

When individuality may not be best



**MERRICK
WEALTH**

**By
Peter
Merrick**

I've received a flurry of calls from people with over 25 years in defined benefit pension plans. These people previously worked at various companies, and all asked if I could review their situations.

When someone is leaving an employer with a defined benefit plan, there are usually the following options: keep their money in the company defined benefit plan; transfer their pension to a new plan — in this case a newly-created individual pension plan; or transfer the entire vested portion of their pension out, where an allotted amount would go into a locked-in RRSP, and the remainder would be deregistered and taxed.

Up until a few years ago, I had

never considered that employer-sponsored defined benefit plans might not be able to meet their financial obligations.

But consider this. As the baby boomers start to retire en masse, beginning in 2010, Canada could see combined pension and health care costs exceeding 30 per cent of our total gross domestic product. In recent years, Canadian companies and their employees have seen their pension assets plummet. At the end of 2000, according to Statistics Canada, two-thirds of pension plans in Canada were in the red.

In the old economy, the average employee would work for the same company for 35 years. In their pension calculations, actuaries of defined benefit plans would make the assumption that male and female workers would retire at 65 years old, and the majority would die by 72. Now, actuaries need to factor in that a minimum of 10 per cent of all defined benefit male pensioners will live beyond age 91, and female pensioners beyond 94.

Members of these plans are asking themselves, "What if there's not enough pension money to go around when I retire?"

The answer for most plan members is not a very appealing one. If the plan can't meet its obligations,

retirees will get first claim on the assets of the plan. Next will be employees who are eligible for pensions. The remaining money is then divided among the rest. In Ontario the Pension Benefits Guarantee Fund offers limited protection for the over one million defined benefit plan members. But if a plan in Ontario has insufficient funds, the Pension Benefits Guarantee Fund will guarantee only the first \$1,000 per month of benefits.

The problem with the Pension Benefits Guarantee Fund is that it doesn't have enough money in its reserve (approximately \$200 million) if one of the large pensions in the province hits the financial skids. Plus the government does not provide any guarantees to defined pensions, as it does for money held in savings, chequing accounts and GICs, which are all protected through the Canada Deposit Insurance Corporation.

As a result many defined benefit members are reviewing their pension options, and considering transferring their pensions to a new employer's plan, which means creating their own individual pension plan (IPP).

The Canada Revenue Agency (CRA) Registered Plans Directorate has enhanced efforts to mon-

itor IPP compliance. If the CRA determines that an IPP does not comply with governing pension acts or CRA regulations, the CRA may revoke the IPP's registration. To remain registered, IPPs must at all times satisfy four criteria:

- The IPP must comply with all laws and regulations governing registered pension plans; all filings must be up to date.

- The plan sponsor must have been established for a reason other than to create a pension plan, prior to the plan being set up and prior to the transfer to the IPP of pension benefit assets from another defined-benefit plan from another employer.

- There is a bona fide employment relationship between the plan member (employee) and the sponsoring company (employer).

- If assets from another defined-benefit pension plan have been transferred to an IPP, the member of the IPP must expect to have employment earnings from the new employer similar to earnings from the prior employer for three years.

Let's say an IPP is established at a company that meets the criteria, with funding of the new IPP originating from the transfer of defined benefit plan assets. If the IPP

member owns more than 10 per cent of the sponsoring company — or is related to someone who owns more than 10 per cent of sponsoring company — they will only be permitted to transfer money from the older pension plan dating back to 1991. It is possible that hundreds of thousands of dollars within the older pension plan will not be eligible for the newer IPP.

In many situations, an employee is better off leaving their pension with their former employer if possible. Or, they could transfer the allowable monies from their former pension plan into a locked-in investment retirement account (LIRA) and be taxed on the surplus, instead of creating an IPP.

Someone with 30 years in a defined benefit plan is usually better off transferring money into a LIRA than an IPP.

Peter J. Merrick, BA, FMA, CFP, FCSI, is the president of Merrick-Wealth.com, a fee-for-service financial planning and executive benefit consulting firm in Toronto. He is the author of "The Essential Individual Pension Plan Handbook" (Lexis-Nexis Canada, 2007). He can be contacted at: (416) 854-1776 or peter@merrickwealth.com.