Choosing the right pension decisions when leaving your employer

When changing employers or retiring early, whether voluntarily or not, there are many decisions you need to make about company benefits. These include company savings plans, group life insurance and health and dental plans. The most complex decisions usually involve your company pension plan.

There are two types of pension plans:

1. Defined Benefit (DB) plans pay a monthly retirement income calculated based on years of service and average earnings.
2. Defined Contribution (DC) plans are locked-in investment accounts that employees and employers contribute to based on a percentage of earnings.

If you are a vested member of a DC plan, you will very likely transfer your pension value to a Locked-In Retirement Savings Plan or similar account and you will be faced with similar conversion options detailed below.

The more complex decisions involve DB plans. If you have a DB plan, and you depart before being eligible for early retirement (usually age 55) you must decide between staying in the plan to receive a deferred income and transferring out a commuted value lump sum. This lump sum is usually transferred to a locked-in account but in some cases part of the payment may go to a regular Registered Retirement Savings Plan or a non-registered account with taxes owing immediately.

You will be faced with these options if:

- You are leaving your employer
- You are a member of your employer's DB pension plan
- If you have investment experience
- If you have access to other sources of income

KEY BENEFITS

- Maximize the flexibility of your retirement income
- Create an estate for your beneficiaries

	Lump Sum	Annual Pension
Risk	The responsibility for managing these assets is transferred to you.	Your pension benefit is guaranteed.
Flexibility	You can choose the timing and the amounts (min./max.) of your withdrawals.	Once the payments begin the amount is fixed.
Indexation	An appropriate asset allocation should protect your portfolio from inflation.	Your pension may or may not be indexed annually.
Estate Objective	The locked-in plan is left to your beneficiaries upon death.	Benefits cease unless your spouse survives you or you've selected a guaranteed period.
Group Benefits	You may lose access to benefits.	Benefits may be maintained.

Strategy in action

The issue: leaving employer before early retirement age

You have been forced out of your job due to a corporate restructuring. Employees who have already reached the early retirement age of 55 may receive an immediate pension, but below or at this age, you will have two options:

1. Opt for a deferred pension and receive $24,000 per year for life starting at age 65.
2. Opt for transferring the commuted value of $123,000 to a locked-in RRSP.

Which is the better option?

The strategy: choosing the right pension option

The following table compares the deferred pension with the lump sum transfer assuming the withdrawal limits and a balanced investment approach earning annual returns of 6.9%. The account will grow to $343,000 by age 65 at which time you will convert the plan to a LIF or an LRIF and start taking withdrawals. These withdrawals must be between minimum and maximum amounts that are calculated each year. The table shows two possible withdrawal scenarios: the minimum every year and the maximum. Any withdrawal amounts between these limits are also permitted.

The annual pension income cannot be matched in the early years due to the LRIF/LIF withdrawal limits but the total income exceeds the pension in both scenarios due to higher incomes later. In this example the deferred pension will provide the higher income if the return is reduced to 6% or below.

Should you transfer out the commuted value of the funds, you could receive a Pension Adjust Reversal which could allow you to make additional RRSP contributions. You should consult your Federal Notice of Assessment in the year following the transfer.

Age	Pension	Minimum Withdrawals[1]	Maximum Withdrawals[1]
65	$ 24,000	$ 0	$ 15,441
66	24,000	15,031	20,670
67	24,000	16,068	22,345
68	24,000	17,177	22,345
69	24,000	18,362	22,345
70	24,000	19,629	22,345
71	24,000	29,423	25,548
72	24,000	29,526	25,638
73	24,000	29,632	25,730
74	24,000	29,735	25,820
75	24,000	29,869	25,936
76	24,000	29,948	26,004
77	24,000	30,046	26,090
78	24,000	30,153	26,183
79	24,000	30,258	26,274
80	24,000	30,350	26,354
81	24,000	30,417	26,412
82	24,000	30,515	26,496
83	24,000	30,586	26,558
84	24,000	30,644	26,609
85	24,000	30,694	26,652
86	24,000	30,733	26,686
87	24,000	30,775	26,723
88	24,000	30,794	26,739
89	24,000	30,799	26,743
90	24,000	30,797	26,741
Total	**$624,000**	**$691,692**	**$651,425**

(1) The rates used are based on Ontario LRIF figures. Beyond 90, the pension of $24,000 would continue. The portfolio remaining under the minimum withdrawals is estimated to be approximately $230,000 and the portfolio remaining under the maximum withdrawals is estimated to be approximately $190,000.

Estate planning, flexibility, indexing, life expectancy, required returns and risk tolerance should all be accounted for when deciding between pension options. For more information, please contact your Investment Advisor. Make sure you also consult with a qualified tax and pension professional before taking action.

Professional Wealth Management Since 1901

RBC Dominion Securities