BY BEASLEY HAWKES

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DOING YOUR HOMEWORK

Something's been on my mind more and more lately—the trend of moving clients' guaranteed pension plans into private investment accounts.

I know, shoot me now; that's how we earn a living. Have I been smoking something?

Obviously, transferring a pension's commuted value into a personal account makes perfect sense *sometimes*, but have you considered the wrong reasons for doing so?

Here's a scenario. The client has $100,000 non-registered and $200,000 in RRSPs with the advisor, plus a $500,000 commuted value in the pension plan. The investments have done really well recently (invested mostly in Canadian equities, income trusts and balanced funds), and have a three-year average return of 12%.

The client is about to retire. The pension plan will provide $3,100 per month for life, on a joint-and-two-thirds survivor pension. For the sake of argument, let's say there's no inflation indexing (though often there is some cost of living adjustment involved). This client has no children and the pension plan is solvent.

Many advisors would say: "The pension plan is giving you the equivalent of 7.5% on your money, and you have none left over after you and your spouse die. Your RRSPs have just earned 12%. Which would you rather have?

"Of course, the monthly pension payments are guaranteed (as long as the pension plan stays healthy) and there is some risk involved with the personal investments in the market, but you've seen how they've done. The good years will more than make up for the bad. Over the long term, the stock markets perform better than 7.5%. Come on, it's a no-brainer."

So where have you gone wrong? By not considering the following:

- **The client's realistic risk tolerance:** Have you ever watched people squirm through a two-year bear market as they're withdrawing 7% a year from their account and watching it steadily dwindle?
- **How you would actually be investing the money:** The RRSPs could be invested fairly aggressively, as you had the guaranteed pension to fall back on. But if you invest the new locked-in money at anything more than 50% equities while drawing capital each year, you have decreased your sustainable withdrawal rate significantly. If you're in a province where some or all of the money can be unlocked and withdrawn, have you used this as a selling point? It likely isn't one, as the client has non-registered money and unlocked RRSPs to draw upon.
- **The math and science:** Have you had an actuary tell you what you really need to achieve on the capital to sustain the same monthly income amounts as the pension? Do you understand fully how annual (or even monthly) fluctuations can wreak havoc with the principal amount, even if the average rate of return hits the target? Have you pointed out that living longer could mean they run out of money down the road?

The right reason to transfer out a pension is to maximize estate value. An alternative to the transfer may be the purchase of permanent life insurance, but this requires the same rigorous evaluation as the former.

We need to do our homework so we can look our clients in the eyes in 10 or 20 years. Also consider preparing a checklist for clients to review and sign, showing that they, too, have done their homework and understand what they are doing. There are instances where transferring the commuted value is the right thing to do, but remember, you might not be totally objective about that. AE

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