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SPECIAL BULLETIN

PENSIONS

Perhaps one of the most common requests I have from clients and individuals referred to me is clarifying the confusion often involved with pensions and pension roll overs. For individuals who have spent many working years establishing a foundation for retirement and the earnings necessary to secure a comfortable and sustainable lifestyle in that retirement, these pension inquiries are critically important. Knowing how to take advantage of the options available, including roll overs and commuted values while understanding the long term growth and tax implications of each is paramount in making the correct decisions for your future. Consequently, regardless of what you feel you already understand, I can always provide you that extra feedback that will allow you to have confidence in the decisions you are making. Remember your pension was formatted to provide for the rest of your life.

REGISTERED PENSION PLAN ROLL OVERS

There are generally two formats for developing corporate and government pension plans in Canada. The most common is the defined benefit pension plan. Under this arrangement a specific monthly benefit is declared upon retirement for the remaining life of the recipient. This monthly payment is based on a formula involving the employee's length of service, their earnings history and their age. This is by far the most common plan for long standing companies and for the majority of individuals employed by governments or near government agencies.

A second format is the defined contribution pension plan where contributions to the plan are characteristically made by both the employer and employee. Some companies may have both plans due to the adoption of a defined contribution plan at a later date, meaning all employees hired after that point participate in only the new plan. Some long term employees could possibly have both.

The popularity of defined contribution plans has steadily increased over the last twenty years. This is primarily because these plans are less expensive to administer and because the future income is not simply based on the funds contributed, but also on the accumulated growth achieved from the underlying investment pools both before and after retirement.

Characteristically, the companies sponsoring and administrating these plans (usually an insurance company) offer a mix of pension approved asset classes that will include Canadian equities, foreign equities and some fixed income investments. Within certain guidelines, a contributor can select a mix of these asset classes according to their own investment philosophy and risk tolerance. All participants are **restricted** to the options

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REGISTERED PENSION PLAN ROLL OVERS continued

available within the plan and each investment category will be a pool of all those choosing to invest in each asset class. This format allows some flexibility for knowledgeable investors or their financial advisors to potentially influence the ongoing value of their specific holdings by actively managing the ratios between the asset classes, and of course by extension, influence the amount that develops within the plan. This added growth can be paid out over the life span of the individual receiving the pension. Consequently with this type of arrangement, there can be a strong incentive to actively manage the assets both before and after retirement in order to increase the monthly payment.

With a defined contribution pension plan, there are a number of options that become available near and upon retirement. These options generally exist for a limited amount of time. A very common choice is the purchase of an annuity. An annuity is essentially an insurance product that provides guaranteed income for life based on the amount of assets dedicated to the purchase of the annuity and existing interest rates. Some financial advisors question the current wisdom of this given almost record low interest rates, yet others, would suggest this option eliminates the risks of investing. Whether this is a wise choice or not is a strategy that should be discussed with your financial advisor and should be based on your individual future income needs and your risk tolerances. It is important to realize that an annuity is a contract to purchase a product that provides a set income for life. Because this is a lifetime contract, a decision to purchase an annuity is not reversible.

A defined contribution pension can also be rolled over into a locked-in retirement income fund or LIF (locked-in retirement income fund). Unlike regular RRSP funds where you have the option to withdraw as much as you want if you pay the applicable taxes, the amount you can withdraw each year is restricted. The original intent of the pension was to give and protect a regular lifetime income as opposed to opting to use the assets to fund a summer cottage, a new car or a grandchild's education.

This is why the assets are described as locked-in and have built in restrictions. It is important to note that at retirement the pension funds must go directly from one qualified sponsor to another to avoid the total amount being classed as income and becoming subject to taxation.

The LIF can be housed with the pension sponsoring company essentially using the same investment pools that were available while the proceeds were still part of the pension plan. However, many individuals do opt to roll over the pension assets to other qualified financial companies in order to trigger more diverse investment options and to engage more active management.

The management of retirement funds or more specifically LIFs should be considered in the same management light as other registered investments and non-registered investments. All these assets should be responsibly managed according to their purpose within your portfolio. Consequently as a matter of proper money management, you should expect personalized service, regular contact with the advisor, appropriate and timely investment changes and advice that is specifically relevant to your circumstances. An 800 number is a poor substitute for a competent advisor.

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A Special Note: ARCELORMITTAL DOFASCO "DEFINED CONTRIBUTION PENSIONS"

Given the increasing number of Arcelormittal Dofasco clients I have the privilege of assisting with their financial needs and the growth in referrals from these clients of other Arcelormittal Dofasco employees, I believe it is timely to revisit some of the general idiosyncrasies of the Dofasco defined contribution pension.

I have written about this before, but I cannot over emphasize the importance of thoroughly understanding the options available within this pension format and the crucial timing of the options.

In general, most defined contribution pensions will have individual characteristics that differ from employer to employer. This is basically due to the nature of industrial relations and contract negotiations. Over the years, many clauses in the pension agreements have been points of negotiation resulting in clauses that are specific to that pension plan. Consequently, it is important to understand what these nuances are in order to interpret and guide the pension and future income most advantageously.

With the Dofasco defined contribution pensions, one third of the monies available must go into a life income fund or LIF. These are essentially tax deferred formats that structure the payments derived from your pension plan, locked-in RRSP or other locked-in retirement account assets. LIF's allow you to control the investment options, but the actual amount paid out is determined by a government formula. In Ontario, the remaining assets in a locked in pension must be converted to an annuity when the recipient reaches the age of 90.

If the individual is represented by a professional and accredited advisor, this locked in portion can be reduced to half according to guidelines established by the **Ontario Pension Board**. The remaining half of the pension assets can go into an RRSP or RRIF. All of the assets, locked in or not, can be managed according to the individual's risk tolerance and income requirements.

There are also timing guidelines applicable if the recipient of the pension opts to take advantage of any of these strategies. Consequently, you must be aware of these as they cannot be implemented hastily.

With the number of options available, seeking timely and informed choices is very prudent. In every case, I would recommend that if spouses are part of your financial framework, that they too have a good understanding of your pension options.

I also get asked a lot, "When can I retire based on my pension numbers?" I have helped numerous retirees establish a timeframe of when they are able to retire based on their personal plans. Please feel free to contact me if you would like a personalized retirement income plan prepared for you or if you work with someone who you feel may benefit from my service.

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THREE NEW SOCIAL TRENDS THAT MAY AFFECT YOUR RETIREMENT

Most of us look at retirement as a time to step down from the stress of working for a living and as an opportunity to finally do some of the things in life that were curtailed as a result of work and family responsibilities. However, there appear to be some growing trends that may impact on this simple vision or retirement. At the very least, these trends should be a part of the retirement discussion.

The first trend is adult children either returning to the parental home after initially leaving or being reluctant to make a first departure for financial reasons. According to Statistics Canada, in 1981, roughly 11 per cent of young adults between the ages of 25 and 29 were living with their parents. By 2011 this figure had climbed to over 25 per cent. Among people aged 20 to 24, 60 per cent were living with their parents in 2006, up from 49 per cent 20 years earlier.

- As one 27 year old returnee stated, "For me it just made good economic sense. Establishing yourself and getting an education that would generate the independence I wanted takes more time now than it did years ago."

Most of the reasons for this development are related to two economic factors. Young people now need to go to school longer to get credentials that that will generate the same kind of income as their parents experienced. And secondly, the housing market in most Canadian centers has become a great deal more challenging. Rental units are not as accessible and down payments for purchasing, especially in cities like Toronto and Vancouver, are requiring many more years to save.

Barbara Mitchell, a sociologist at Simon Fraser University, has stated, "Young people really are growing up in a very different social and economic climate than their parents did.''

This trend is not likely to turn downward in the near future.

Although it might make economic sense to the young adult, to parents working on accumulating their retirement assets, this could be a serious drain on future resources.

The reverse is also a developing phenomenon. Many children are now having to think about or actually direct retirement resources to looking after elderly parents. Although the obligation for some may be debatable, the reality is that many children are now directing financial resources to maintaining quality of life for parents. With an increasingly strained public system, many Canadians are spending their own savings to care for their elderly loved ones. With the possibility of two sets of parents requiring assistance, all of whom are potentially living longer, the financial strain can be financially debilitating and the prospect of retiring comfortably challenging.

A 2012 BMO survey suggested that 7 in 10 caregivers were providing some sort of financial assistance to their parents or aging relatives, and half of these individuals said they had to adjust their own retirement plans as a result.

The key to proper financial adjustments for these contingencies is to anticipate and plan accordingly.

A third consideration in retirement is the increasing trend towards grandparents taking on the financial and practical responsibilities of attending to the needs of grandchildren. With the increasing occurrence of both marital failure and the necessity of both parents having to work, many grandparents are finding they have to supplement the needs of their grown and theoretically independent children.

These circumstances are always unfortunate if needed retirement income is being tapped to subsidize those family needs.

In all cases, these are issues that I can help with by providing workable formulas that will address these financial demands.

- "I knew financially it would be smarter to move back with my folks while I just got things sort of sorted out,'' Harris, 27, said in an interview about looking after his retired parents.

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CURRENT MARKET OBSERVATIONS

As we see summer coming to a close, autumn is at our doorstep and historically so are the volatile markets.

International Monetary Fund managing director Christine Lagarde recently announced there would likely be a downgrade in its 2016 global growth forecast again as economic prospects are dim. Two months have passed since the Brexit vote and, although the dust is gradually settling, the external regions still remain challenging. Following the vote, market expectations for a more accommodative monetary policy stand around the world increased, which, in turn, stimulated risk appetite to rise even higher: equities around the globe have reached new record highs and commodities prices, led mainly by crude oil, have returned to the gradual recovery path which was briefly interrupted by the aftermath of the Brexit vote.

Below is a brief detail of what is happening around the world:

- **Eurozone:** After a positive start to the year, growth in the eurozone has declined. The slowdown was partly due to temporary factors as growth in Q1 benefited from a mild winter and the early timing of Easter. In the third quarter it has demonstrated resilience in the face of intensified concerns over the impact of Brexit on the economy. In addition, the region’s banks showed a relatively clean bill of health in the European Banking Authority’s latest stress tests. The results revealed on July 29 showed that all but one of the 51 lenders tested—Italy’s Banca Monte dei Paschi di Siena—had enough capital to withstand the toughest scenario.

- **Emerging Countries:** Among developing economies, the outlook for Asia ex-Japan remains in a holding pattern of slow growth. Latin America’s dismal economic outlook also remains unchanged (minimum growth opportunities continues) as many economists are less doubtful about the outlook for Brazil, although Venezuela continues to be a ticking bomb. In Russia, a less negative outlook is supporting growth prospects in the region, although spillovers from the Brexit vote are expected to hit some countries in Central Europe going forward. Lastly, the recent bounce in commodity prices following the Brexit vote has prompted the outlook for the Middle East and North Africa to stabilize.

- **US:** Business economists still think the US economy will continue to grow for the next two years, but they again have scaled back their expectations. The driving factor for lower expectations is business investment, but also worries about the outcome of November's presidential election are weighing on expectations. “Will they or won’t they raise interest rates?” seems to be at the forefront of the news recently. After reading numerous articles and listening to endless webcasts, I still believe that the interest rates will remain the same until after the election in November. On the bright side, the economists don't expect the reduced GDP expectations to carry over to consumer spending. Analysts expect GDP for 2016 to be 1.7%, which is down 0.2 percentage points from July’s forecast. For 2017, they see GDP growth at 2.1%.

- **Canada**: The Bank of Canada (BoC) has left interest rates the same. With a devastated oil sector plus the worst natural disaster in the country’s history, the wildfire that swept through parts of Fort McMurray in Alberta, 2016 has been a year of unwelcome hardships. For the decision-makers at the BoC, their tool of choice is monetary stimulus. If the US Fed gets too far out front with interest rate hikes the BoC will have no choice but to start raising rates.

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CURRENT MARKET OBSERVATIONS continued

Increased leverage remains a source of discomfort for the Bank of Canada. A new study from credit agency TransUnion shows that of the 26 million credit-active Canadians in the country, 718,000 can't absorb a 25-basis point increase or they won't have enough cash flow to cover their debts. Raise rates one percentage point, something not likely to happen overnight, and 971,000 Canadians end up in a cash crunch. The risk seems to be that consumers have been building up debt because they're attracted to low rates that never seem to rise. The next interest rate announcement is not due until mid-October but the consensus among economists is there will not be a rate hike until the third quarter of 2017. That may be part of the problem, since consumers have come to expect rates will never go up and are now borrowing based on a prime lending rate of 2.7 per cent.

I feel that the current volatility in the markets is a reminder that capital market investments are not always rational. For that reason, I believe it is important to take a longer-term approach, and to be diversified amongst all sectors, geographies and assets thereby reducing ones risk in their portfolio. I continue to advise clients, that based on all the geopolitical issues occurring around the world and at home, to lower their return expectations until global growth rates start to increase.

If you have any questions regarding your accounts or my thoughts on the current economic markets please do not hesitate to contact me.

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