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NOVA SCOTIA HEALTH EMPLOYEES' PENSION PLAN

Spring 2014 Newsletter

For Active Members of the NSHEPP

A small lesson for our newer members

From Calvin Jordan, CEO of NSHEPP

I enjoy making presentations to NSHEPP members as they approach retirement. In a typical year, I meet with about 1,000 of these "near-retirees". I hear lots of stories from them that we can all learn from.

While these near-retirees are generally at the same stage of life and belong to the same pension plan, their retirement readiness is definitely not the same. Some will have extremely comfortable retirements while others, unfortunately, won't.

If you are a new NSHEPP member, what can you learn from today's near-retirees? What were the key decisions that they made throughout their careers that were most important to their ability to retire well?

There are many decisions that we make throughout our lives that impact our finances. But if I had to pick just one factor that is most revealing about a near-retiree's financial situation, it is their years of NSHEPP service.

A long-service NSHEPP member (let's say with 30+ years) is typically able to retire with roughly 90% of their pre-retirement take home pay. This is after their OAS and CPP pensions start, and after factoring in reductions to their income taxes and other deductions. Some retired long-service members say they have more discretionary income than they had when they were working. And, more often than not, these long-service NSHEPP members are retiring while still in their 50's!

Unfortunately, some of our retirees have fairly short service in NSHEPP. Sometimes this was unavoidable if NSHEPP only became available where they worked, part-way through their career. But in other cases, their service could have been much longer if they had only made a few decisions differently.

So what is the lesson if you are a new member of NSHEPP? In my opinion, it is to *try to manage your career so you will retire with as much NSHEPP service as is practically possible*. Before you change jobs to work for an employer who doesn't participate in NSHEPP, think carefully about whether you really will be financially further ahead in the long run.

And if you do terminate from NSHEPP covered employment, remember that under current rules you can reduce the long-term impact of your termination if you return to work with an NSHEPP participating employer within 5 years. This is subject to you repaying any funds that you withdrew when you terminated (with interest) within a year of rejoining NSHEPP *(this option is described on page 21 of the member booklet – point #3)*.

Mind the gaps

Retirement income for most NSHEPP members will be made up of a combination of their NSHEPP pension, OAS and CPP. Members who retire with a full career of service under NSHEPP, usually find that the total of these three pensions will replace a very large portion of what their "take-home pay" (after taxes and deductions) was before they retired. A problem may arise, however, in years when they don't yet qualify for all three of these pensions. These "gap" years are what this article is about.

The first possible gap impacts members who retire before age 60. This gap is the period between the date of retirement and age 60. During this period, the member is too young to start their OAS and CPP pensions.

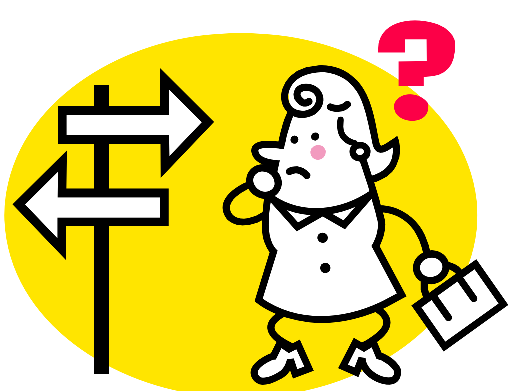
The second possible gap occurs at age 65 for members who are currently younger than about 56. At age 65, the NSHEPP pension reduces by roughly 30% when the "bridge" benefit ends. The idea behind the NSHEPP bridge is that it stops at about the same time that the CPP pension starts, so one more or less cancels out the other. Many people start their CPP pension well in advance of 65, relying instead on their OAS to more or less cancel out the loss of their NSHEPP bridge. The problem is that the OAS retirement age is changing from age 65 to 67, creating a gap between when the NSHEPP bridge stops and when the OAS pension starts. This is not scheduled to happen soon. The transition from the OAS retirement age of 65 doesn't start until 2023, and isn't scheduled to reach 67 until 2029. Therefore, the gap at age 65 will not significantly impact most members who are currently retiring.

So if either of these two gaps will impact you, what can you do about it?

There are many possible solutions. Some members will receive a retirement allowance that could be used during the gap years. Some retirees return to work part-time and will have part-time earnings to fill the gap. Other members may find that they are able to make do on less during a few gap years, especially if they are debt free by that time. Another solution could be to accumulate some savings before you retire that could be drawn upon during the gap years.

Your pension options on termination

We usually think of a retirement pension as being the main benefit provided by NSHEPP. However, there are actually more NSHEPP members who terminate employment each year than who retire. Over the last three years the ratio has been 1.7 to 1.



Most members who terminate before they are entitled to an immediate pension have two pension options. The options are to either leave your funds with NSHEPP or to transfer out.

If you leave your funds in NSHEPP, you will be a "deferred member". This means that you will eventually receive a monthly retirement income based on your service up to the date of your termination.

If instead you transfer your funds out of NSHEPP, you will in most cases, transfer your funds to a "Locked-In Retirement Account" (LIRA). This is a special kind of RRSP that must eventually be used to purchase an income at retirement. There are limits on how much can be transferred to a LIRA, with any excess being paid out on a taxable basis.

Deciding which pension option is best can be difficult. Many terminating members choose to transfer their funds to a LIRA but this doesn't mean that this is always the best option.

If you leave your funds with NSHEPP, your deferred benefit may be increased for inflation each year. These inflation increases are not guaranteed to occur, but NSHEPP has a track record of granting them in most years. If you transfer your funds out of NSHEPP, you do not get the value of these future inflation increases. Because of this, transferring out may not provide you with as much financial value, unless you take more investment risk.

As an example, let's look at a 40-year-old member who is terminating employment. Their LIRA would have to average about 5¼% per year for the rest of their life to provide the same expected value as their deferred pension option. *(See Note)* To expect to do this well today, they would have to accept a fair amount of risk on their LIRA investments.

Perhaps the most common argument we hear in favour of transferring to a LIRA is to provide a better death benefit. This argument is only partly valid. Your transfer value option is worth exactly the same as your deferred pension option based on various assumptions. One of these assumptions is that you will live an average lifespan. The LIRA may provide more financial value if you retire and then die younger than average. However, if you live longer than average, the deferred pension tends to provide better financial value.

Ultimately, your best pension choice will depend on your personal preferences and circumstances.

Note: Based on transfer value calculations that were applicable in April 2014 and assuming the deferred pension would be indexed for inflation each year.