

Pension plan options when you leave your employer



Many employers offer registered pension plans, which may be a defined benefit (DB) or defined contribution (DC) plan. If you're a member of a pension plan, you'll need to decide on what will happen to your pension after you leave your employer. This article discusses four common options that may be available to you.

Pension legislation differs across the various provinces and each pension plan has its own unique terms, so there may be situations where the information in this article will not apply to a specific employer retirement plan. Therefore, it's imperative to consult with your pension plan administrator on any questions you may have relating to your employer retirement plan.

Reviewing your options

If you've been a member of a pension plan for many years, the benefits you've earned in the plan may be the largest source of income you'll 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 don't act before the deadline, the pension plan administrator will assume you've selected the default option, which may or may not be the best option for you.

The options that are available to you will depend on the specific pension plan as well as the applicable pension legislation that governs the benefits you've accumulated. The following discusses some of the more common options.

Option 1: Remain in the pension plan

You may be able to stay in the company's pension plan, but you will generally no longer accrue additional pensionable service. Remaining in the pension may entitle you to benefits such as 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's important to understand the package.

Immediate or deferred pension

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.

If you've 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 don't need the pension income immediately, you may want to consider choosing a later date to start your pension, if your plan provides you with the option to defer.

Spousal and survivor benefits

If you have a spouse (as defined in your plan), they may be entitled to receive survivor benefits following your death, usually at a reduced level, for the remainder of their 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.

Bridge 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.

Risks associated with remaining in a DB plan

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 by making contributions. The employer takes on the investment risk in a DB plan if there are any shortfalls. This helps to ensure you would get the benefits you were promised, as the pension is based on a fixed formula and not on investment returns.

Your DB plan can be at risk if the company sponsoring the plan runs into cash flow problems and cannot make the required payments to make up any shortfalls in the pension plan. 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 may be reduced.

If you choose to remain in DB plan, you should be comfortable the company will remain financially viable and able to make

up any shortfalls in the pension plan to ensure you receive expected retirement benefit.

Risks associated with remaining in a DC plan

There is no mechanism for you or your employer to make additional contributions to a DC plan if there are poor market returns and the plan value drops. If the value of the DC plan drops, you may receive a retirement income stream that may be less than what you expected. You assume the investment risk with a DC plan.

The pension plan administrator will typically provide you with a selection of investment options that you can choose from. If you choose to remain in the DC plan, you need to be comfortable that the investments you make will help you generate your desired retirement income.

Option 2: Purchase an annuity

You may be able to transfer the value of your pension to an insurance provider to buy an immediate or deferred annuity. The annuity will pay you an income stream beginning at the age set out in the annuity contract. The insurance provider 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's 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 may also 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. Typically, once you buy an annuity, you can't change the terms of the contract. This means you can't switch to a different type of annuity or get your money back.

Option 3: Transfer your pension value to a locked-in plan

Another option that may be available is taking the commuted value of the pension plan. This requires the pension plan administrator to calculate and transfer the commuted value of your pension to a locked-in plan. The type of locked-in plan that's available to you will depend on your age and the pension legislation that governs the plan. Ask your RBC advisor for an article on locked-in plans for more information.

This option allows you to invest the money yourself and decide when you want to begin receiving income, subject to age

restrictions and annual minimum and maximum amounts. Once you transfer the commuted value to a locked-in plan, 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.

A locked-in plan is similar to a registered retirement savings plan (RRSP) or registered retirement income fund (RRIF) in many ways. Some of the key features include:

- Funds can grow tax-sheltered, until you're required to begin making withdrawals in the year you turn age 72;
- 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's customized to your specific objectives in terms of producing income, offering growth and providing liquidity;
- Withdrawals may begin as early as the age your pension would have started;
- 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 OAS;
- Some strategies are available to unlock certain amounts of money held in a locked-in plan and transfer them to an RRSP or RRIF where withdrawals are not restricted; and
- You can use part of your locked-in funds to purchase an annuity contract at any time.

If you're a member of a DB plan, the Income Tax Act may limit the amount of the commuted value that you can transfer to a locked-in plan. 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.

While receiving a taxable amount may appear to be a drawback, consider the following:

- The lump-sum amount is not locked in, so you can use the after-tax amount to repay debt before you retire or fund a large expense, purchase or other project; and

- If you have unused RRSP contribution room, you may be able to make a contribution to your RRSP or to a spousal RRSP. By making an RRSP contribution you can defer the tax on all or a portion of the lump-sum payment.

Option 4: Transfer your pension to a new employer

If you join a new company and your new employer provides a pension plan, you may be able to transfer the vested amount of your pension into a new employer's pension plan.

If your 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. Your new employer can let you know if they're willing to accept funds from the DB plan provided by your old employer and, if they do, how much they will accept. In some cases, you may still receive a taxable payout from the DB plan.

Generally, if you're transferring from a DC plan to another DC plan, there should be no taxable payout. You will need to contact the pension plan administrator of both pension plans to determine if a transfer is possible.

Evaluating the options

The following are some of 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-sum payments when required;
- Benefits available to your surviving spouse or others upon death;
- Investment management – degree of your involvement in making decisions; and
- Investment risk – impact of strong or weak investment performance on your retirement income;

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	<p>Limited or no ability to modify payments from a DB plan once they begin. Benefits are payable for life of annuitant.</p> <p>Limited or no ability to access lump sums from the pension plan.</p>	<p>If pension payments from a DB plan have started, the surviving spouse generally receives a reduced monthly payment for the remainder of their lifetime. Unless a guarantee period is provided, there's generally no payment to non-spouse beneficiaries.</p> <p>If plan member dies prior to pension payments beginning, the commuted value may be available to surviving spouse or other beneficiary/ beneficiaries).</p>	<p>DB plan investment decisions are made by pension plan administrator. DC plan investment decisions are made by plan member subject to limited choices.</p> <p>The investment risk lies with the sponsoring company for a DB plan and with plan member for a DC plan.</p>
Option 2: Purchase an annuity	<p>Limited or no ability to modify payments once they begin.</p> <p>Limited or no ability to access lump sums from annuity contract.</p>	<p>Details agreed to when annuity is selected. Various options are available to provide benefits to surviving spouse and/or estate.</p>	<p>Insurance provider manages the funds and assumes risk associated with investment performance.</p>
Option 3: Transfer to a locked-in plan	<p>Flexible amount of income may be taken each year, subject to minimum and maximum amounts and minimum age requirements.</p> <p>Some flexibility to delay receipt of income and allow funds to potentially grow in value on a tax-deferred basis, subject to age limits.</p> <p>Some flexibility to withdraw lump sums and/or unlock funds for increased accessibility at a later date.</p>	<p>Surviving spouse may receive 100% of remaining plan value on a tax-sheltered basis.</p> <p>Remaining plan value payable to estate or other beneficiaries if there's no surviving spouse.</p>	<p>Annuitant may select desired degree of involvement and choose from wide range of investment solutions.</p> <p>Annuitant benefits from strong investment performance and assumes risk of weak investment performance.</p>
Option 4: Transfer to a new employer pension plan	<p>Your new employer must be willing to accept funds from your existing pension plan.</p> <p>If it's a DB plan, you'll need to determine whether the whole amount can be transferred. In some cases, you may still receive a taxable payout from the DB plan. You can use the after-tax amount of the lump sum as you wish.</p> <p>Funds you transfer to your new employer's pension are generally locked in with the new employer's pension plan. Review the terms of the new pension for more details.</p>	<p>Survivor benefits will be subject to the terms and conditions of the new employer's pension plan.</p>	<p>DB plan investment decisions are made by pension plan administrator. DC plan investment decisions are made by plan member subject to limited choices.</p> <p>The investment risk lies with the sponsoring company for a DB plan and with plan member for a DC plan.</p>

Making your choice

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

Speak with your RBC advisor and qualified tax advisor, who can help you evaluate your options and prepare a customized analysis to ensure all of the considerations that are unique to your specific personal goals and circumstances are taken into consideration when you select your pension plan option.

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If you have questions on any of the issues in this article, please speak with your advisor.



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