



## Retirement Dilemma – Take Company Pension or Commuted Value

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When an individual who is a vested member of an employer's pension plan ceases to work for that employer they will have to decide what to do with their vested pension benefits. Should they leave the funds in the pension plan and eventually draw a retirement pension benefit, or should they transfer the commuted lump sum value of those benefits into a locked-in retirement account (LIRA)?

Most individuals have difficulty comparing these options because they don't have a clear understanding of the total value of the benefits emerging from either option and the risks associated with each option.

The question becomes; if you take the lump sum commuted value and invest it, will it provide the same or greater annual income as the pension payment benefit being offered over the duration of your life expectancy?

Using time-value of money calculations, it is possible to do a fair comparison of both options and come to a reasonable conclusion. Let's use a simple example to demonstrate:

Fred is 65 years old and is about to retire. The pension plan administrator has given him two options:

- accept an annual pension of \$16,750 payable at the end of each year; or
- receive a lump sum of \$96,660

Fred is an average Canadian male and we'll assume his life expectancy is another 15.72 years. So, for the purpose of comparing the two options, we will have to compare the present value of an annual pension of \$14,250 provided for 15.72 years, with the lump sum amount of \$96,660. We will assume that Fred can earn 8% on the lump sum amount.

Given these assumptions, the present value of this annual \$16,750 pension is \$146,929. This is somewhat higher than the lump sum, commuted value offered by his employer.

We can take this illustration one step further by determining the interest rate that Fred would have to earn on a lump sum commuted value of \$96,660 to provide the same annual income of \$14,250. Using the same life expectancy and payment information, the interest rate would be 15.5%.

Because Fred is unlikely to be able to earn a return of 15.5% on an investment of \$96,660 without entailing substantial risk, he would likely opt for the annual pension of \$16,750 instead of the lump sum of \$96,660.

Clearly in making a decision of such importance, there are many other issues to consider and as such the example above is general in nature and should not be relied upon as, nor considered to be the rendering of professional advice. Readers would be well advised to consult with their own advisors, accountants and/or lawyers for advice on specific circumstances before taking any action.



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