FINANCIAL POST

November 3, 2016

The RRSP's less flexible cousin: Everything you need to know about the LIRA

By Jonathan Chevreau

Leaving a job with a defined-benefit or defined-contribution pension plan? It'll be a locked-in retirement account. Jonathan Chevreau explains

You've been in the company pension plan for years or decades and suddenly your situation changes. Whether because you've accepted a buyout offer, been laid off or simply decided to leave your position for greener pastures, suddenly you have a pot of money and some big decisions to make.

Welcome to your LIRA (locked-in retirement account), also known as a locked-in RRSP in some provinces. Once a seemingly obscure investment vehicle, LIRAs are becoming far more common in today's always-in-flux workplace. As a result, the number of LIRAs will continue to rise, predicts Matthew Ardrey, vice-president and wealth adviser for Toronto-based TriDelta Financial.

Whether you're leaving an employer-sponsored defined-benefit or defined-contribution pension plan, a LIRA will be the tax-sheltered structure in which your funds will be held. But because the funds originated with the purpose of funding your future retirement, it's not a windfall you can spend today, particularly if you haven't yet reached the age of 55. And even if you have passed that milestone, several strings are attached to LIRAs - that's what "locked in" means, after all.

"There are restrictions on when and how much you can take out of your LIRA at any given time," says Sean Cooper, a Toronto-based pension administration senior analyst.

Having a LIRA allows you to become the steward of your own pension plan

In many ways, a LIRA behaves just like the better-known RRSP: Both hold the same kinds of investments (chiefly stocks, bonds, GICs, mutual funds and ETFs) and the income generated is tax-deferred until the day arrives when you need to start tapping it for income.

But, unlike the more flexible RRSP, the only way you can get access to LIRA funds before age 55 is under special circumstances, such as disability, financial hardship and a few other situations.

If the source of funds is a DB plan, the plan's actuaries will calculate the commuted value of the plan - that is, the amount that is equivalent to the present value of the pension payments you could have elected to wait and receive in the future.

If the source of funds is a DC plan, its current balance (based on today's market value) will be transferred to the LIRA.

"Having a LIRA allows you to become the steward of your own pension plan," says portfolio manager Adrian Mastracci, president of Vancouver-based KCM Wealth Management Inc, adding that specific terms and conditions vary by province.

One thing is constant, however: a LIRA is less flexible than a regular RRSP, and once a LIRA is set up you cannot make additional contributions - the money held in the account comes exclusively from your pension, plus any return on investment. Additionally, aside from exceptions, you can't withdraw funds whenever you want, as you can with RRSPs (which of course is a taxable event).

And just as RRSPs must be eventually annuitized or converted to Registered Retirement Income Fund (RRIFs) by the end of the year you turn 71, a LIRA must be converted either to a life annuity or to a Life Income Fund (LIF) or LRIF (Locked-in Restricted Life Income Fund). As with a RRIF there will be minimum annual withdrawals that will be taxable. But, unlike a RRIF, there are also maximum permitted draws.

I have some personal views here. If you're the type of person who finds comfort in the guaranteed lifetime income of a DB plan, then if corporate circumstances have forced you to convert a DB pension into a LIRA, your ultimate intention should, at age 71, be to convert it to an annuity. That way, you will mimic the DB payout you might have had if you stayed in that pension plan.

If, on the other hand, you like making your own investment decisions and can live with market volatility, then if your DC pension has been converted to a LIRA, you may feel you can do better by choosing a LIF or LRIF once you reach age 71.

With the rise in the number of LIRAs, Ottawa has made a major change to increase flexibility for federally administered LIRAs.

"They now allow for a one-time unlocking of up to 50 per cent of your LIRA into another tax-deferred vehicle, such as an RRSP or RRIF, once you have reached the calendar year in which you turn 55," Ardrey says.

With half the balance unlocked, that portion will no longer be subject to the maximum withdrawals limits of the LIRA. If your LIRA is provincially regulated, check with your province to see if this option is available and, if so, at what age you can take advantage of it.

You don't have to keep your LIRA housed with the company that administered your pension plan. If leaving a plan, your employer will give you a package that gives you the option of moving your funds to your choice of financial institution. To make the move, you just need to complete a locking-in agreement and T2151 form, Cooper says.

And if you've left several pension plans over the years, you can consolidate multiple LIRAs from previous jobs into a single locked-in account, but only if they share the same pension jurisdiction, says Aaron Hector, a financial consultant with Calgary-based Doherty & Bryant Financial Strategists. He also notes the $2,000 pension income tax credit will be available only on income from a life annuity prior to age 65; after age 65, income from a LIF or RRIF would also qualify for the pension income tax credit as eligible pension income.

Financial Post

Jonathan Chevreau is founder of the Financial Independence Hub[1] and is co-author of Victory Lap Retirement[2]. He can be reached at jonathan@findependencehub.com[3]

References

1. findependencehub.com
2. victorylapretirement.com
3. jonathan@findependencehub.com