



Karl's choice

Karl Warden is losing his job – and his pension. At least he's getting a big payout. But how should he use his money to rebuild his retirement plan?

BY DAVID DIAS

Only a year ago, Karl Warden's path to retirement seemed clear. As the supervisor of a pulp mill in Ottawa, he was earning \$80,000 a year and, although only 48, was just seven years from his permanent vacation, funding a well-earned retirement with his company's defined-benefit pension plan. All that changed last November. "We showed up at work one day and the mill was closed," says Karl (not his real name). "We gathered for a meeting and were told that the mill would be shutting down over the next year. We'd all lose our jobs."

To make matters worse, the company also announced it would be terminating its pension plan. In its place, each employee would receive a one-time buyout worth the "commuted value" of his or her contributions. In Karl's case, that amounted to \$350,000. In addition, he would receive severance of \$95,000, plus a "bridging benefit" of \$100,000. All told, his fare-thee-well package would be worth \$545,000 when the plant closed for good.

Today, just weeks away from a pink slip, Karl faces the most important investment decision of his life: how to invest his payout to secure his retirement. His plan had been to retire part-time at 55, then completely at 60. With annual pre-tax income of \$50,000, he'd hoped to maintain his current lifestyle, with an occasional trip to spice things up. But the loss of his pension throws his goals into doubt. For the first time, Karl must take full responsibility — and risk — for his financial security, and that of his wife, Melinda, who suffers from a degenerative condition that may require expensive health care in the future.

At the heart of Karl's dilemma is the choice he's been given with respect to his pension buyout. The company is offering two options. He could take the bridging benefit and pension buyout as a \$450,000 lump sum, then deposit \$350,000 of it tax-deferred into a Locked-in Registered Account (LIRA) — similar to an RRSP, but with strict withdrawal rules to preserve the fund throughout retirement. The LIRA would give him the flexibility to invest as he chooses, but he's not sure if he likes the risk. Karl also says the withdrawal restrictions are onerous. "When you hit 85, you're still going to have half your amount left," he says. "They're projecting you're going to live to be 100."

The second option would be to purchase a non-indexed life annuity, arranged through the company, which would pay Karl \$32,000 a year starting at age 55. In this scenario, the

Karl Warden has two options for turning his payout into a nest egg. Each one has an upside as well as a downside. "What do I do with this money?" he asks

ILLUSTRATION BY CHIP WASS

\$100,000 bridging benefit would start at the same time, paid out in 10 yearly installments. Karl loves the stability of the annuity, but worries that he'll miss out if the LIRA brings better returns.

With only two options — the LIRA or annuity — Karl's problem would seem simple. But he's never had to actively manage his retirement investments before, aside from a recent practice of saving \$10,000 year. The wrong move could cost him later on. "That's my main concern," he says. "What do I do with this money?"

WHAT THE EXPERTS SAY

"In this particular case, there's no clear-cut winner," says Marc Lamontagne, a financial planner at Ottawa-based Ryan Lamontagne Inc. To match the guaranteed proceeds of the annuity, the LIRA would have to return about 5% a year (before inflation and projecting to age 100) — considered easily attainable with the right mix of mutual funds. In fact, many advisers would say the LIRA could do even better — if Karl accepts some risk. The annuity, meanwhile, comes with no risk at all.

According to Nancy Graham at PWL Capital, also in Ottawa, the Wardens should pay less attention to projected rates of re-



turn and more attention to their needs, given that they face a high degree of uncertainty. They don't know when Karl will find another job, or what it will pay. They also don't know what they'll need in retirement, due to Melinda's health.

With virtually no margin for error, she says the Wardens might welcome the safety of an annuity, despite the conservative return. The drawback, however, is that an annuity is not indexed to inflation, which will hit hard later on. By age 80, for example, the Wardens' \$32,000 benefit may only be worth \$16,000 in today's dollars. Fortunately, the staged introduction of the bridging benefit (age 55), CPP (age 60) and OAS (age 65) will help offset the declining value of their annuity.

Tip of the Month

Retirees can ride out soft markets with cash

For retirees living off their savings, here's a simple but often overlooked piece of advice. Be sure to keep a couple of years' worth of cash in your portfolio. This way, when the markets sour, you won't be forced to sell your investments at a locked-in loss. Conversely, when the markets are on a tear, you can top up cash reserves by selling more than you'll need that year, providing a hedge against future downturns.

Under either scenario, however, both advisers say that the Wardens will probably fall just short of their retirement income goal of \$50,000, even if Karl continues to put aside \$10,000 a year until his target retirement date. He and Melinda could sell their \$350,000 home to make up the difference. But they might need that money as an emergency fund, should Melinda require long-term nursing care.

For greater financial security, the Wardens have to compromise. Karl, for instance, could work full-time until, say, age 58. Or they could lower their income goal to \$45,000 a year. "Even small changes will make a big difference," says Lamontagne.

Before making big decisions, though, Karl needs to find a new job — and soon. He could use his \$95,000 in severance to cover living costs, but our advisers say he'd be wiser to make a \$45,000 RRSP contribution permitted under the pre-1996 "retirement allowance rule," a gift from the federal government he shouldn't refuse. After that, he'd still be on the hook for \$21,000 in taxes, leaving him with only \$29,000 for expenses until he finds work.

For now, though, the Wardens can take heart. Whether they choose the LIRA or the annuity, they're not far from their goals. In fact, they could view their dilemma as an opportunity. After all, with the LIRA, they have the option to control their investments actively. If they choose the annuity, they'll enjoy guaranteed pension-style payments. It's up to them. **B**

Financial Snapshot

INCOME

Karl's salary	80,000
Melinda's disability pension	7,000
TOTAL INCOME	\$87,000

EXPENSES

Income taxes	20,000
Mortgage, property taxes	17,000
CPP/EI	2,600
Pension plan	2,700
Medical, dental	800
Utilities, Internet	3,500
Insurance (home, car, life)	2,000
Groceries	3,600
Dining out	4,000
Vacations	3,000
Home improvements	4,000
Clothing, haircuts, etc.	3,000

Gifts, charity	2,800
Car maintenance, repairs	1,500
Recreation, golf, etc.	1,500
Miscellaneous	5,000
Savings	10,000
TOTAL EXPENSES	\$87,000

ASSETS

House	350,000
Pension plan	350,000
Bridging benefit	100,000
Severance payment	95,000
RRSP	50,000
Savings	20,000
Car	10,000
TOTAL ASSETS	\$975,000

LIABILITIES

Mortgage	75,000
TOTAL LIABILITIES	\$75,000
NET WORTH	\$900,000

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