Retirement Q&A

Three reasons to stick with a defined benefit pension plan

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Question from Derrick Alstein, Port Elgin, age 60: I have a number of friends and a relative who are considering cashing in a defined benefit pension plan. I think an article on the pros and cons of a cash out strategy versus taking normal payments would be informative. Many people I know that have cashed out are taking advice from people that want to invest their money, have not done well and have had to go back to work.
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Over the last 25 years, Ms. Mizgala has helped clients make smart life and financial decisions as they transition to and through retirement

Karin Mizgala is a certified financial planner and the co-founder and chief executive officer of Money Coaches Canada. While the lump sum offered to people who consider cashing out their defined benefit pension can be very tempting, I rarely advise clients to withdraw from their pension and invest the proceeds with a financial adviser. Here's why:

1. Ease of Management. With a defined benefit pension, your employer hires an investment company to manage the pension assets and is responsible to ensure that employees receive the monthly payment they are entitled to based on a formula that considers earnings history, years of service and age. You have no direct involvement in the management of the investments and there is no need for you to make any investment decisions before or after retirement. At retirement you receive a regular monthly payment from your employer for life. Simple.

Most people who want to weigh the pros and cons of a lump sum withdrawal turn to their financial advisers for advice. Of the almost 100,000 financial advisers in Canada, 99% have a vested interest in directly or indirectly managing your investments. I'm not saying that it's impossible for advisers to provide unbiased advice on whether to stay with the pension or not, but when the potential investment dollars are significant, let's face it, it's not easy to remain impartial. To avoid any potential conflicts of interest, it is best to consult an accountant, actuary or fee-for-service financial planner on pension decisions.

2. Security. While it is possible to earn higher returns from managing money outside a pension, you need to ask yourself if you're willing to trade off the security and simplicity of a regular monthly "pay cheque" that will last through your lifetime (and potentially your spouse's) for the *potential* to make more money. Most retirees that I work with overwhelmingly want safety and peace of mind - not income maximization. Good cash flow management and risk minimization should be the focus for a stress-free retirement.

3. Fees. Pension management costs are typically quite low when compared to adviser managed investments especially if your adviser uses traditional mutual funds. Even if your investments do better outside a pension, it's the after-fee return that matters so be sure that investment projections include fees. If your pension is worth $300,000 and you are paying even an extra 0.5% management fee, that's $1,500 in your pocket annually.

Some reasons to consider taking the cash value of the pension would be if you expect lower life expectancy for health reasons, if the pension isn't indexed or if the company is struggling financially. Otherwise, leave the pension where it is, relax and enjoy your retirement.