



# A Professor Retires by Commuting His Defined Benefit Pension

John Ambrose, CFA 416-203-8139

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# Experience

## **John Ambrose, P.Eng., CFA**

- **Started MD Private Trust,**
  - **AUM \$2 billion for 80,000 doctors**
- **Chair, Banting Research Foundation**
- **VP Citibank, corporate finance**
- **Governor, University of Toronto**
- **Rotman School of Management**
- **Started Ambrose Investment Counsel in 2003**
- **B.A.Sc., M.Sc. (Aerospace), M.B.A.**
- **Chartered Financial Analyst**



# What You Want & Need

- Retire happily without worry
- Feel valuable
- Safe home
- Take care of the kids now
- Take care of the kids later

# How We Help You



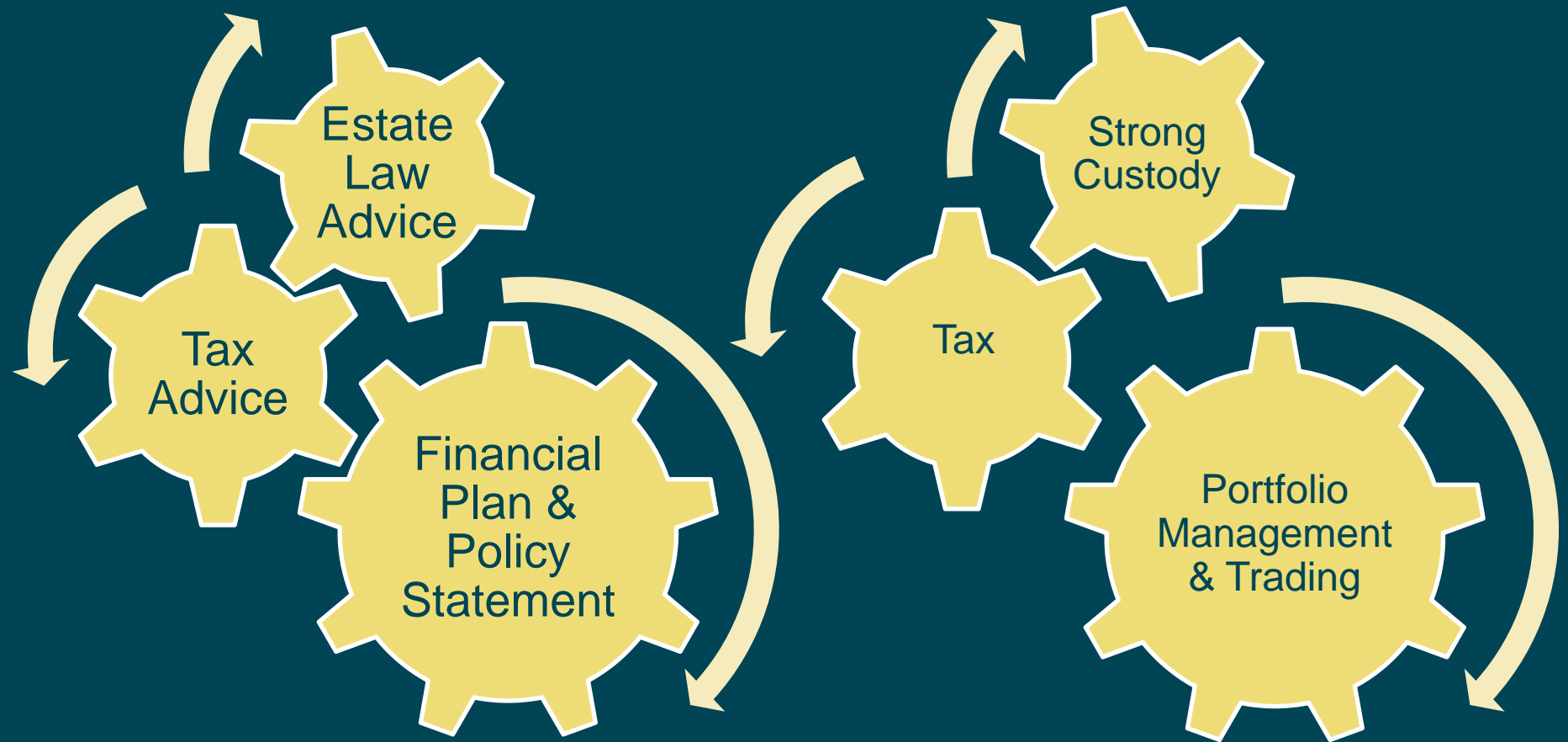
- **Build a strong team of excellent investment, law and tax advisors**
- **Develop novel solutions to handle your special situation**
- **Reduce anxiety from volatile markets for those without an income**
- **Enjoy your retirement**

# Our Strong Team



- **Experienced estate lawyers:**
  - Roberta McGill of Cassels Brock & Blackwell LLP
  - Janet Sim of Osler, Hoskin & Harcourt LLP
- **Experienced tax advisors:**
  - Rachel Gervais, BDO Canada LLP
- **Experienced portfolio manager:**
  - John Ambrose
- **Strong custody**
  - TD Waterhouse (Canada) Inc.
- **Strong Audit process**
  - Grant Thornton LLP

# Managing A Portfolio Relies on These Parts





## Role as Custodian and Safety

### Role:

- Custody client accounts – all types offered (personal, corporate, registered)
- Execute trades on all exchanges – Canada, United States, International
- Perform account maintenance – Modifications, deposits, withdrawals
- Provide the investment counsellor with trade authorization only
- Withdrawals can ONLY be sent via:
  - Electronic funds transfer to the bank account enrolled during account opening with the same name of the account holder
  - Cheque in the name of the account holder – must be requested in writing

### CIPF and Strength of TD Waterhouse and TDBFG:

- All accounts are covered by the Canadian Investment Protection Fund (CIPF)
- Financial security of the TDBFG, guarantees each account above CIPF coverage
- International TD presence with TD Waterhouse UK, TD Bank and TD Ameritrade

# Satisfied Clients

- **Retired Professor Emeritus**
  - Liberated pension with the lump-sum option, created estate
  - Plan to reduce debt, simplify assets
  - Started new hobby business
- **Professional & family**
  - Used inheritance to start a new wine business
  - Now bottling first production
- **Doctor & family**
  - Created a new professional corporation to defer taxes
  - Plan to repay debt, build estate



# Defining a Few Terms

## Talk to the Pension Department

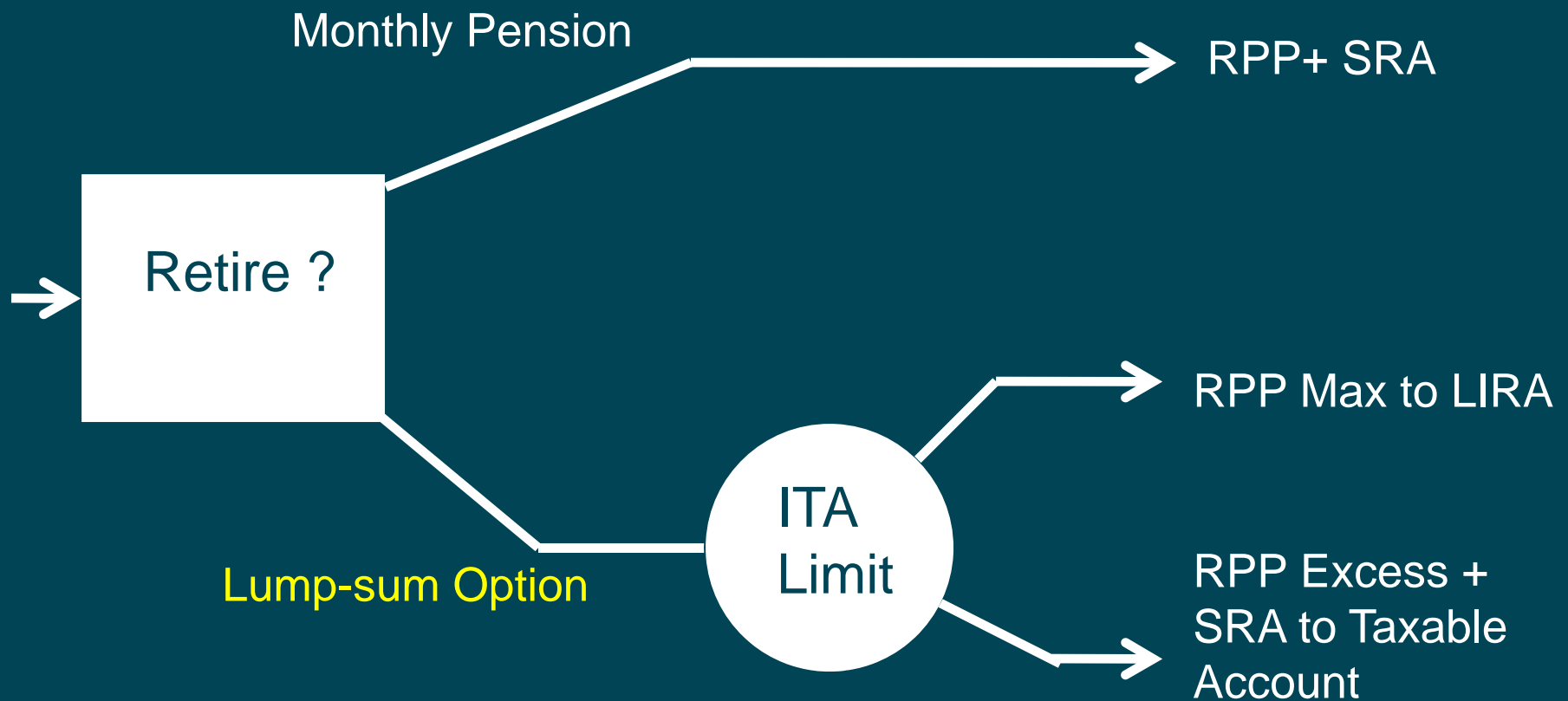
### University of Toronto Pension Plan:

- Pension Benefit = RPP + SRA
- RPP under the ITA: Registered Pension Plan under the Income Tax Act
- SRA: Supplemental Retirement Arrangement
- Joint & Survivor Pension, e.g. 60%
- Lump-sum Option
- Commuted Value

### Outside the University:

- LIRA: Locked-in Retirement Account
- LIF: Life Income Fund
- Taxable Account

# Two Choices of Retirement Flows



# Benefits of The Lump-sum Option

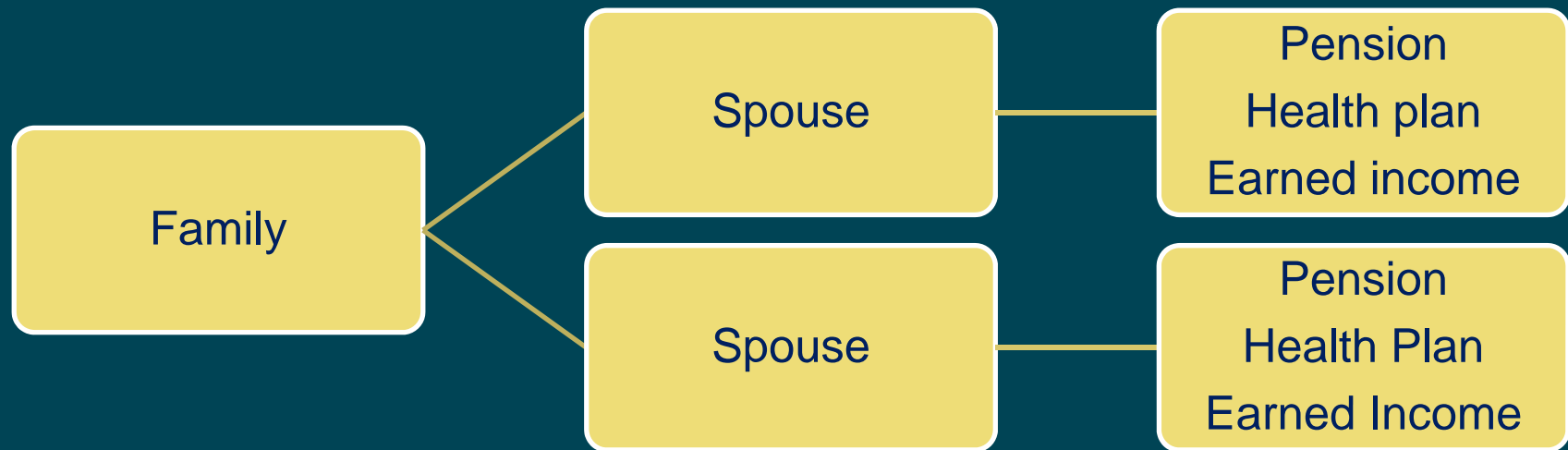
- **Lump-sum option:**
  - Present value of future benefits into LIRA, taxable account
  - Active control of investments with associated market risk
  - Choice of deferral of taxable income
  - Choice of timing and amount of income
  - Choice of special withdrawal
  - Remaining capital to beneficiary or estate
- **Monthly Pension Plan:**
  - Defined benefit for life of annuitant
  - 60% benefit for life of annuitant's surviving spouse
  - Nothing for estate

# Lump-sum Option is Ideal for Some Professors

## 200 Retiring Professors at the University of Toronto



# Parallel Coverage Is Ideal



# Ideal Client

- Family has two incomes
- Family has two defined benefit pension plans
- Family has two health plans
- Annuitant has second earned income after retirement
- Family wants to actively manage estate
- Family has estate lawyer, tax advisor and investment manager

# Comparing Two Choices for the Retiring Client

- **Choice #1:** Accept the normal monthly pension , or
- **Choice #2:** Take the “Lump-Sum Option.”

## Method of Evaluation

- Estimates the accumulated future after tax value at the end of each year for each choice subtracting all current and deferred tax liabilities.
- Collapses the tax-deferred LIRA and pays deferred taxes.
- Adds investment returns at a constant annual rate of 6% before tax.
- Does not subtract any management or other fees listed in slide 31.
- Forecasts hypothetically; does not subtract any living expenses.

# Key Assumptions Common to Both Choices

- Life expectancy for the male pensioner is 20 years, 23 years for his wife.
  - Source: <http://www.canadianbusiness.com/tools/21287>
- Pension benefit escalates at 1.5% p.a.
- Spousal benefit is 60% after pensioner dies.
- Management fees and other fees on slide 33 are excluded.
- Income tax rate ranges from 30% for smaller withdrawals to 40% for larger withdrawals such as collapsing the LIRA.
- Fixed annual investment return of 6% p.a. before tax or 4% p.a. after tax.
- Wealth from income accumulates without living expenses.



# Risks to Choosing the Pension Benefit

- Pensioner and his wife die before 20 years and 23 years respectively without saving the full benefit for their expected life spans.
- Pensioner and his wife die without having an estate for their children from the proceeds of the pension.
- Pensioner will not have capital from his future pension benefits to start a business today.
- Pensioner spends too much on a monthly basis.
- Terms of the University Pension Plan change reducing the benefits to pensioners.

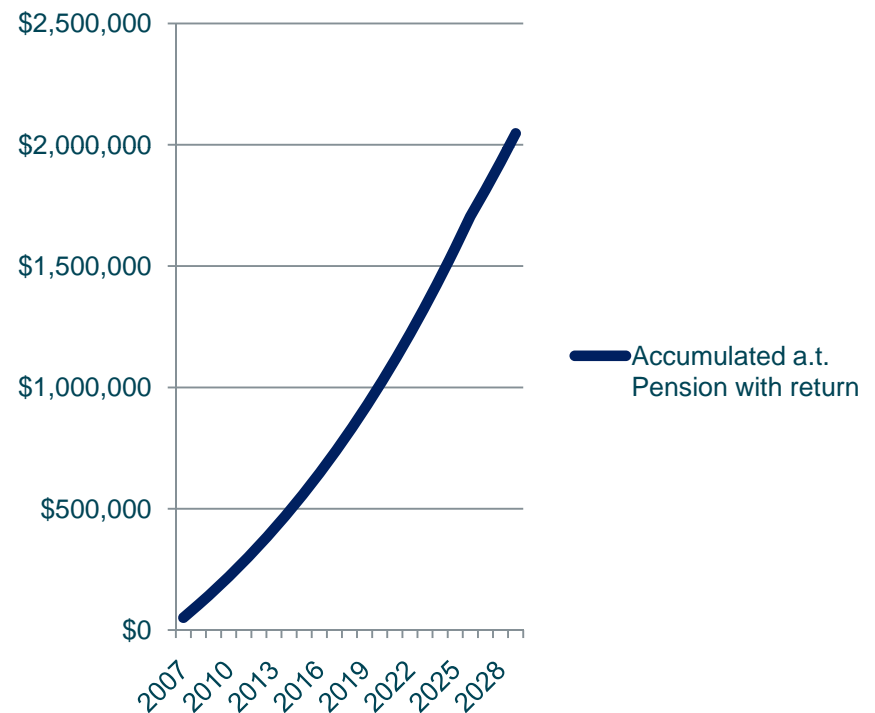
# Risks to Choosing the Lump-Sum Option

- Client and his wife live longer than the pension expected life span and do not receive the extra pension benefits.
- Investment returns are inadequate to pay for retirement expenses.
- Owner of custodian holding the client portfolio goes bankrupt.
- Client spends too much especially from the taxable portion.

# The Normal Pension

- Valued annually after taxes paid
- Monthly payment \$6,000 before tax with pension & SRA
- 60% spousal benefit
- 0% after both die
- Tax paid at an average 30%
- After tax return averages 4% p.a.
- No consumption of wealth
- Age 62, 20-year life span for male pensioner, 23 years for wife
- Total value in 2029 is \$2.1 million

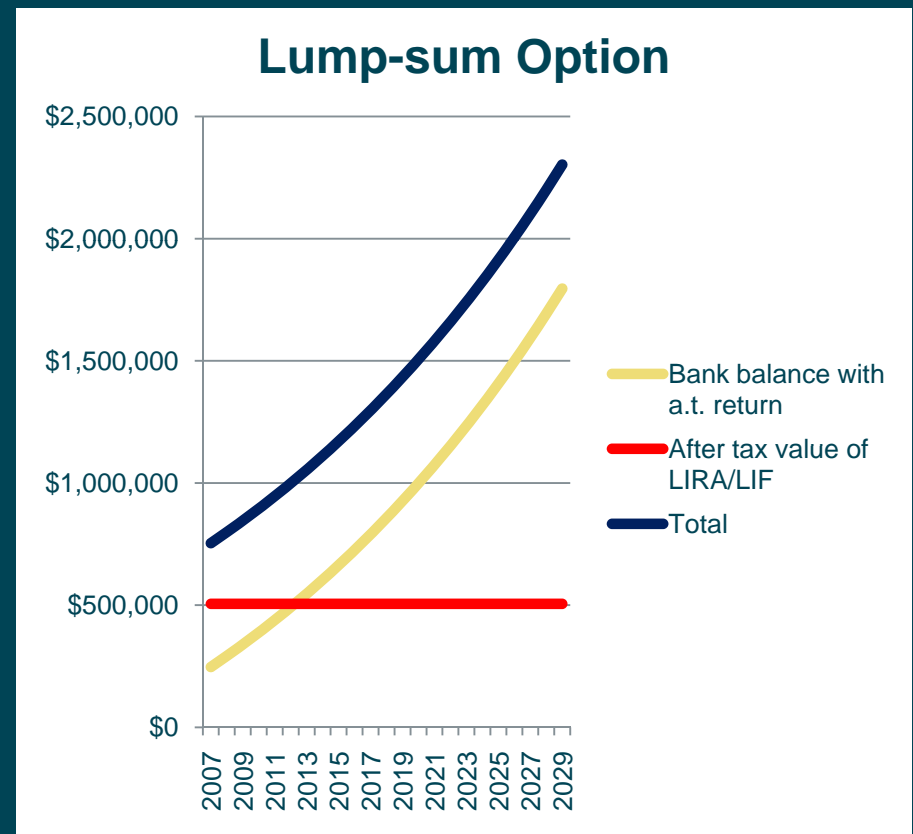
**Normal Pension, SRA**



Note: Past results do not guarantee future performance.

# The Lump-Sum Option

- Valued annually after taxes paid
- #1 payment to LIRA/LIF
  - Tax-deferred
  - Return 6% before tax
  - Withdraw at 6% p.a.
  - Tax of 40% if collapsed
- #2 payment for SRA,RPP surplus
  - Taxed at 30%
- After tax return averages 4% p.a.
- 20-year life span, 23 years for wife
- Total value in 2029 is \$2.3 million

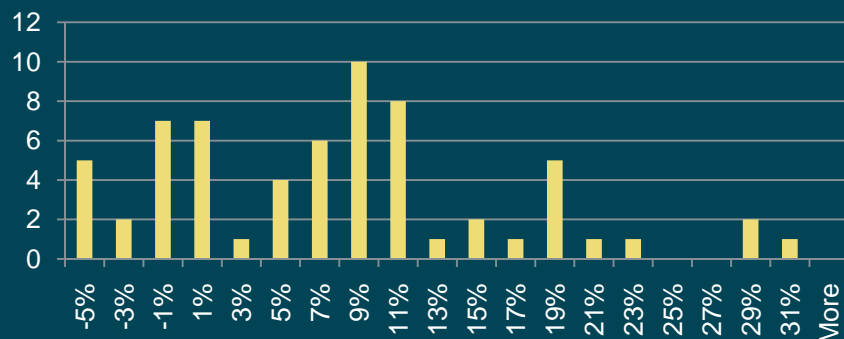


Note: Past results do not guarantee future performance.

# Results from Comparison of Two Choices

- Lump-Sum Option shows higher future value for until actuarial life expectancies of 23 years for both pensioner and wife.
- Normal Pension Option shows a higher value at longer life expectancies than actuarial expectations.
- Normal Pension Option shows higher future value if the average annual return in the Lump-Sum Option is less than 4.5% p.a. before tax.

Annual Market Returns 1940-2005  
for S&P 500 Total Return Index \$C



Median return: 7.05%  
# years above 6%: 35  
# years below 6%: 29

Source: Global Financial Data

# IC/PM is Different

- **Stock broker:**
  - Client decides on suitability
  - Client chooses to buy or sell
  - Commissions from transactions
  - Regulated by Investment Industry Regulatory Organization of Canada
- **Investment Counsellor/Portfolio Manager (IC/PM):**
  - Client delegates to manager
  - Manager chooses to buy or sell
  - Fees based on assets
  - Regulated by Ontario Securities Commission

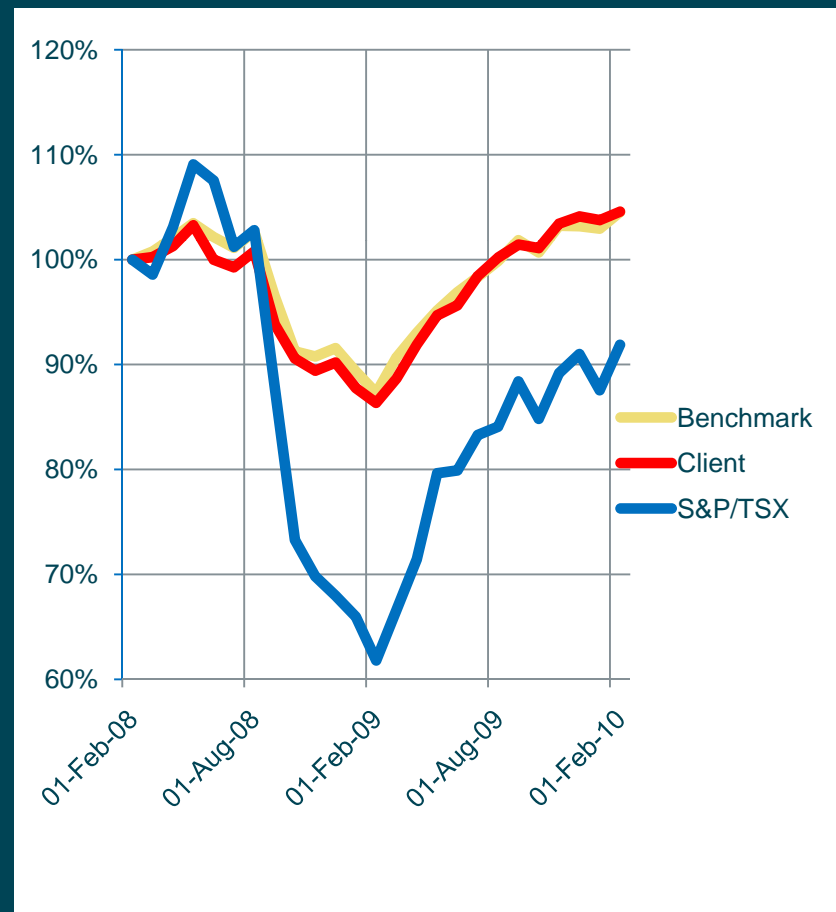
# Asset Mix Policy is Job #1

- **Asset Mix:**
  - blends cash, bonds and stocks
  - instead of high equity
- **Criteria:**
  - Investment time horizon
  - Risk-tolerance
  - Need for income

# Performance During the Market Crisis

- Asset mix is the #1 decision
- Equity is volatile
- Bonds are less volatile
- Policy asset mix favours bonds
- The benchmark is a blend as shown in next slides 25, 26, 27
- Investment management agreement specifies benchmark
- Performance and benchmark exclude management, other fees

Note: Past results do not guarantee future performance.





# The Client's Blended Benchmark

- 1. The Income/Growth Registered benchmark blends 5% of the 91-day t-bill plus 55% of the DEX Universe Bond Index plus 25% of the S&P/TSX Composite Total Return Index plus 15% of the S&P 500 Total return Index in \$C.**
- 2. The Investment Management Agreement for the client's account specifies the blended benchmark formula as a particular weighting of basic market benchmarks.**

Note: Past results do not guarantee future performance.

# The Blended Benchmark: Income/Growth Registered

Basic Asset Classes	Client's Weighting in the Blended Benchmark
Cash	5%
Canadian Bonds	55%
Canadian Equities	25%
United States Equities	15%
International Equities	0%
The Blended Benchmark	100%

We call this particular blended benchmark the “Income/Growth Registered” benchmark as specified in this particular client’s Investment Management Agreement.

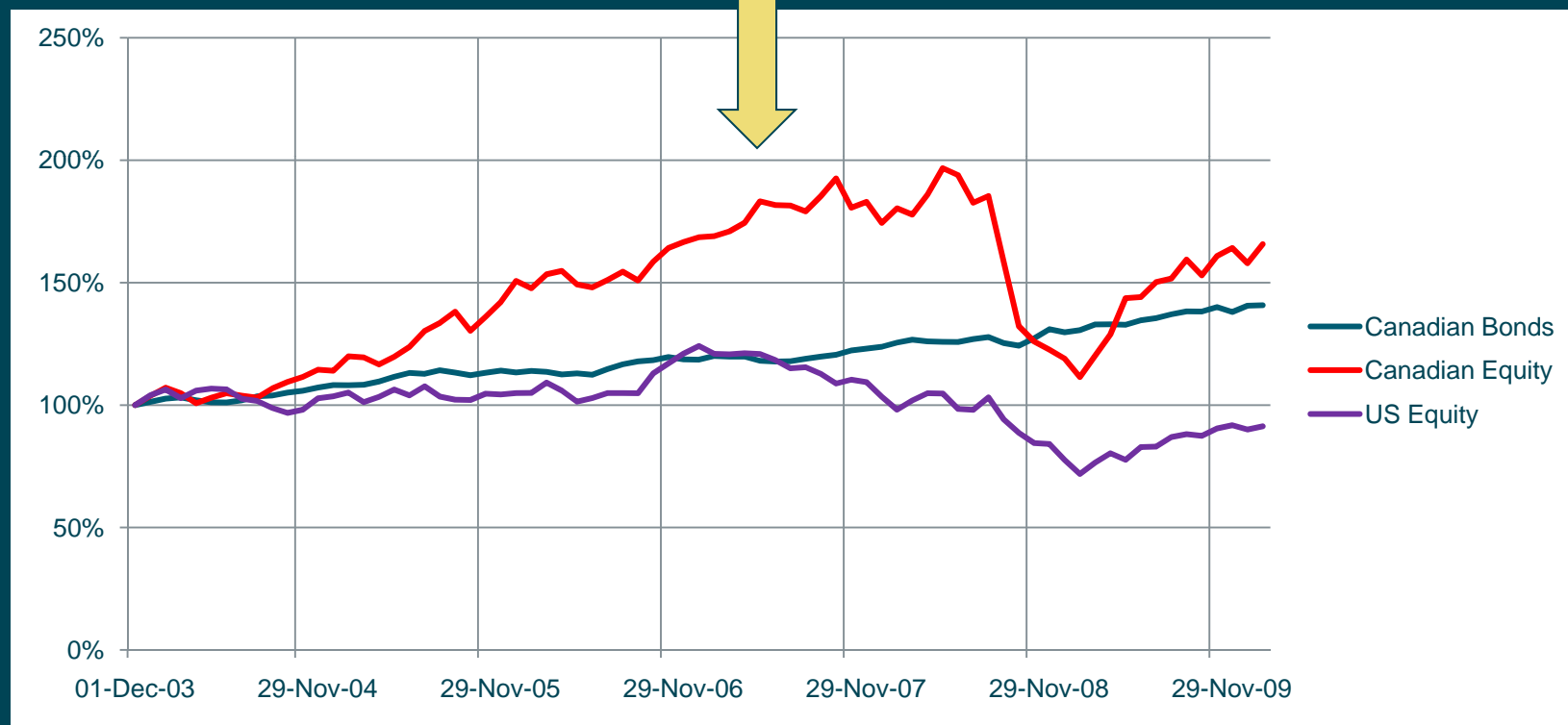
# Benchmark Information for The Basic Asset Classes

- 1. The Canadian Equity benchmark is the Standard and Poor's (S&P) / TSX Composite Total Return Index.**
- 2. The U.S. Equity benchmark is the S&P 500 Composite Total Return Index in Canadian dollars**
- 3. The International Equity benchmark is the Morgan Stanley Capital International EAFE ( Europe, Australia and Far East ) Total Return Composite Index net of with-holding taxes in Canadian dollars.**
- 4. The Canadian Fixed Income benchmark is the DEX Universe Total Return Bond Index (formerly the Scotia Universe Total Return Bond Index).**
- 5. The Income/Growth Registered benchmark blends 5% of the 91-day t-bill plus 55% of the DEX Universe Bond Index plus 25% of the S&P/TSX Composite Total Return Index plus 15% of the S&P 500 Total return Index in \$C.**

Note: Past results do not guarantee future performance.

# Overcoming Temptation for Quick Returns

Client started here



Note: Past results do not guarantee future performance. Graph for Canadian Bonds is the DEX Universe Bond Index, for Canadian Equity is the S&P/TSX Total Return Index, for U.S. Equity is the S&P 500 Total Return Index in \$Canadian.

# Investment Performance for the Income/Growth Registered Portfolio

3-year returns p.a. gross of fees as at July 30, 2010



\$Canadian	Client	Benchmarks	Rank	# Globefund competitors	Median
Cdn. Equity (1)	-1.8%	-2.6%	#3	37	-4.64%
U.S. Equity (2)	-6.9%	-8.0%	#4	41	-9.03%
Int'l. Equity (3)	-9.5%	-10.9%	#12	49	-12.01%
Fixed income (4)	7.2%	7.0%	#5	30	6.01%
Blended (5)	1.8%	2.4%	#1	27	-1.39%

Note: Past results do not guarantee future performance. See slide 27 for benchmarks.

# Methodology to Compare the Relative Performance in slide 29

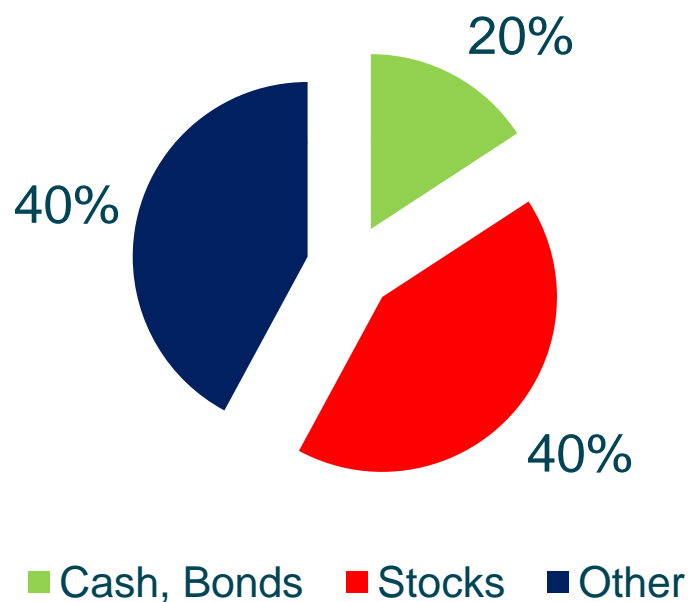
- Source is [www.globefund.com](http://www.globefund.com) that compares 13, 278 funds in different classifications. We use specific classes of these public funds as a comparison for our client's relative investment results for each of the basic asset classes.
- The Median is the return of the middle ranked fund.
- Canadian Equity compares the client's Canadian Equity portfolio total returns with the 37 Canadian Focused Equity Funds larger than \$500 million in assets under management after fees in Globefund.
- U.S. Equity compares the client's U.S. Equity portfolio total returns in \$Canadian with the 41 U.S. Equity Funds larger than \$500 million in assets under management after fees in Globefund.

# Methodology to Compare the Relative Performance in slide 29

- Source is [www.globefund.com](http://www.globefund.com)
- International Equity compares the client's International Equity portfolio total return in \$Canadian with the 49 International Equity Funds larger than \$100 million in assets after fees in Globefund.
- Fixed Income compares the client's Canadian fixed income portfolio total return with Canadian Fixed Income Funds larger than \$1 billion in assets after fees in Globefund.
- Blended represents the Income/Growth Registered portfolio from slides 25, 26 and 27.
- Blended compares the total return of the client's portfolio including all asset classes from slide 26 with the 27 Canadian Equity Balanced Funds larger than \$500 million in assets after fees in Globefund.

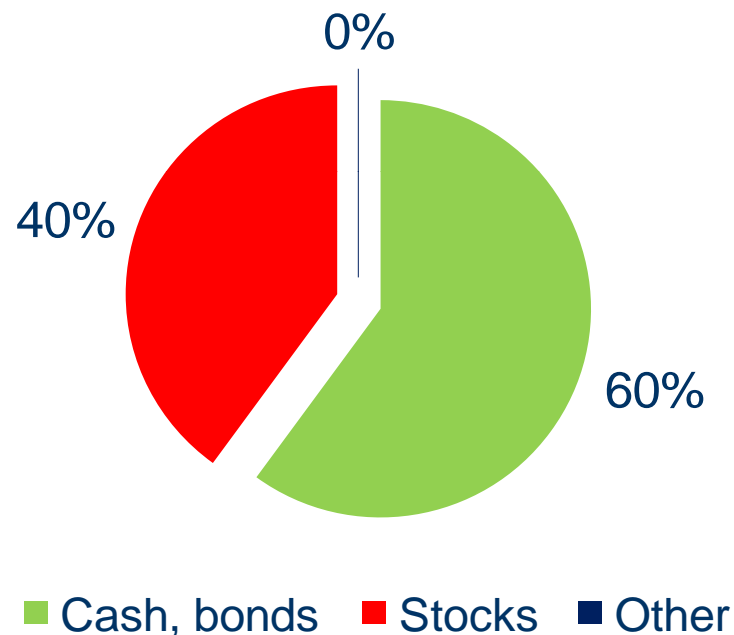
# Prudent Asset Mix

### U of T



### 100-Year Horizon

### Client



### 10-Year Horizon

Note: Past results do not guarantee future performance. Source UT Pensions 2009 Annual Report.



# Fees

## Excluded from this analysis

**AMBROSE**

INVESTMENT COUNSEL

- **Investment Management Fees:**
  - 1.25% on first \$2 million of Assets Under Management
  - 0.75% on next \$3 million
  - Negotiable beyond \$5 million
- **Trading commissions: institutional rates paid by client**
- **Mutual fund management fees: paid by client, institutional rates**
- **Custody fees: 0.2% paid by client**
- **Legal advice: negotiated with independent lawyer**
- **Tax advice: negotiated with independent accountant**

Call now and we can talk.

**AMBROSE**  
INVESTMENT COUNSEL

- **Timing is good now to retire and have us manage your retirement:**
  - **Interest rates are low so the Lump-sum Option value is high**
- **Perhaps you want to travel without worrying**
- **Perhaps you want to start a small business**
- **Call John Ambrose at 416-203-8139**