Time for a new approach

Couple should look at diverting RRSP contributions to life-income plan

By Joel Schlesinger

In the second half of a two-part Money Makeover, our financial planner helps this couple dealing with disability develop their retirement plan.

THOMAS and Jane face a two-pronged challenge when planning their retirement. As mentioned last week, Thomas suffers from a degenerative illness and worries the day will come when he can't work.

But Thomas and Jane are also self-employed and without work pension plans. They have to rely on their RRSPs to fund much of their retirement.

Thomas has only about $14,000 in RRSPs while Jane has more than $100,000, and they have another $3,500 in a TFSA for short-term expenses.

In last week's makeover, disability-tax-benefits specialist Brematson and Associates provided the couple with advice to apply for the disability tax credit and CPP disability.

Determining whether Thomas will qualify for the disability tax credit is in the hands of his physician, and he can apply for the CPP disability if he finds he is no longer able to work.

But at this juncture, those pieces of their financial plan remain up in the air, and despite the uncertainty, Thomas and Jane still want a plan of attack for retirement savings.

"I don't even know if I can retire, to be honest," says Thomas, 49.

Ideally, he and Jane, 51, would like to retire before age 65. But their lack of savings is an obvious stumbling block.

"Right now, I would have nothing to live on," he says. "I'd like to build up more savings and definitely a retirement income of some kind."

Certified financial planner MaryAnn Kokan-Nyhof says even if Thomas encounters resistance from his doctor at first, he should not lose hope. Doctors are often focused on treatment, not on administrative matters relating to their patients' tax situations.

"As a financial adviser to many families facing this situation, I've been very successful at challenging a doctor's assessment," says the financial adviser with MGI Financial.

Kokan-Nyhof says physicians are busy and often not fully versed on how the CRA measures disability, or are unaware the credit can be retroactive to 10 years.

"I have written letters on behalf of my clients to doctors and found they then reviewed the files and completed the disability checklist with a different set of criteria," she says.

"And the result was the clients got the tax credit."

And the disability tax credit is not to be overlooked: The two will need all the help they can get because Thomas's medical condition puts them in a financially precarious position.

Assuming he doesn't get the disability tax credit and can still work until age 65, they should be able to save up enough to have a modest retirement income from savings, combined with CPP and OAS (and yes, both have been paying into CPP, despite being self-employed).

"Since neither of them has a pension plan that guarantees lifetime income, I would recommend they look at one of the available insurance products that provides a guaranteed income for life," Kokan-Nyhof says. Many large insurance firms, such as Desjardins or Manulife, offer these types of products, which provide both inflation protection and a death-benefit guarantee.

AS an RRSP strategy, they could start contributing $200 a month each into this type of product instead of continuing with their other RRSP plan. Their current RRSP accounts would also be invested in the insurance plan. One of the upsides with these plans is they can receive guaranteed increases during their savings years. With the Desjardins product, for example, their investment would receive a five per cent annual bonus for every year they remain part of the plan without drawing income.

Fees for mutual funds within these plans are higher than typical mutual funds because these types of segregated fund products — meaning they're offered by insurance firms — provide guarantees that, of course, do not come for free.

By the time Thomas and Jane reach 65, Thomas will have $88,000 in this RRSP plan and Jane will have $250,000 in hers.

At that point, Jane could start drawing an income, about $1,166 a month for life. Thomas would be able to draw an income of about $320 a month.

The benefit is they receive a floor income that is guaranteed for life, Kokan-Nyhof says. But these products also offer the possibility of increasing benefits over time because they are linked to performance in the equity markets. With the Desjardins plan, for instance, if the markets perform well between ages 65 and 71, Jane's monthly payment could increase to $1,635 a month at age 71, and Thomas's payment could rise to $430 a month.

Combined with OAS and CPP ($515 and about $600, respectively), they could have monthly before-tax income ranging between $3,428 and $4,295, depending on the performance of the guaranteed plan.

The couple can also opt to take lump-sum withdrawals, which would reduce their monthly benefits.

They can even leave the plan entirely, but additional charges may apply.

Still, the success of this strategy is dependent on Thomas's health, she says.

"If he has to go on CPP disability, his earning and savings power goes down," she says. "That's the monkey wrench."

As a fallback, they may have to consider selling their home, moving to a smaller, less costly residence and using any money left from the sale to supplement their income.

"The reality of their situation is they have to hope and pray that he can stay healthy long enough and keep earning until they're 65 to have enough money put away, and then hope he's well enough to enjoy retirement."

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MONEY
MAKEOVER

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Thomas's and Jane's finances

▼ INCOME
Thomas: $72,471 annual business income ($3,900 monthly net)
Jane: $35,000 annual business income ($2,000 monthly net)

▼ EXPENSES
Monthly: $2,185.76

▼ DEBTS
Mortgage: $100,000 owing at 2.5 per cent variable, $358 biweekly payments on home assessed at $300,000

▼ ASSETS
Thomas's RRSP: $14,000 in mutual funds
Jane's RRSP: $103,000 in mutual funds
Home equity: $200,000
TFSA: $3,500 in savings
Cottage lot: $35,000

Catastrophe

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And it's not an altogether uncommon tale either, says Jason Roy, the senior investigator for the MSC.

He says the MSC receives about one call a month from Manitobans who have taken the commuted value of their work pensions — sometimes nearing the $1-million-mark — as a lump sum and invested the money with or without advice, only to wish they hadn't.

"It's important to understand all the positives and negatives," he says. "We always hear after the fact someone has taken out the commuted value and regretting it."

In instances where wrongdoing can be proven, the MSC can take action against advisers who have engaged in fraudulent behaviour. But in many instances, once the money is lost, it's gone for good.

"The message isn't that we think it (taking the commuted value) is bad all the time," he says.

But the strategy can involve substantial market risk, more than most people realize, and much more risk than the alternative: a steady income stream for life.

Certified financial planner James Kraemer says he has worked with clients who have chosen to take the commuted value and invest it on their own or with his advice. But that only occurs after a long discussion and careful analysis of each client's individual situation.

"What we basically would do is show clients if we can average over 'X' percentage for the next 20 to 25 years, or whatever you figure your retirement is going to be, you'd be better off taking it out, but if you can't, you're better off leaving it there," he says.

Generally speaking, taking the commuted value of a work pension may make sense in a few situations, such as if you have a shortened life expectancy. In that case, taking guaranteed payments for life from a pension plan may not be as beneficial as taking out the total value and drawing on the capital at an accelerated rate.

Many pension plans do offer a survivor benefit, but once the surviving spouse has passed away, the payments often stop, leaving no inheritance. In contrast, if the commuted value had been taken out of the plan, the money could make up a substantial portion of an estate.

"There might be a situation where someone has got the pension plan, but they're changing jobs and still plan to work for a long period, so they want to take the commuted value and invest it while they work so they don't have the added income while they're working," Kraemer says, offering another scenario in which taking the commuted value may make sense. "This way, they are better able to control the flow of income once they retire."

But for most people, staying with the pension plan likely is a better, less worrisome choice, says MSC investigator Len Terlinski.

"For the average Johnny Lunch Buckets, they shouldn't be doing it," he says.

"With a good pension plan, there are always people coming up and putting money into the plan to fund it, but once you cash out your money, you're on your own, and there's no way back."

Adamson says he learned this lesson the hard way, and he hopes that by coming forward with his story, others will think twice about the risks.

"I trusted that the money was going to be safe. It was not the case," he says. "I should have kept in with the plan. It would have made less, but it would have been safe."

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Buyer beware

After Frank Adamson lost most of his investment with an adviser over a four-year period, he sought to do something about it. But that turned out to be more difficult than he first realized. "I felt that I needed some kind of support, but everybody was running away from it," he says. "Even though they admit that these things happen, they couldn't move forward in any kind of regulation applying to him."

Part of the problem was the adviser didn't commit fraud or any securities violation that could easily be proven, so Adamson had little recourse with the provincial regulator. He then took his case to the Mutual Fund Dealer's Association of Canada (MFDA), which licenses dealers in Canada. The organization can impose sanctions against advisers selling funds who commit wrongdoing, such as breach of trust and investing clients in funds that aren't suitable to their needs, which was what Adamson's adviser had done. Still, he found no help.

Unfortunately in Adamson's case, MFDA spokesman Ken Woodard says, the alleged violations took place in 1999 when Adamson was first invested in the higher-risk funds. That was before the MFDA existed. "We weren't recognized by the securities commissions until 2001."

While Woodard couldn't speak specifically about Adamson's case because he didn't know all of the details, it was likely the MFDA rules that today apply to advisers wouldn't be enforceable in this instance because they weren't yet in place when the alleged violation occurred.

Best defence a good education

While investors may implicitly trust their financial advisers, they're always better off doing their own homework, says Tamara Smith, spokeswoman for the Financial Planning Standards Council (FPSC).

First and foremost, they shouldn't be afraid to ask a lot of questions because the trust they put in advisers should be earned.

"They really need to be empowered and not assume that just because someone has letters beside their name or works for a large firm that they're going to put their clients' interests ahead of theirs," she says. The council regulates certified financial planners, and the CFP designation provides consumers with some assurance an adviser has met a set of professional standards that includes a code of ethics.

"If there is a case to support that a CFP has not acted in the client's best interest, we will investigate," she says. But even she admits the ability of the council to sanction wrongdoers with the CFP designation is limited. "We may decide that a letter of admonishment is required in their file or if it's severe enough, we'll remove their ability to use the mark so they'll no longer be in good standing," she says.

"Unfortunately, we do not have the authority for any kind of compensation."

Questions to ask your financial planner

This past week was Financial Planning Week, aimed at raising awareness about the importance and benefits of developing a good financial plan to achieve your goals in life. To mark the occasion, the FPSC offered up the following questions to ask when shopping for advice:

What are your qualifications? No one needs a professional designation to offer you financial advice, but most planners and advisers do undergo rigorous training to receive a number of professional designations. Certified financial planners (CFPs), for instance, are trained to develop financial plans, whereas chartered accountants (CAs) are trained in tax advice.

What experience do you have? Ideally, you want your adviser to have a proven track record in the industry. There's no harm in asking for references.

What services do you offer? Some advisers are planners who develop financial plans for retirement. Others are more geared for investment advice. But you don't know until you ask, and it may be their services fall short of your needs.

What is your approach to investing or financial planning? Every professional has a different view of how to handle finances. And their approach might not be to your tastes.

Who else will I be working with? Many advisers work with teams. You may work with a planner, for instance, who also consults a lawyer and accountant. You might want to meet them, too.

How will you be compensated? Reputable advisers will outline how they're compensated in writing. Generally, they're compensated in one of three ways. They are paid by selling you investments. They are paid a fee for service, or they are on salary with a firm.

How much do you charge? Once you know how they're compensated, you want to know how much their services will actually cost. Some charge flat fees, or others may earn a percentage of the commission on products they sell.

Who else might benefit from your recommendations? Professional advisers should put in writing their potential conflicts of interest, such as selling you funds that may earn them a higher commission than an otherwise similar fund.

Who regulates you? While advisers and planners don't legally need to have a designation, they do generally need a licence to sell legitimate investments. If they're a licensed dealer, or have a professional designation, they often belong to a governing body. If you're not sure about their credentials, contact the Manitoba Securities Commission.

Can I get it in writing? A reputable professional is willing to provide you with an understandable agreement in writing. Once signed, keep it somewhere safe if the @$#t hits the fan.