Retirement: Transfer of a Locked in Pension Plan

When Do You Transfer a Locked in Pension Plan?

By: Joe the Investor

The transfer of a locked in pension plan generally means that money is being transferred from the original company who operates the plan to another institution and invested by the beneficiary. If you are going to receive the money held inside the pension plan when you retire, you are the beneficiary. The funds will still be locked in, but how the money is invested will be determined by the receiver of the money, and the terms of how the plan is operated will also be determined by you.

When Can I Do this?

Generally speaking, this can be done when you are leaving an employer, or when the pension plan is being dissolved, wound up or merged. You will generally be told that these situations are happening, but due to the complexity of pension plans, most people will leave the funds where they are until retirement and then take a smaller or "deferred monthly payment" when they reach retirement age. Retirement age is the age when you can start withdrawing money as mandated by the plan. It is not necessarily a particular age – some plans allow you to withdraw at age 55, age 60, age 65 or somewhere in between. Some plans allow you to withdraw when you are younger, but it depends on how many years you have contributed to the plan. Other plans will allow you to withdraw money at age 55 or later, but the conditions will be different compared to age 65.

When I say a pension plan, this can be a Defined Benefit Plan (DB Plan) or a Defined Contribution Plan (DC Plan). The difference between these two types of pension plans are that with a defined benefit plan, the *payments in retirement (or benefits) are predetermined at a certain amount per month* and these are guaranteed by the plan sponsor (entity who operates the pension plan). Note that the contributions that you are making as a member of this plan can change at any time before retirement, and your payouts do not necessarily have to change to go along with the contributions. A defined contribution plan is *when the amount of money put into your plan is predetermined*, but the payments in retirement depend on how the money is invested. You will see the contribution as a deduction on your pay stub in both cases. How the money is invested is determined by you and is usually determined by what products (mutual funds or something similar) you choose and how they perform.

Why Would I Bother Transferring My Pension Plan?

In most cases, leaving retirement funds where they are is not a bad idea. It is easy, and there is the least chance of getting involved in something you don't understand. I will highlight situations when you may consider moving money out of a pension plan because they are unusual circumstances, and transferring your money may benefit you. Keep in mind that as time goes by, these situations may become more common, and this decision should be kept open as a possibility.

Is Your Employer Going Bankrupt?

If your employer is in this category, or might be in the near future, the pension plan that it is contributing to may not be getting any money from the company. This means that the plan would have to rely on investment returns only, or eventually be wound up or closed down. Typically a pension plan relies on contributions from the company, employees and money generated through investment returns from past contributions. If you are working at a company, keep an eye on the company finances. Note that layoffs or outsourcing may not be a sign of bankruptcy, because many companies lay off people even when they are making large profits. Some companies outsource jobs even when they don't need to. This is done to increase profits rather than protecting against losses.

Note that for a defined contribution plan, the company you are working for is not running the plan, but they still may contribute money on your behalf. You would need to examine who is providing the mutual funds or products that your money is invested in. In most cases, this would be an insurance company, bank or mutual fund company, and there wouldn't be much concern unless the financial institution would need a bailout or has its own financial problems.

Are Your Contributions Going Up Quickly?

Are your pension plan contributions going up quickly? This information is easily found on your pay stub over time. Rising contributions may mean that the fund is running out of money, and needs these contributions to pay the bills. Rising contributions may mean other things as well, so it is advised to delve further into the state of the pension plan. You will need to see the funding status, or how much liability the fund has versus how much assets the fund has. A pension fund is like any business or entity. There must be adequate money to pay all the bills and ensure that the entity survives. This information tends to be complex, so it you want to find out what is happening, do your research and ask people in your company how to read the statements and what the numbers mean. If you need help interpreting the situation, ask a professional who can interpret the information for you.

Are Investment Returns Poor Over Many Years?

This is related to the pool of contributions of the defined benefit pension plan. A DB plan derives money from contributions and investment returns of money contributed to the plan in the past. The pension plan gives out money to pay benefits and pension income. If investment returns are poor, part of the equation is suffering. In general, poor returns for a year or two are usually recovered. If poor returns persist for many years, the funding status of the plan may be called into question. This is usually determined by an actuary every few years on average. If you are investigating plan contributions or the pension plan returns, always tie them together with the plan funding and see if there is a story unfolding. These items will be linked together.

Is the Company Switching from a Defined Benefit to a Defined Contribution Plan?

This is not an indicator of stress in itself. What can happen here though is that your retirement expectations would be changed because the original promised payments will be different if the plan type changes. You would need to go through your current scenario and what would happen if the new type of plan were instituted. These calculations require a lot of forecasting, and can be very complex, so allow a lot of time and if needed, obtain the advice of a financial professional who can interpret the risk and rewards in different scenarios. Allow a lot of time to make this decision because the changes can be significant over your working career. Many companies are changing from defined benefit plans to defined contribution plans to save money and reduce future payments. This may not mean that your pension plan is in trouble – it may mean that the employer is trying to increase profits. This has changed from years ago where companies tried to pay as much as they could to retain employees. Nowadays, companies may pay as little as they can to still retain the same employees. Pensions and other benefits are viewed as costs like salaries or bonuses, so they will be minimized over the long run if it is deemed necessary to do so.

Is Your Company Being Merged or Bought By Another Company?

This event in itself may not trigger any issues, but it will depend on why the company was bought. If the company you work for has bought another company, there wouldn't be too much concern. If the company you work for was the target of the takeover, then you should take notice. Some companies announce a "merger of equals" when in fact there was a takeover. Make sure you understand why the merger really happened. The keys to knowing this are: Who will control the new entity after the buyout? Who is making the decisions in the new entity? If it is your former bosses, you are part of the acquirer company. If you find that you are getting orders from the other company, then you are part of the target company. If you are part of the acquired company, there are situations when the pension plans may also get merged. The merged entity may decide to save money be changing the plan type, reducing benefits or eliminating the pension plan altogether. Be aware of what is happening in the months following a merger to see what is being contemplated.

How Do I Actually Do the Transfer?

If you find you are in a situation where you have to decide whether to leave the pension plan where it is or transfer it out, treat it as a major retirement decision. If you do transfer your pension plan, it will become a locked in retirement account (LIRA), and the money would be transferred to another institution. The institution can be a bank, mutual fund company, insurance company or other enterprise. Since the retirement funds are locked in, there are no tax consequences of the transfer itself. You will only pay taxes once the money is withdrawn, and this is part of your conversation when doing your retirement planning. Once the money is transferred to the institution, you will generally have to manage the funds on your own, or hire someone to do it for you, which could be your broker, financial planner or financial advisor/counselor. This would be managed like RRSPs or other monies that you would invest for retirement.

To do the transfer, there are some forms that are required. Some of these are required by the government and others by your employer and the institution. Make sure to ask who your money is coming from (your employer) and who the money is going to (the institution) and the government to know what forms are needed. When you actually do the transfer, if it is a defined contribution plan, the amount accumulated up to the date of the transfer is available on the statement of the plan. For a defined benefit plan, this valuation or commuted value is more complex. Generally, the amount accumulated equals your contributions plus employer contributions plus the guaranteed rate of return over the time period in which you were part of the plan. The plan sponsor would have to provide you with this number, or can provide you with calculators to help you estimate the value yourself.

Should the decision to transfer a locked in pension plan presents itself to you, make sure to allow a lot of time and have all the information on hand to make a wise decision.

Contact me, Joe Barbieri by email at joetheinvestor.today@gmail.com, or by telephone at 647-286-8020 for an independent consultation on what these options are. **Note: This site is intended for people who want to learn about the world of investments and how to research for themselves. If you would like to buy or sell investment products, or specific advice on investment products, tax or legal issues, please consult your investment advisor, accountant or legal counsel.**