Leaving an employer?

Consider Your Options for Defined Benefit Pension Plans

A change or termination in employment can prompt a decision to leave a defined benefit pension with the pension plan of the former employer or transfer the commuted value of benefits from the pension plan to a locked-in registered plan. The factors influencing the decision that one should take into consideration will vary from person to person. There are situations where it is best to leave the pension in the plan, and there are other reasons where it makes more sense to transfer the pension.

When a member of a defined benefit pension plan leaves their employer prior to retirement, the employee may be presented with several options for their pension. They may elect to leave the funds in the plan, and if eligible for retirement, begin receiving the pension. Or they may opt to defer the pension to a future date. If the individual can find employment swiftly with a company that also offers a pension plan, they may be able to transfer the pension from their previous employer to the pension plan of their new employer. The other option is to transfer the commuted value of the pension to a Locked-in Registered Account ("LIRA").

A major consideration that may influence the decision for the pension commutation of a defined benefit plan is the tax implication. For instance, there are restrictions imposed by the Income Tax Act of a maximum transfer value which is based on an age-derived factor. This limit may prohibit the transfer of the full value of the commutation of a defined benefit pension plan to a locked-in RRSP plan. If a portion of the commuted value is not transferrable to a locked-in plan, then it must be received as a taxable lump sum. However, taxes may be deferred if there is available RRSP contribution room and the excess portion above the maximum transfer value is contributed to an RRSP. Otherwise, there may be additional strategies to consider which are best discussed with a tax professional.

The lump sum versus the pension benefit

The commuted value of the pension is the lump sum present value that needs to be invested today to provide a retirement income in the future. This value is based on current long-term interest rates and mortality rates. The commuted value, depending on the plan terms, may reflect all aspects of the defined benefit pension plan including: ancillary benefits such as pension indexation for inflation; enhanced benefits of early retirement such as the ability to take early pension without reductions; or a death benefit such as a guaranteed period or pension payable to a surviving spouse upon death of the employee.

Basically, the lump sum is the amount that the pension plan is willing to pay as a replacement for a future monthly pension. Ideally, there should be no difference whether the commuted value or deferred pension is taken. Yet, there are several factors or issues to consider when deciding which option to take. Notionally, either of the two options should have an equal value, but the individual's perspective and/or circumstances may affect their decision or bring into focus the more valued option due to their own personal situation.

What's your perspective on this important decision?

The decision whether to transfer or leave the pension will uniquely be dependent on you and how you feel about the situation and your comfort in making one decision over the other. Initially, you may approach this decision from a financial perspective and begin reflecting on how you would invest the lump sum, and what sort of investment returns you could expect. While these are important considerations, they are not the only ones.

Taking into consideration some of the non-financial aspects of the decision will help you make a confident decision about your well-being in the future. For instance, how do you feel about having flexibility and access to funds; and does it appeal more to you than peace of mind and access to other benefits? Alternatively, what are your thoughts about the company's solvency or management of pension funds; and does that concern you more than having to make investment decisions or not having a defined income stream for as long as you live? How you react emotionally and psychologically to these considerations will influence your perspective and your final decision. It is important to reflect on these non-financial considerations when making this important decision.

By creating a comprehensive financial plan, your BMO financial professional can help you compare the differences between receiving the lifetime pension benefit or the commuted value from a defined benefit pension. A complete financial assessment will illustrate your current financial situation combined with the impact of taking the lifetime benefit and be compared to a "what-if" scenario of taking the commuted value. This analysis and illustration will allow you to make an informed financial decision on the option that is right for you.

Non-financial and financial considerations influencing the decision

The decision to either leave your pension or take the commuted value should not be taken lightly. It merits a deep reflection of your situation, in conjunction with a detailed financial analysis. The table below provides a comprehensive list of non-financial and financial factors for your consideration.

In order to make a sound and informed decision, you may want to consider these factors from one of two perspectives: *I will take the commuted value, or I will take the lifetime benefit from the defined benefit pension, because of my (for example) level of knowledge and comfort with investing*.

The decision to leave the pension or transfer it – is ultimately yours to make. You have only one opportunity to make the right choice – the decision is irrevocable.

Take the time to weigh your options and consider all factors from both financial and non-financial perspectives. Your BMO financial professional can help you understand these considerations and assist you in making a decision that is right for your future.

For more information, please speak with your BMO financial professional.

Non-Financial and Financial Considerations for Pension Options When Leaving an Employer

Non-financial	Financial
☐ Family situation, I have dependents such as a spouse, children	☐ Financial goals, objectives and priorities
☐ Level of knowledge and comfort with investing	☐ Financial goals, objectives and priorities
☐ Life expectancy or family history of longevity	☐ Reliance as a primary source of income
☐ Emotional response to the situation of being terminated or downsized	☐ Need for flexibility to unlock and use funds for other financial priorities
☐ Concern for pension assets being mismanaged, underfunded or the company's solvency	☐ Requirement for the ancillary pension benefits such as indexing, survivor and bridging
☐ Fear of outliving funds	☐ Need for the unlocking provisions due to shortened life expectancy, financial hardship
☐ Peace of mind with guarantees and certainty	☐ Investment profile and risk tolerance
☐ Desire to leave an inheritance for my heirs	☐ Specific incentives offered to take commuted value
☐ Sense of security that the pension is fully funded	☐ Tax situation and the impact of pension income splitting and non-sheltered amounts above pension limits
☐ Necessity for other residual benefits such as health, dental, insurance, etc.	☐ Need for creditor protection

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