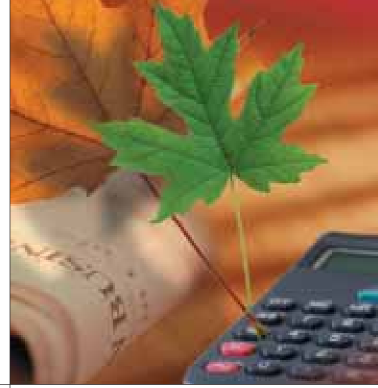
# FactSheet

*FactSheets contain in-depth information on select topics for members of the OPSEU Pension Trust*



# Deferred Pension or Commuted Value Transfer?

## Your Options if You Leave the OPSEU Pension Plan

OPSEU Pension Plan members who leave their jobs before retirement often have an important decision to make. Once they receive their *Termination Statement* from OPTrust, many members will have to choose between one of two options:

- leaving their pension credit in the Plan and receiving a deferred pension from OPTrust, or
- transferring the "commuted value" (CV) of their deferred pension into a registered, "locked-in" investment, such as a registered retirement savings plan (RRSP).

These options are available if you are terminating from the Plan and:

- have two or more years of pension credit or continuous membership in the Plan (you are "vested")
- are younger than age 55
- do not qualify for an early unreduced pension (under Factor 90 or 60/20), and
- are not leaving the Plan as part of a divestment.

The "commuted value decision" is not a simple one. There are a number of important factors that you should consider if you are deciding whether to withdraw the value of your pension or stay with the OPSEU Pension Plan. In fact, we suggest that you talk to an independent financial advisor before making your decision.

### Your Options

If you leave your OPTrust employer, are vested and under age 55 and are not eligible for an immediate pension, you will have two options:

### Option #1:
### A deferred OPTrust pension

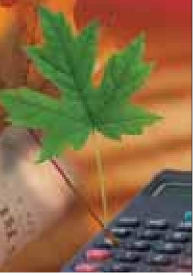
If you decide to take a deferred OPTrust pension, you will receive a lifetime retirement income. Your pension will be based on:

- your average annual salary (typically the average of your highest consecutive five years of annual salary rates) and
- your years of credit in the Plan.

Your deferred OPTrust pension includes the following features:

- *Early retirement benefits:* Your deferred pension is payable at the Plan's normal retirement age of 65. You also have the option to collect a reduced lifetime pension as early as age 55 under the Plan's early retirement provision. At age 65, your OPTrust pension is reduced for integration with the Canada Pension Plan (CPP).

OPTrust



- *Inflation Protection:* Your deferred pension is protected against inflation. Before you start to receive your pension, it will be adjusted for inflation over the deferred period. The annual pension escalation for inflation is based on increases in the Consumer Price Index (CPI), to a maximum of 8% per year. Any increase of more than 8% in the CPI will be rolled over to future years when inflation is below 8%. Once you start to receive your pension, your payments will continue to increase annually with the cost of living (subject to the 8% annual maximum) for the rest of your lifetime.
- *Survivor Benefits:* Your deferred pension includes survivor benefits. Once you start your pension, should you die before your eligible spouse, he or she will receive a survivor pension equal to 60% of your pension, indexed to inflation, for the rest of his or her life. The pension amount will be integrated for CPP the month following your 65th birthday, even if you die at a younger age. Death benefits are also payable if you die before you start your pension, so the value of your pension entitlement under the Plan is not forgone if you die before retirement.

Depending on your years of credit in the Plan, your OPTrust pension may qualify you for post-retirement health, dental and life insurance benefits provided by your former employer (see page 4).

## Option #2:
## Transferring the commuted value of your pension

Alternatively, you have the option of transferring the commuted value (CV) of your pension entitlement to a locked-in RRSP or similar registered investment. The amount you can transfer out of the Plan will be listed on your *Termination Statement*. The commuted value of your pension is the lump sum present value of the stream of payments you and your surviving spouse, if applicable, are expected to receive following retirement, based on expected interest, inflation and mortality rates. The CV reflects the value of your early retirement and inflation benefits at the time you terminate from the Plan.

This option of a CV transfer may be attractive to members who want greater control over their retirement savings, and who believe that they can realize a higher retirement income by managing their investments themselves. If you choose to move the commuted value of your pension to your own RRSP, your retirement income will be based on the market performance of the investments you choose.

Sometime between the ages of 55 and 69, you will have to choose one of several options for converting your locked-in RRSP into retirement income. These include:

1. purchasing an annuity
2. transferring your money to a Life Income Fund (LIF) and drawing regular income from that fund until you reach 80 years of age. At that time you will be required to purchase an annuity with the remaining funds or transfer them to a Locked-in Retirement Income Fund (LRIF).
3. transferring your money to a LRIF, which is similar to a LIF, but with no annuity purchase requirement.

If you purchase an annuity, it will provide you with a monthly retirement income. The amount of each payment will depend on your age, the value of your investments and interest rates at the time of purchase. An annuity that provides inflation protection or survivor benefits will cost more than one that does not include these features.

If you choose a deferred pension (Option #1 above) when you first terminate, you will still have the option of taking a CV transfer at any point in the future, provided you are under age 55. Your CV will be recalculated according to your age and interest rates in effect at the time of your election.

## Considering the risks and benefits

In making their decisions, some members will opt for the security of a deferred OPTrust pension, with its guaranteed lifetime retirement income based on

their salaries and pension credit. The Plan's survivor benefits and access to employer-sponsored, post-retirement health and dental coverage for those who qualify may also be factors in their decisions.

Other members may choose to transfer the commuted value of their pensions in anticipation of earning a higher retirement income by investing their money themselves. In making this choice, these members assume individual responsibility for their investment decisions. While they may achieve a higher retirement income, this is not guaranteed. Managing your retirement investments yourself involves financial risks associated with the particular investments you choose.

If you are leaving the Plan and are wondering whether to take a deferred pension or a CV transfer, you should consider carefully which option best suits your individual needs and circumstances.

## How is your commuted value calculated?

The commuted value of your pension is the lump sum present value of your expected future pension plus related benefits. In calculating the CV, OPTrust uses a number of assumptions concerning mortality, interest and inflation rates. These assumptions are based on the Canadian Institute of Actuaries *Standard of Practice for Determining Pension Commuted Values* (CIA Commuted Value Basis).

If you take a CV transfer, you would have to realize a "real rate of return"[1] on your funds (including the "real rate of return" inherent in the annuity purchase rates)[2] as high as those used in calculating your commuted value. If you achieve this "real rate of return," you should be able to purchase the same pension at retirement as if you had stayed in the Plan. If your investment returns are higher, then you should be able to purchase a higher pension. If you have lower returns, you will receive a smaller pension.

For example, let's assume you take a CV transfer that has been calculated in accordance with the CIA Commuted Value Basis for February 2005 and you retire in 10 years at age 60.

If:

1. you earn an annual "real rate of return" of 2.25% on your funds, and
2. annuity purchase rates are based on a 2.75% "real rate of return" at the time of your retirement,

then you should be able to purchase the same income at retirement as you would have received through your OPTrust pension. However, you also need to consider the fee to purchase an annuity.

If you take a CV transfer you should discuss your investment options with an independent financial advisor. It may be possible to achieve a "real rate of return"[1] on your CV that will give you a retirement income greater than what you would have received had you left your money in the Plan. However, investments that have a potential for higher returns usually also carry a higher risk. And, while market indexes such as the *S&P Composite Index* reflect overall trends, each individual investment is subject to its own risks.

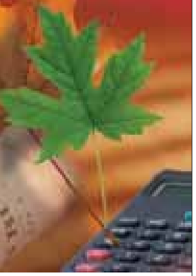
Also, you will incur certain investment costs[2] on your RRSP investments. For mutual funds, these costs can average $2 to $3 for every $100 you invest. That means your investments may need to earn an extra 2% to 3% to cover these costs.

For example, if you plan to start receiving a pension in 10 years, you will need to earn a net rate of return of 2.25% per year after inflation to match the value of a deferred OPTrust pension. If you buy mutual funds that carry a 2% management expense ratio (MER), you would need to earn about 4.25% per year, after inflation, to cover the MER and still break even.

If you are thinking about withdrawing the commuted value of your pension and investing it, you may want to get a quotation from the individual annuity market to help you decide. If you do so, you should ensure that the insurance company preparing

[1] The annual percentage return realized on an investment adjusted for changes in the price level due to inflation or deflation. For example, *if you earn 10% on an investment, but inflation is 2%, then your real rate of return is actually* 8%.

[2] In the mutual fund industry, these costs are referred to as Management Expense Ratios (MERs). Direct investment in stocks and bonds incur trading costs.



the quotation has all the facts about your OPTrust pension, including:

- the inflation protection on our OPTrust pension, both before and after retirement
- your pre- and post-retirement survivor benefits
- the Plan's early retirement provisions
- your personal pension data, including your age, the age and sex of your spouse if applicable, and your accrued pension.

The market for a deferred annuity with all these features is very limited. You may find that either you will be unable to purchase the same amount of retirement income with an annuity, or you will not be able to purchase an annuity with comparable features to the OPSEU Pension Plan, such as inflation protection.

## Insured benefits

Currently, many members who retire with an OPTrust pension have access to continuing health and dental benefits provided by their former employer. If you qualify, these benefits may cover some or most of the costs related to vision care and hearing aids, hospital stays, dental care, certain medications and other paramedical services for you and your dependants. Post-retirement benefits may also include basic life insurance coverage. Once you become eligible, these benefits will continue and will be available for your surviving spouse and dependants, if applicable. These benefits are provided by the Government of Ontario. To check whether you are eligible, contact your employer.

If you choose to leave the OPSEU Pension Plan, you will have to pay for these services directly or purchase insurance coverage on your own (unless you have access to these benefits under your spouse's plan). This can be very expensive and, in some cases, coverage may not be available if you have a pre-existing health condition or once you reach a certain age. Furthermore, the cost of health coverage in Canada is increasing at a much faster rate than the general rate of inflation. (This is sometimes called "health inflation.")

## When to retire

In calculating the commuted value of your pension when you terminate from the Plan, OPTrust assumes that your pension payments will start at the age that gives you the maximum value of the Plan's early retirement benefits. For most members this would mean starting to collect a pension at approximately age 60.

If you keep your pension in the Plan but do not start collecting it until after age 60 (or if you start your pension before age 60), you will lose some of the value of the Plan's early retirement benefits. On the other hand, if you take a CV transfer and do not retire at age 60, the early retirement value will not be lost and can be converted to additional pension when you actually retire (all else being equal). If you have no intention of starting to receive your pension at age 60, in some cases taking a CV transfer (whether at your date of termination or before age 55) could be a desirable option. Once again, this is something that should be discussed with an independent financial advisor. The key is whether you can achieve the investment returns from your CV payment.

## Plan improvements

Every three years, OPTrust's actuaries prepare an "actuarial funding valuation" of the OPSEU Pension Plan, which is filed with Ontario's pension regulators. This independent study compares the growth in the Plan's assets to the anticipated cost of members' and pensioners' benefits. Gains result when the Plan's investments grow more quickly than its liabilities. If assets grow more slowly than needed to fund the Plan, the result is an actuarial loss.

Future gains in the Plan are not guaranteed, and gains may not always be used to improve benefits. However, future gains may result in pension improvements that apply to members who leave their

deferred pension in the Plan or who go on to become pensioners. For example, deferred members and pensioners benefited from several improvements in the OPSEU Pension Plan that came into effect in 1999 and 2002 as a result of Plan gains.

Members who choose to withdraw their commuted value when they leave the Plan will not benefit from any future Plan improvements.

The Plan's next funding valuation must be completed and made available no later than mid-2007. OPTrust also has the option of valuing the Plan at any earlier date. At this time, gains at the next funding valuation are not expected, but could occur in future years.

## Examples

The following examples show the kind of investment return two members would need to earn on their CV transfer amounts to generate a retirement income comparable to that provided by the OPSEU Pension Plan today. We have also provided information on the cost of post-retirement health and dental benefits.

Both examples use the following assumptions:

- rate of inflation is assumed to be 2.25% per year, for the first 10 years and 3.25% thereafter.
- the commuted value of the member's pension is based on a "real rate of return" of 2.25% per year, for the first 10 years and 2.75% thereafter.

When the above inflation rate is added, this is equivalent to a nominal rate of return of 4.5% per year for the first 10 years and 6% per year thereafter. (These are the CIA rates that would apply for terminations occurring in February 2005.)

- To determine annuity purchase rates at retirement we have assumed a "real rate of return" of 2.25% per year. This is a more conservative basis than that used to determine the member's commuted value, and reflects current realities of the annuity market for fully indexed pensions.
- The examples do not reflect the investment costs that may be payable. Each individual's investments would have to generate additional income to cover these costs.

**EXAMPLE ONE:**

Sanjay, 30, is a Systems Analyst with eight years of credit in the Plan and an average annual salary of $45,000. Sanjay was laid off when his branch was restructured. Since his skills are in demand, he has decided to move to the private sector. There is a lot of mobility in his line of work and he doesn't expect to stay with his next employer until he retires.

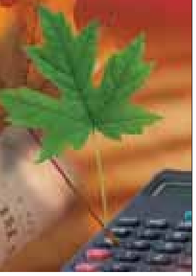
### *Sanjay's OPTrust pension*

If Sanjay keeps his money in the OPSEU Pension Plan and starts receiving pension payments at age 65, he will receive an annual pension of $14,220, including adjustments for inflation and integration with CPP. If he starts collecting his pension at age 60, he will receive a reduced annual pension of $12,790. At age 65, after 5 years of increases for inflation and the reduction in his pension for CPP integration, he will receive $10,660 per year.

### *If he withdraws from the fund*

What happens if Sanjay decides to withdraw the commuted value of his pension and invest it in a locked-in RRSP? In this case, assuming he retires at age 60, he would need to earn 5.8% per year (plus the extra returns required to cover the investment costs on his RRSP) to be able to purchase an annuity that would provide the same income as his OPTrust pension.

Let's suppose that Sanjay decides not to retire until age 65. If he continues to earn 5.8% per year on his funds (net of the MER), he can purchase an annual pension at age 65 in the amount of $14,900.



This is $680 per year higher than the pension he would receive from OPTrust. By taking a transfer value, instead of losing the value of the early retirement benefits under the Plan, he was able to invest the value of that additional benefit for five more years. This provides him with a greater retirement income than he would have received had he left his money in the Plan.

### *Sanjay's investments*

Suppose Sanjay invests his money in a diversified mix of stocks and bonds (including some foreign content) and manages to earn 6.5% per year after paying the MER fees. At age 60, Sanjay could purchase an annual pension of $14,840, reducing to $13,070 at age 65. If he deferred his retirement to age 65, he could receive a pension of $18,770 per year.

### *Post-retirement health, dental and life insurance*

Since Sanjay has only eight years of service in the OPSEU Pension Plan, he is not eligible for post-retirement health, dental and life insurance benefits provided by his employer.

After consulting an independent financial advisor, Sanjay is tempted to take the commuted value transfer option. Before he makes his decision however, he needs to think carefully about the downside risk and whether he could bear the financial consequences of disappointing investment returns on his commuted value.

## EXAMPLE TWO:

Isabelle is an Information Officer for the Ministry of the Environment, where she has worked for 15 years. At age 40, Isabelle has decided to go back to school to pursue a degree in environmental studies. Isabelle's average annual salary is $45,000 per year.

Isabelle has a number of things to consider. She will be without an income for the four years during her program; she will not be contributing to a pension plan and her initial salary at her new job may be lower than her current income. She is married and has one child, age 7. Her husband works for a company that does not provide post-retirement health, dental and life insurance benefits comparable to those available to qualifying retirees from the Ontario Public Service (OPS). Isabelle hopes to retire at age 60, as her husband will be 65.

### *Isabelle's OPTrust pension*

If Isabelle keeps her money in the OPSEU Pension Plan and starts receiving pension payments at age 65, she will receive an annual pension of $19,360, including adjustments for inflation and integration with CPP.

If she starts collecting her pension at age 60, she will receive a reduced annual pension of $17,420. At age 65, after 5 years worth of increases for inflation and the reduction in her pension for CPP integration, she will receive $14,520 per year.

### *If she withdraws from the fund*

What happens if Isabelle decides to withdraw the commuted value of her pension and invest it in a locked-in RRSP? In this case, she would need to earn 5.7% per year (plus investment costs) to be able to purchase an annuity that would provide the same income as her OPTrust pension.

Let's suppose that Isabelle decides not to retire until age 65. If she continues to earn the above rate of return on her funds, she can purchase an annual pension at age 65 in the amount of $20,360. This is $1,000 per year higher than the pension she would receive from OPTrust. By taking a transfer value, instead of losing the value of the early retirement benefits under the Plan, she is able to invest the value of that additional benefit for five more years. This provides her with greater retirement income than she would have received had she left her money in the Plan. However, to do this she would have to postpone her retirement by 5 years.

### *Isabelle's investments*

Let's say that Isabelle, like Sanjay, invests her money in a diversified mix of stocks and bonds (including some foreign content) and manages to earn a total return of approximately 6.5% per year after

investment costs. At age 60, Isabelle could purchase an annual pension of $19,590, reducing to $17,070 at age 65. If she deferred her retirement to age 65, she could receive a pension of $24,580 per year.

### *Post-retirement health, dental and life insurance*

While Isabelle initially thought a CV transfer might be worth considering, the picture changed considerably when she looked at the value of the post-retirement benefit she would be giving up by taking a transfer value.

Currently, for a 60-year-old, premiums range from $3,200 to $3,800 per year for health and dental coverage comparable to that available to qualifying OPS pensioners. Let's assume that health inflation will increase the cost of these benefits at 7.5% per year for the first six years and 5% per year thereafter. By the time Isabelle reaches age 60, premiums for this coverage could range from $9,780 to $11,610 per year for a couple. At a marginal tax rate of 31%, this is equivalent to pre-tax income of $14,170 to $16,830 per year.

To make the transfer option worthwhile in these circumstances, Isabelle would have to earn at least 9.9% to 10.4% (after investment costs) on her transfer value. This would enable her to retire at age 60 and purchase enough pension to replace both her OPTrust pension and the post-retirement health and dental benefits she had given up.

Given her situation and the cost of the health and dental benefits, Isabelle believes that taking a deferred OPTrust pension makes more sense for her than the CV transfer option. She thinks it would be hard to achieve the rates of return necessary to earn a higher pension than she would receive under the Plan, especially since she would like to retire at age 60. Although she knows that there is no guarantee, employer-paid, post-retirement health benefits could still be available when she retires.

## ASSUMPTIONS USED IN THE CV CASE STUDIES

The following are the assumptions used in preparing the case studies described in this Fact Sheet.

**1 INFLATION**

| | |
|---|---|
| Rate of inflation | 2.25% per year for the first 10 years, 3.25% thereafter per year |

**2 ASSUMPTIONS USED TO DETERMINE THE COMMUTED VALUE OF A MEMBER'S PENSION ON TERMINATION**

| | |
|---|---|
| Real rate of Return | 2.25% per year for the first 10 years, 2.75% thereafter per year |
| Mortality after retirement | UP-94 @2015<br>Blended mortality rates, 40% male / 60% female |
| Mortality before retirement | None |
| Age of member's spouse | A member's spouse is assumed to be the same age as the member |
| Age at retirement | Age 60 |

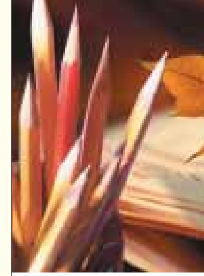
**3 ASSUMPTIONS USED TO DETERMINE ANNUITY FACTORS AT RETIREMENT**

| | |
|---|---|
| Real Rate of Return | 2.25% per year |
| Mortality after retirement | UP-94@2015<br>Blended mortality rates, 40% male / 60% female |
| Mortality before retirement | None |
| Age of member's spouse | A member's spouse is assumed to be the same age as the member |

**4 ASSUMPTIONS USED TO DETERMINE PREMIUM RATES FOR POST-RETIREMENT HEALTH AND DENTAL COVERAGE**

| Age | Premium Rates* | |
|---|---|---|
| | Low | High |
| 60 | $3,200 | $3,800 |
| Health and Dental Inflation | 7.5% per year for the first 6 years, 5% per year thereafter | |
| Reduction in Health Premium at age 65 for integration with Ontario Drug Plan | 15% | |
| Marginal Tax Rate | 31% | |

* Low rate taken from competitive providers of individual health and dental insurance (2004).



## A Checklist for Your Commuted Value Decision Conditions

Leaving your job is a big step that involves a number of important decisions. Whether you stay in the OPSEU Pension Plan or transfer your pension value to a locked-in RRSP, your choice will affect you for many years to come. Make sure you've looked at all the facts before you make your decision.

If you are deciding whether or not to withdraw the commuted value of your pension consider the following steps:

☑ Get independent advice from a financial services professional. Be cautious about accepting financial advice from someone who hopes to sell you a product or ongoing service.

☑ Consider comparing a deferred pension with an annuity purchased with the investment income from the commuted value of your pension. Be sure that you take into account the OPSEU Pension Plan's:
- early retirement provisions
- inflation protection features
- pre- and post-retirement survivor benefits
- post-retirement health, dental and life insurance benefits that may be provided by your employer.

☑ Consider the potential value of these benefits and what you might be foregoing if you choose a CV transfer option instead of a deferred pension option.

☑ Remember, your investments will need to generate a higher income at retirement to cover the cost of these insured benefits.

**Make sure** that the annuity income generated from a CV transfer option will be enough to offset health inflation, which is running higher than general inflation, and is expected to continue at a higher rate.

**Make sure** that you can get adequate post-retirement insurance coverage in the individual insurance market. Remember that you or your spouse may be required to undergo a medical exam before coverage is granted.

**Remember** that if you take a CV transfer, your rate of return will be subject to market conditions. You should be comfortable that the level of risk you are assuming does not outweigh the potential benefits.

**Take the time** to consider your options carefully and perhaps discuss them with your family. This is an important decision - and one that will have long-term consequences for you and your family.

## For more information please contact the OPSEU Pension Trust

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OPSEU Pension Trust — Fiducie du régime de retraite du SEFPO

This **FactSheet** summarizes certain provisions of the OPSEU Pension Plan. It does not create any rights to benefits not provided for in the actual terms of the Plan. In the event of any conflict or omission, the legal documents of the OPSEU Pension Plan will govern in all cases.

Members who have questions about their pension entitlements or are considering a pension-related decision should contact OPTrust directly.