



EXCLUSIVE INTERVIEW:

Today I'm pleased to be talking to Marilyn Lurz, a Certified Financial Planner and owner of the pension consulting firm Lynmar Associates Limited about what CAP members need to know in order to plan for a successful retirement.

Thanks for joining me today Marilyn.

Sheryl, thanks for arranging this. I'm looking forward to our discussion.

Q. How important is it for employees to make retirement investment decisions in the context of their own overall financial plan? What factors should they take into consideration?

A. I think it is important to actually create a retirement plan before making these important investment decisions. People need to think about what they need the money for – how are they going to spend their time in retirement? For example, if someone has expensive hobbies that they intend to pursue in retirement, that person may need more money than someone else.

The retirement planning process is an offshoot of basic financial planning, which involves 6 steps. Here are the steps:

- Define what you're trying to accomplish
- Determine your goals and gather data
- Clarify your present financial status, including problem areas and opportunities
- Develop a plan
- Implement the plan
- And lastly, monitor and evaluate the effectiveness of the plan periodically

Whether a person gets help or not, they can still follow these basic steps.

In addition to personal goal-setting, it's important to prepare cash flow and net worth statements. Fortunately, there are many tools for this available on the internet. Then one needs to include in the plan such things as estate planning and tax planning in addition to asset and risk management tactics.

Q. So there is a lot to think about. Say an employee has accumulated a respectable lump sum in her employer-sponsored group retirement plan and she is coming up to her retirement date. What is different about investing before retirement and after?

A. Well, when you're in the accumulation phase, you're injecting new capital into your asset holdings every year. After retirement, you're taking money out instead of adding new money, so you need to be prepared in terms of what you will sell of your current assets in order to pay yourself an income.

If you're planning on buying some annuity at retirement (which helps to manage your risk of living a long time – called longevity risk), then you may need significant cash in hand in order to buy your annuity. So you may be looking at a big “sell.” The concept of dollar cost averaging works just as well when you sell as when you buy – you don't want to sell a lot of assets at one time because it might not be the best time to sell, so you need to spread the “sell” over a period of time.

Tax planning comes in here too, of course – if you're lucky enough to have some after-tax assets as well as tax-sheltered assets, it may be a good idea to live off your after-tax assets first and keep the tax-sheltered assets working for you as long as possible.

Q. In most cases an employee must transfer the lump sum out of the employer's group plan at retirement. What kinds of transfer vehicles are available?

A. At retirement, members of employer-sponsored capital accumulation plans generally have three choices for what to do with their assets – they can buy an annuity, they can buy a Registered Retirement Income Plan (RRIF) – in some cases locked in, or they can do some of each.

Of course, depending on the plan type and jurisdiction, members also have access to cash. Is cash a good option? My problem with it is the taxation implications, but who am I to tell someone who has, for example, large credit card debt that it's not a good idea to take some cash?

This again is all part of the planning exercise.

A quick word on the product often referred to as the “Guaranteed Minimum Withdrawal Benefit.” This is normally a RRIF where you continue to invest but you’re somewhat protected from downside risk during your payout years.

This product isn’t for everyone, and I say that simply because there are extra fees involved. One therefore has to weigh the perceived benefit of these products against the extra fees one pays over time.

Q. Some of the insurance companies have taken a hit on GMWBs because of the nature of the promises they have made.

A. Yes they have.

Q. Under what circumstances might each of these transfer vehicles be the right choice for an individual retiree?

A. I think you’ve asked the million dollar question. When one reviews a financial plan or retirement plan, the variations are so different depending on each person’s circumstances.

Having said that, the longevity risk piece is a big issue, in my opinion. If we know how long we’re going to live, then the answer is easy. Generally speaking, short life means RRIF is the best choice; long life means annuity is the best choice.

But most of us don’t have the answer to that question. So just like any other sort of investing, it’s a good idea not to put all of one’s eggs in a single basket. That leads to the conclusion that it’s a good idea to have some investment in an annuity and some in a RRIF. This way, you protect yourself against short life and long life at the same time.

Is a 50-50 split the right answer? It depends! If someone tells me they’re very concerned about estate planning and the risk of dying early – they have people who depend on them to bring home the bread – then you might want to skew the planning in favour of a RRIF. On the other hand, if a healthy person tells me they have many family members who have lived a long time and their biggest worry is running out of money in old age, then the answer might be different.

Unfortunately, I don’t think there’s any “one size fits all” answer to these questions.

Q. How can retiring employees learn about the pros and cons of each type of transfer vehicle, which one is best for them, and where to go to get one?

A. Wow, another big question! There's a huge amount of information out there. Every insurance company, bank and investment dealer has volumes of information available. But I haven't seen a lot of material that makes it simple for people to figure out what's best for them.

There is certainly some material that provides you with a "pros and cons" list of the various options. A person needs to take these "pro-con" lists and weigh each of the points listed in the context of their own individual situation. One also has to remember that, if a list is coming from a source that sells product, the list might be somewhat skewed in favour of certain outcomes.

It's a "buyer beware" marketplace out there, and one of the best defences is a knowledgeable buyer. Acquiring the knowledge may not be everyone's "cup of tea" though. In my profession, I'd say over 90% of CFPs sell product, but there are some who do not. Individuals can find a list of qualified CFPs at the Financial Planning Standards Council website.

Q. How do investment fees change when moving from a group retirement plan to a retail RRSP or RRIF? Are "rollover" group RRIFs offered by insurance companies to employees of their clients a better deal than individual RRSPs, RRIFs?

A. Investment fees in a group product are generally much more reasonable than in the retail marketplace. In some big plans, I've seen situations where the investment fees are less than one half of what you'd pay in the retail market; in some cases, less than one third. The fees groups pay are a function of the group marketplace combined with a plan sponsor's negotiating "clout" – and that clout is usually a matter of size – the bigger you are, the less fees you pay.

So members taking money out of their CAP at retirement are in for a fee "shock" in the retail market. The "rollover" group RRIFs of which you speak can be slightly better than the retail market, but from what I've seen, the member's fees are going to go up no matter what if/when they move out of the group plan. This is another point of investigation for members, before making final decisions on what to do with their money at retirement.

Another option to consider is the self-RRIF. The Saskatchewan Public Employees Pension Plan which is the largest DC plan in Canada has been doing this for some time and this gives retirees the same access to lower cost investing as active members.

Q. One of the major problems with a CAP is that if interest rates are low at the employee's retirement date, an annuity can be very expensive. What kinds of financial strategies both before and after retirement can help to mitigate this interest rate risk?

A. There's no doubt that interest rates, especially short-term ones, are very low at the moment. But annuities are based on long bond rates, and usually a mix of government and corporate bond rates, with some other investments in the blend as well.

So it would not be surprising to find that interest rates underlying current life annuity rates are in the range of 4.5% to 5%. Of course, insurance companies add fees to cover commissions and expenses, so that's not the net rate, but people also pay lots to continue investing if they choose a RRIF.

It's not easy to figure out exactly what interest rate is being used, since life annuities also include mortality factors which can differ from company to company. But it never hurts to ask. I'd say that understanding the underlying interest rate for a given annuity is a factor that needs to be considered when making the decision to purchase. If you have an actuarial calculator, you can at least attempt to determine the approximate interest rate on your own.

Q. That's very interesting. Now, if an employee does purchase an annuity, is there a way to achieve dollar cost averaging? In other words, when is the right time to buy an annuity?

A. Sheryl, this is a great question. When I first started working in the pension field, I was at an insurance company and we administered traditional "Group Annuity" plans. Bits of annuity were purchased for members every year, thereby automatically achieving dollar cost averaging.

That methodology has all but disappeared. Maybe there are a couple of the old-style group annuity plans out there, but I haven't come across one for many years.

I think insurance companies need to step up to that plate – what's wrong with the "everything old is new again" adage? I'm not saying that we should bring back the old product, but some variation that lets people buy into annuities easily and inexpensively over time – perhaps a few years before retirement, or even for a period during retirement. Because one can always start out with a RRIF and move gradually to annuity purchase over time. Where is this product? (Of course, you can buy bits of annuity over time now, but it will cost you in fees every time you do this.)

Q. Do you think that plan sponsors and service providers are giving plan members the assistance they need to make these crucial decisions?

A. I believe both groups are just starting to deal with the payout phase. Since DC RPPs (and even Group RRSPs) have not been around to see many members through birth to death, the greatest focus has been on the accumulation phase.

Having said that, the CAP guidelines require plan sponsors to ensure that members have sufficient information to make informed decisions. And I think the planning for those decisions has to start a number of years before actual retirement. So plan sponsors and their service providers need to pay a lot more attention to this area – and the sooner the better. For some of the baby boomers coming up for retirement soon, it's already late to begin the planning.

Q. What steps would you like to see employers and the service industry take in order to improve employee decision-making around retirement investment decisions?

A. In my opinion, members need an array of information channels – good forms, good booklets, a good website, a way of reinforcing the key messages in small chunks at regular intervals and perhaps most important, a way of getting face-to-face time with the right experts. Many of the things members need to know about retirement involve complex concepts – and it's been my experience that people learn better if they're able to ask questions and/or have things explained in more than one way.

Group sessions have the ability to help plan members a great deal – it's an important part of the learning process. But members then need to take that learning and apply it to their own personal situations. I think plan sponsors also need to think about whether their service provider is the right and/or the only source to provide assistance in the learning process. This is no disrespect to insurance companies but I've actually heard members state categorically that they believe the presentations done by the service provider are biased. If they believe that, then the learning may not be as effective as it could be.

Q. What advice do you have for employees planning their retirement? When should they start? Where can they get the help they need and how much will it cost them?

A. Planning entails making a plan – so the most important thing is, in fact, to make a plan, believe in it, implement it, and monitor success over time. When should it start? Sooner rather than later, for sure. Assuming an individual has done a good job over time setting aside money for retirement, I'd say five to 10 years before stopping work is not too early.

Getting help is definitely a challenge. There's lots of "free" advice out there, but when it's free, it's usually because someone wants to sell you something. People can get unbiased help and advice, but it's usually not without cost. Maybe it's worth it, when you're in the run-up to retirement, to spend a few bucks to get the right advice.

Thank you very much Marilyn. You've given us all a lot to think about.

My pleasure.

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