RBC Wealth Management Services

THE NAVIGATOR

# Early Retirement Part 2 – Pension Plan Options

Early retirement is something you may strive for, if it is your decision and made voluntarily. Whether you are retiring early, starting a new job or taking time off, leaving an employer can often be an emotional time. In recent years, early retirement has become synonymous with termination, or involuntary retirement, due to corporate restructuring and downsizing.

Whether you are leaving your employment voluntarily or involuntarily, there are generally three main issues that need to be considered:1) retiring allowance planning, 2) pension plan options and 3) company benefits. Deciding what to do with options presented involves many variables and can be quite confusing. And, once you make a decision, it is often irreversible.

To assist you with your decision making, a three part series of articles will discuss the following:

Part 1: Retiring allowance planning;

**Part 2: Pension plan options;** and,

Part 3: Company benefits options.

This article (part 2 of the series) will discuss four common options for a pension plan that may be available when employment has ended.

*This article outlines several strategies, not all of which will apply to your particular financial circumstances. The information is not intended to provide legal or tax advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax advisor before acting on any of the information in this article.*

## Reviewing Your Options

If you have been a member of a pension plan for many years, the benefits that you have earned in the plan may be the largest source of income you will receive in retirement. When you have terminated employment, your employer will send you a written summary outlining your company pension plan options. You will be required to select one of the options by a specific deadline. Sometimes you may not have very much time to make your decision. And if you don't act before the deadline, your employer may consider that you have chosen one of the options by default, which may or may not be the best one for you.

Your RBC advisor together with your tax advisor can assist you with making the most appropriate choice for your specific circumstances.

Which choices you have, when you will receive the money, how much money you will receive and how your spouse and other dependants may be affected, will all depend on your specific pension plan as well as the applicable legislation that governs the benefits you have accumulated.

Speaking with your pension and benefits representative is the best way to find out what options are available to you when you terminate employment. Your RBC advisor together with your tax advisor can assist you with making the most appropriate choice for your specific circumstances.

The options available vary significantly from one plan to another. Some of the more common options include:.

## Option 1: Remain in the Pension Plan

You may be able to stay in the company's defined benefit or defined contribution pension plan, but stop contributing to it. Some pension plans provide benefits and incentives such as indexing to inflation or continued access to group health, dental and insurance plans. (Refer to the part 3 article discussing company benefits for more information on ancillary benefits.)

Some early retirement packages will offer pension inducements, like added years of service, depending upon your age and position. These benefits can make remaining in the pension very appealing so it is important to understand the package.

### Immediate or Deferred

Depending on your age at the time you stop working, you may have the choice of beginning your pension benefits immediately or deferring the benefits until a later date. Pension plan payments are one of the few types of pension income that you can receive before age 65 that qualify for pension income splitting with your spouse as well as the $2,000 pension income tax credit.

You may be given a choice to delay receiving your pension to a later date and if you do, you will generally receive a higher monthly amount choosing this option than you would if you took your pension immediately. If you have not yet reached the age at which the plan allows you to receive benefits, or if you will have new employment or alternate sources of income and do not need the pension income immediately, you may want to consider choosing a later date to receive your pension, if your plan provides you with the option to do so.

### Spousal and Survivor Benefits

If you have a spouse (as defined in your plan), he or she may be entitled to receive survivor benefits following your death, usually at a reduced level, for the remainder of his or her lifetime. Your employer may provide you with the option to select enhanced survivor benefits for your spouse — but there's a cost. Typically, Choosing the appropriate level of survivor benefits is a critical decision. The age, health and life expectancy of you and your spouse should be considered carefully.

if you opt for enhanced survivor benefits, the initial amount of your pension benefits will be lower.

Choosing the appropriate level of survivor benefits is a critical decision. The age, health and life expectancy of you and your spouse should be considered carefully. Also, the degree to which your spouse and any other dependants may need to rely on this income to meet their expenses is an important consideration.

Many defined benefit plans are designed to provide a higher level of benefits from the time that payments begin until the age at which certain government benefits, such as the Canada or Quebec Pension Plan (CPP/QPP) and Old Age Security (OAS) are scheduled to start (usually age 65), and a reduced level of benefits afterwards. Pension plans that are designed this way are referred to as being "integrated" or "bridged" with CPP/QPP or OAS. Knowing how your plan is designed will help you make the right choices about when and how to draw on your other sources of retirement income. Note: your ability to apply for CPP/QPP early and the value of the benefit you will receive is not affected by receiving a bridged pension benefit.

You may be presented with other options requiring more information if you decide to remain a member of the pension plan. Your RBC advisor, together with your pension and benefits representative or human resources specialist, can help you work through these important decisions.

### Option 2: Purchase an Annuity

You may be able to instruct your employer to transfer the value of your pension to an insurance company to buy an immediate or deferred annuity. The annuity will pay you a set income beginning at the age set out in the annuity contract.

Annuity contracts are available with many different features and benefits. They produce a predictable, recurring income stream and allow you to customize the amount of income payable to a surviving spouse.

You will not have any control over the management of the funds once the contract is purchased and the decision to have it reversed may incur substantial penalties if it can even be reversed at all.

The income provided by the purchase of an annuity should be compared with the projected income provided by the other available options.

### Option 3: Transfer Your Pension Value to a LIRA/LRSP

A third option allows you to invest the money yourself and decide when you want to begin withdrawing it, subject to age restrictions and annual minimum and maximum amounts. This requires the pension plan administrator to calculate and transfer the commuted value of your pension to a locked-in RRSP (LRSP) or a locked-in retirement account (LIRA).

In order to receive a retirement income, you will need to convert your LRSP/LIRA to a Life Income Fund (LIF), Annuity (refer to option 2), a Locked-in Retirement Income Fund (LRIF), a Prescribed Retirement Income Fund (PRIF) or a Restricted Locked-in Income Fund (RLIF). Ask your RBC advisor for more information on what types of plans

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are available for the pension plan you have.

Managing your pension money yourself gives you more flexibility and control than remaining in the pension plan or purchasing an annuity as follows:

- Funds can grow tax-sheltered, until you are required to begin making withdrawals in the year you turn 72.
- Withdrawals may begin as early as the age your pension would have started.
- If you began receiving income but no longer need it, you may be able to stop receiving income by transferring the funds back into a LRSP/LIRA before the year you turn 72. However, the ability to do this varies by provincial and federal legislation.
- You can choose from a wide range of investments to achieve your specific income and retirement objectives and have your RBC advisor design a portfolio that is customized to your specific objectives in terms of producing income, offering growth and providing liquidity.
- Each year, you may decide to receive more or less income, within minimum and maximum amounts, giving you greater control over your taxable income. This may help you maintain your eligibility for government benefits like Old Age Security (OAS) or the Guaranteed Income Supplement (GIS).
- Some strategies are available to unlock certain amounts of money held in a locked-in plan and transfer them to a regular registered plan where withdrawals are not restricted.
- You can use part of your locked-in funds to purchase an annuity contract at any time.

The Income Tax Act may limit the amount of pension money you can transfer to a locked-in RRSP or LIRA. For example, with a defined benefit plan you may not be able to transfer all the money from the pension. If the value of your pension exceeds the amount that can be transferred, the balance that you are owed will generally be paid to you in a lump sum and taxed in the year it is paid.

While receiving a taxable amount may appear to be a drawback, this option may have certain benefits:

- In many cases a lump sum of money is needed for immediate uses such as repaying debt before you retire or funding a large expense, purchase or other project.
- If you have unused RRSP deduction room, you may be able to make a large contribution to your individual plan or spousal plan, where appropriate. This could defer the taxation of part or all of the lump sum that you receive and allow for income splitting with your spouse.

### Option 4: Transfer Your Pension to a New Employer

In some cases, if you are not retiring,

In some cases, if you are not retiring, you may be able to transfer the vested amount of your pension into a new employer's pension plan.

you may be able to transfer the vested amount of your pension into a new employer's pension plan. If a new employer provides you with the option to participate in a defined benefit pension plan, this transfer will involve exchanging some or all of the value of your pension for a certain number of years of "pensionable service" in the new plan. This is possible only if your new employer is willing to accept the transfer.

### Pension Adjustment (PAR)

If you ceased being a member of a Registered Pension Plan (RPP) or a Deferred Profit Sharing Plan (DPSP) in 1997 or later and received the commuted (lump sum) value of your RPP or DPSP out of the plan and chose option 2, 3 or 4, you may now have extra RRSP contribution room due to the Pension Adjustment Reversal (PAR). If you receive a PAR amount, this value can be added to your current RRSP contribution limit. For additional information on the PAR please ask your tax advisor.

### Making the Best Decision for You and Your Family

The following are the main considerations that are likely to influence your decision as to which option, or combination of options, is best for you and your family:

- Flexibility to access regular income and lump sums
- Benefits available to your surviving spouse or others upon death
- Investment management — degree of your involvement in making decisions
- Investment risk — impact of strong or weak investment performance on your retirement income
- Access to ancillary benefits that may be contingent on membership in the company pension plan

The table below summarizes the general implications of many of these considerations for each of the four pension options.

## Summary Table of Pension Options

| | Flexibility | Survivor Benefits and Estate Planning | Investment Management and Investment Risk |
|---|---|---|---|
| **Option 1** Leave pension with employer | Limited or no ability to modify payments once they begin. Benefits are payable for life of annuitant.<br>Limited or no ability to access lump sums from the pension plan. | If pension payments have started, survivor spouse generally receives a reduced monthly payment for the remainder of their lifetime.<br>If plan member dies prior to pension beginning, the commuted value may be available to surviving spouse or beneficiary (-ies). | Defined Benefit (DB) Investment management decisions are made by pension plan administrator.<br>Defined Contribution (DC) investment decisions are made by plan member subject to limited choices.<br>Risk lies with pension plan administrator for a DB plan and lies with plan member for DC plan. |
| **Option 2** Purchase an annuity | Limited or no ability to modify payments once they begin.<br>Limited or no ability to access lump sums from annuity contract. | Details agreed to when annuity is selected. Various options are available to provide protection to surviving spouse and/or estate. | Insurance company assumes risk assoc ated with investment performance. |
| **Option 3** Transfer to a LIRA/ locked-in RRSP | Flexible amount of income may be taken each year, subject to minimum and maximum amounts.<br>Some flexibility to delay receipt of income and allow LIRA/locked-in RRSP to potentially grow in value, subject to age limits.<br>Some flexibility to withdraw lump sums and/or unlock funds for increased availability at a later date. | Surviving spouse may receive 100% of remaining plan value on a tax-sheltered basis.<br>Payable to estate or other beneficiaries if there is no surviving spouse. Estate is responsible for paying taxes.<br>In some provinces, surviving spouse may have increased access to lump sums (i.e. unlocking). | Annuitant may select desired degree of involvement and choose from wide range of investment solutions.<br>Annuitant benefits from strong investment performance and assumes risk of weak investment performance. |
| **Option 4** Transfer to a new employer pension plan | If you terminate employment with your new employer and remain in that employer's pension plan refer to option 1.<br>If you terminate membership in your new employer's plan and purchase an annuity or commute to a LIRA or locked-in RRSP, refer to option 2 or 3 as applicable. | If you terminate employment with your new employer and remain in that employer's pension plan refer to option 1.<br>If you terminate membership in your new employer's plan and purchase an annuity or commute to a LIRA or locked-in RRSP, refer to option 2 or 3 as applicable. | If you terminate employment with your new employer and remain in that employer's pension plan refer to option 1.<br>If you terminate member ship in your new employer's plan and purchase an annuity or commute to a LIRA or locked-in RRSP, refer to option 2 or 3 as applicable. |

Every pension plan is different; therefore, if survivor benefits are important, it is necessary to determine what benefits are available under the different pension options and weigh this information when choosing your option.

## How Do You Choose?

When analyzing which pension option is best for you, the goal is to find the option that will provide you with the best cash flow throughout your retirement at a risk level that is acceptable to you.

You may want to choose the option that will provide the largest benefit to your spouse or to your estate upon your death. For instance, if the commuted value is transferred to a Locked-in RRSP or LIRA, any remaining assets in the plan upon your death can be transferred to a named beneficiary (-ies) or your estate. If you decide to remain in the company's pension plan and it is a defined benefit pension plan, then upon your death, your spouse will generally receive a reduced annual pension for the rest of his/her life. If you have no surviving spouse upon your death, then it is possible that no further payments will be made to your estate. However, every pension plan is different; therefore, if survivor benefits are important, it is necessary to determine what benefits are available under the different pension options and weigh this information when choosing your option.

While it may seem difficult to know which is best for you and your family, working with your RBC advisor, tax advisor and pension and benefits representative or human resources specialist, may help you select the option that is best for you and your family. These advisors have access to a wide range of information and sophisticated forecasting tools and calculators that can help you analyze your options. They can prepare a customized analysis of your situation and make a recommendation based on all of the important considerations that are unique to your specific personal goals and circumstances.

Please contact us for more information about the topics discussed in this article.



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