The Navigator

Wealth Management

RBC Wealth Management Services

Pension plan options when you leave your employer

Leaving an employer can often be an emotional time. Whether you are leaving your employment voluntarily or involuntarily, there are generally three main financial issues that need to be considered: 1) retiring allowance planning, 2) pension plan options and 3) salary continuance and company benefits. It is important to carefully evaluate the options presented to you as the decision is often irreversible.

This article will discuss four common options for a pension plan that may be available when employment has ended. Ask your RBC advisor for our articles on retiring allowance planning and salary continuance and company benefits if applicable to you.

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.

Please contact us for more information about the topics discussed 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 leave your employer, your pension plan administrator 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. Generally if you do not act before the deadline, the administrator may consider that you have chosen one of the options by default, which may or may not be the best option for you.

Your pension plan options, including 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.

You may be able to stay in the company's defined benefit (DB) or defined contribution (DC) pension plan, but will no longer be able to make contributions.

Speak to your pension and benefits representative to find out what options are available to you when you leave your employer. Your RBC advisor together with a qualified 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 (DB) or defined contribution (DC) pension plan, but will no longer be able to make contributions. This option may provide benefits and incentives such as indexing to inflation or continued access to group health, dental and insurance plans.

Some severance packages will offer pension inducements, such as 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. DB 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 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 pension plan administrator may provide you with the option to select enhanced survivor benefits for your spouse — but there's a cost. Typically, 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.

Bridging benefits

Many DB 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. 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.

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

A DB plan is often viewed as being less risky than a DC plan since the employer is obligated to make up investment shortfalls in the plan with additional contributions.

income. Some plans may contain benefits specific to your province of employment that you need to consider carefully.

Risks

Defined Benefit (DB) plans:

A DB plan is often viewed as being less risky than a DC plan since the employer is obligated to make up investment shortfalls in the plan with additional contributions. The employer takes on the investment risk in a DB plan if there are any shortfalls. This ensures that you would get the benefits you were promised as the pension is based on a fixed formula and not on investment returns.

A shortfall in a DB plan is usually referred to as a deficit and is usually the result of bad investments, general market conditions or an increase in the plans liabilities. Companies that sponsor a DB pension plan that is in a deficit position will be required to make increased contributions to bring the plan back to fully funded status.

Your DB plan can be at risk if the company sponsoring the plan runs into cash flow problems and cannot make the required payments. Although the pension funds are segregated and cannot be seized by a company's creditors, if the company goes bankrupt while there is a pension deficit, your promised or current pension benefits can be reduced.

If you leave your DB pension with your employer, you have to be comfortable the company will remain financially viable and able to pay your expected retirement benefit.

Defined Contribution (DC) plans:

A DC plan has no mechanism to make additional contributions if the market goes through a bad spell and the plan value drops. If the value of your pension plan drops just before retirement, your pension will provide a lower income stream in retirement than you may have expected as there are less funds available. You assume the investment risk with a DC plan.

Your sponsoring company generally provides you with various investment choices. If you leave your DC plan with your employer, you need to be comfortable that the investment choices available will help you reach your desired retirement income.

Your RBC advisor, together with your pension and benefits representative or human resources specialist, can help you decide if remaining in the pension plan is best for you and if so help you to work through these important decisions.

Option 2: Purchase an annuity

You may be able to instruct your pension plan administrator 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. The insurance company assumes all of the investment risk once the annuity is purchased as your payments are guaranteed. If an insurance company runs into financial trouble, it is possible that your annuity payments could be in jeopardy. Fortunately, all or a portion of the payment may be protected by Assuris. Assuris is the not for profit organization that protects Canadian policyholders if their life insurance company should fail.

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 is not possible.

The income provided by the purchase of an annuity should be compared

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.

with the projected income provided by the other available options.

Option 3: Transfer your pension value to a LRSP/LIRA

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), Locked-in Retirement Income Fund (LRIF), Prescribed Retirement Income Fund (PRIF) or Restricted Locked-in Income Fund (RLIF). Ask your RBC advisor for more information on the types of plans available for the pension plan you have.

Once you transfer the pension funds to a LRSP/LIRA you have a wide range of investment choices available. The value of your locked-in plan will fluctuate directly with your investment returns and you must be comfortable taking on the investment risk. Fortunately, there are so many choices in a LRSP/LIRA that you can likely choose an investment that is suitable to your level of risk tolerance.

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. In this case, your pension plan administrator will inform you that a portion of your commuted value will be paid to you as a taxable cash payment. 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, consider the following:

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 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 contribution room, you may be able to make a 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, 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 DB 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 Reversal (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. Ask your RBC advisor for our article on the Pension Adjustment Reversal if applicable to you.

Making the best decision for your family

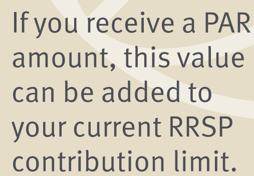
The following are the main considerations that are likely to influence your decision as to which pension plan option, or combination of options, is best for you and your family:

- 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. 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. If plan member dies prior to pension payments beginning, the commuted value may be available to surviving spouse or beneficiary (-ies).	Defined Benefit (DB) investment decisions are made by pension plan administrator. Defined Contribution (DC) investment decisions are made by plan member subject to limited choices. 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. 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 associated 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 and minimum age requirements. Some flexibility to delay receipt of income and allow LIRA/locked-in RRSP to potentially grow in value, subject to age limits. 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. Payable to estate or other beneficiaries if there is no surviving spouse. Estate is responsible for paying taxes. In some provinces, surviving spouse may have increased access to lump sums (i.e. unlocking).	Annuitant may select desired degree of Annuitant may select desired degree of involvement and choose from wide range of investment solutions. 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. 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. 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. 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 receive a PAR amount, this value can be added to your current RRSP contribution limit.

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 DB 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 option is best for you and your family, working with your RBC advisor, qualified 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 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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