Winnipeg Free Press
TODAY'S LOCAL BUSINESS

Retire wisely

Make sure you're getting best pension plan for you

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Updated: **May 11, 2008** at **12:00 AM CDT**

If you're nearing retirement and lucky enough to have a defined benefit pension plan, brace yourself for some difficult decisions.

The choices you make upon exiting the workforce will not only have a major impact on the financial well-being of you and your spouse, but they will also be irreversible.

Once you sign on the dotted line and start to receive pension payments, there's no going back to select a different option. Pension holders unfortunately often don't fully understand the choices and sign up for a payout scheme just because it's the most popular, or seems -- on the surface -- to make the most sense.

By following the pack and not delving deeply into all of the options, you could be robbing yourself of much greater monetary rewards in retirement.

And so today, we look at a few key strategies to consider.

In Manitoba, most pension plans allow the surviving spouse of a member, in the event of his or her death, to receive at least two-thirds of the member's pension allotment. (This is known as a joint and survivor annuity.) But there is usually the alternative to opt out of that, providing both spouses agree and sign a waiver form, so there is no survivor benefit at all (known as a life annuity). There is usually also a choice to receive either a reduced or enhanced benefit for the surviving spouse above or below the two-thirds.

The less money the surviving spouse gets, the more the plan member can collect immediately upon retiring. Suggest this option to your partner this morning, and you might just get a whack to the head with a frying pan.

But hold on a minute. With the higher monthly payouts you would receive upon retiring, you could use that money for some nice gifts or world travels for both of you to enjoy early in your golden years. If your spouse has a pension plan as well, or has considerable money saved up, that might just be an attractive option.

More likely, though, you could reinvest that money to buy long-term life insurance for yourself, naming your spouse as a beneficiary. This is a strategy called "pension maximization." It isn't for everyone, but if you're healthy and easily insurable, it may be worth some serious thought.

Under this strategy, the death benefit is informally earmarked to replace the lost pension benefit if the member dies first. You'll use a portion of the additional pension funds to pay the life insurance premiums.

If the spouse pre-deceases the member, then there's still an insurance policy in place that go can towards any beneficiary you so choose. And all along, the member receives the maximum payouts under the pension.

Mark Halpern, a Certified Financial Planner and founder of illnessPROTECTION.com Inc. in Toronto, suggests this is often an underutilized opportunity.

"It's just smart planning," says Halpern. "It's the difference between you being in control and not being in control."

"People say, 'what's the question here? Of course I want to make sure if something happens to me, my wife gets money.' But what people don't realize is that by choosing (a joint and survivor annuity) it can cost people thousands of dollars per year of lost income and also lock you into an inflexible situation that can potentially disinherit your family."

Halpern notes that under a joint and survivor annuity, pension payouts will remain at the same reduced level even if the pension holder's spouse dies first.

Ted Rechtshaffen, a Certified Financial Planner and CEO of TriDelta Financial Partners in Toronto, agrees that taking the single life annuity is usually the better route. But there are exceptions -- the key one being if the retiree has failing health and buying personal life insurance would be prohibitively expensive.

The most effective way of pursuing this option is by planning well ahead. Halpern even suggests considering the option at age 45, when most people are still healthy, premiums are low and there's a chance to have the insurance paid off by retirement day.

To figure out which may be the best option, David Ablett of Advanced Financial Planning at Investors Group in Winnipeg suggests this: calculate the difference between the monthly payouts under the single life annuity and joint and survivor annuity. Then get a quotation on a life insurance policy (you can do this through a broker or even on the Internet at sites like www.getterm.cc), and find out just how much coverage the difference between the two pension payouts can buy.

Ablett notes most pensions build in a minimum number of guaranteed payments under the single life annuity option if the pensioner dies within five to 15 years after retirement. So, in effect, the spouse would be covered during the early retirement years regardless.

While the majority of people who go for a joint and survivor annuity choose to have the surviving spouse carry on with two-thirds of the pension income, this is often not best choice, says Lyle Atkins, a Certified Financial Planner with Independent Financial Counsellors Inc. in Winnipeg. In many cases, having the spouse be entitled to 100 per cent of the pension income works better, even with the trade-off of the pensioner accepting a lower payout upon retirement.

"I find that any time I really looked at it and worked the numbers, taking the 100 per cent to survivor option always worked out better," says Atkins. This can be a particularly attractive option if a pensioner has health problems and has a short life expectancy, or if someone has a younger spouse who is more likely to outlive the pensioner, he says.

Some plans may also allow you to transfer out the commuted value of your pension into other investments as you near the end of your working life. It's sort of like using the accumulated amount in your pension to invest as you please.

It might be an attractive option for those who belong to a pension plan at a company that is financially struggling -- and is at risk of cutting back benefits in the future. It also can make sense in cases where pensions are not indexed to inflation and monthly retirement cheques are packing less of a punch year after year.

The key consideration, though, is expected lifespan. If your family history and current health suggests you'll live far into your retirement years, then taking the commuted value wouldn't make as much sense.

Ablett notes this option is often only valid if you are 10 or more years away from normal retirement age, so start planning early.

Some individuals can opt to transfer the commuted value into a locked-in retirement account (LIRA). Usually between 55 and 65, they can then elect to convert that LIRA into a life income fund and start to receive regular payouts.

"But by electing the commuted value transfer now, the investment risk has been transferred from the pension plan to the individual," Ablett warns. "That is one of the issues they have to examine," Ablett warns.

Defined benefit pension plans usually guarantee a retiree an income based on a pre-set formula and a member's years of service with a company. While still the most popular retirement plan, the percentage of Canadian workers covered by them has been dropping rapidly, with only 34 per cent holding one in 2003 compared with 44 per cent in 1992.

Many companies have been switching to defined contribution plans, whereby the employer and employee put a set amount of funds into the plan, and there's no guarantee what the value will be in the retirement years.

Here is a comparison of some basic monthly retirement options, as outlined by Halpern:

Option 1:

Life annuity. Pension pays $1,200 a month to employee, but upon his or her death, nothing to the surviving spouse.

Option 2:

Joint and survivor annuity. Pension pays $840 a month to employee, and upon his or her death, surviving spouse gets $840.

Option 3:

Joint and survivor hybrid annuity. Pension pays $1,020 to employee, and upon his or her death, $510 to surviving spouse.

So, in this example, a person who chooses a life annuity over a joint and survivor annuity would be collecting $360 extra a month, which could go towards paying for life insurance.

A word of caution from Rechtshaffen: make sure you are getting well-rounded and ethical advice about your pension plan. There's a lot more money for commission-based investment planners to make if you choose to take the commuted value and have them manage your investments. An unscrupulous planner may be quick to highlight all of the positives and not so much the negatives.

"It isn't always the right solution," says Rechtshaffen. "You want to make sure you're dealing with a financial planner who is looking at things from a few different angles as opposed to someone who focuses entirely on investment management."

Look for a planner well-versed in, and has spoken to you frequently in the past, about such things as taxes, government pensions, debt, lifespan, as well as investments, he says.

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