risk

Mortality risk is the possibility that the individual, and the surviving spouse if applicable, will not live to the anticipated life expectancy. This means the total pension payments could be less than the actuarial value of the benefits earned by the plan member under the pension plan. In a LIRA, LIF, PRIF or LRIF, mortality risk is not an issue, as the full value of the LIRA, LIF, PRIF or LRIF is payable to the beneficiary or estate at death. It is possible to provide a hedge against the mortality risk when selecting the Pension Option by purchasing a "last-to-die" life insurance policy, which will provide a tax-free lump sum benefit to the beneficiaries of the surviving spouse. Mortality risk can also be mitigated if the pension provides a guarantee period.

Sustainability Risk

The sustainability of the invested assets is a factor to be considered with respect to the Transfer Option. The higher the annual payouts, given an assumed investment return, the higher the risk that the invested assets will be depleted during the client's lifetime. The sequence of investment returns is also an important consideration. During the accumulation phase, it does not matter that the returns will be higher in some years and lower in others, provided that the long-term rate of return is equal to or exceeds the assumed rate of return. However, when regular payments start, the sequence of returns become important. Investment losses in the first few years of the payment period could result in a higher risk of depleting the retirement assets.

Investment Risk

Investment risk is the possibility that if the Transfer Option is chosen, the long-term investment performance of the locked-in assets might be lower than anticipated. Investment risk is not a factor with respect to the Pension Option, as the payouts are guaranteed, and may be indexed.

As you can see there are many factors to consider when deciding whether to keep the pension option or transfer the commuted value. It's important to evaluate both the advantages and disadvantages, as they relate to your personal situation and financial goals. Your IG Consultant can help you review your decision and how it relates to your overall financial plan.