These notes are to be used in conjunction with the video segments (on DVD) on the subject of pension evaluations – Additional information on pensions can be found in the resource file section of this DVD.

It is suggested that you follow along with these notes as you listen/view the presentations.

While Mr. Burrows practices primarily in Ontario and makes reference to Pension situations in Ontario, the laws are similar across Canada (in particular with respect to the Federal Govt. and other organizations that come under Federal legislation such as Banks, Airlines, railways etc.)

It is strongly recommended you develop a relationship with a reputable pension evaluator in your province.

The video segments on DVD can be played back using the Windows Movie Player (included on the DVD).
Introduction:

Ed Burrows, F.C.A., President of Pension Valuators of Canada
Pension Valuators of Canada started to assist lawyers and individuals in the complex issues pensions entail, and we continue to specialize in this field. We have been valuing pensions for marriage breakdown purposes for 14 years. We have issued over 8,000 reports to 2,000 lawyers and 700 individuals across Canada. We have an excellent quality control program in place; every valuation report is triple checked. Your pension valuation questions can be answered by one of our qualified staff. The material in this presentation is intended for use only by students enrolled in the Financial Divorce Specialists course.

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Financial Divorce Specialists Presentation:

There are an average of 80,000 divorces every year in Canada. That means 160,000 people. Add to that the common law couples that, of course, don’t get a divorce and also the people who although married, don’t get a divorce (perhaps for religious reasons), and that is an average of about 300,000 in Canada who go through marriage breakdown every year!

In order for you to advise them properly it is important that you understand pensions and pension valuations. It is also vital that you fully understand the equalization of property on marriage breakdown.
What We Will Cover

We will talk extensively about pensions. We will explain how a pension is valued for marriage breakdown purposes. We will do the same for Disability Benefits. We will also explain when Disability Benefits are included in the sharing of property and when they are not. Then we will go into detail to explain the equalization of property on marriage breakdown. It is important that you understand all of these.

Definitions

In order to understand these matters, you must first have an understanding of the meaning of certain special terms.

Accrued Benefit – This is the dollar amount of pension benefit earned to a certain time. This is the amount that will be present valued in our calculations.

Benefit – any form of payment to which a person is entitled under the terms of a plan

Benefit Formula – the provision in a plan for the way to calculate a person’s benefit at any time

Bridging Benefit – the temporary benefit paid on early retirement until age 65 to “bridge” the person’s retirement income until they qualify for Canada Pension Plan Benefits and Old Age Security.

Committed Value – the amount of immediate lump sum estimated to be equal in value to a series of future payments based on special criteria. Same as transfer value – the actuarial present value of the benefit to which an employee or spouse is or will be entitled. This is rarely the right value for equalization on marriage breakdown.
Contributory Plan – a pension plan that requires the employees to make contributions by payroll deduction in order to qualify for benefits under the plan.

Credited Service – the length of service used in the plan formula to calculate a defined benefit. This is often different from the actual years of service that the employee has with the company.

Deferred Pension – a pension benefit, payment of which is deferred until the person entitled to the pension benefit reaches the normal retirement date under the pension plan.

Definitions

Defined Benefit Plan – a pension plan that provides a formula so that the distinct benefit the participating member will receive upon retirement can be established. The value of benefit must be at least equal to the member's accumulated contributions with interest.

Defined Contribution Plan – the plan sponsor's contributions are defined, usually as a percentage of earnings. The plan may also include specific contributions to be made by the plan member. (1) At retirement, these contributions plus interest are used to purchase an annuity for former members. (2) The size of member’s pension depends on the amount of contributions made by and on behalf of that member and will also vary due to interest earned on contributions and annuity rate at retirement time. The exact amount of pension is unknown until the member reaches retirement age. There is no guarantee of what the benefit will be at retirement. The value of a member’s entitlement is the sum of accumulated contributions with interest that are identified as being for that member, less a reasonable allowance for the income tax that must be paid on the pension benefits as they are received.

Family Law Act – this Act provides for the sharing of property and other matters on the breakdown of a marriage. It only applies to married couples. It does not apply to common law couples, as they have no property rights under this Act on the breakdown of their relationship. The Act provides that when the marriage breaks down each party must list and value their property. Then the party who has the larger value must
transfer property to the other party until their values are the same.

Definitions

Fifty Percent Rule – There are actually two “50% rules”. Paragraph (a) of the OPBA, Section 51 subsection 2, says that the non-member spouse can never receive from the pension an amount greater than 50 percent of value of pension accrued to the member during the period when the party and the member were spouses. (It relates only to the pension value and not to the pension benefit.)

(b) OPBA, Section 39 subsection 3 says that as of January 1987, the sum of the contributions and interest accumulated under a pension plan made by a plan member shall not be used to provide more than 50 percent of the post-1987 commuted value on the date of termination. If the plan member is entitled to a contributory benefit, any amount above that is deemed surplus value and can be given to the member in a lump sum or returned to the value of pension. This relates only to pension contributions and interest. It is usually referred to in pension reports as Excess Contributions or a Special Adjustment.

Flat Benefit Plan – A defined benefit plan that specifies a dollar amount of pension benefit to be credited for each year of service.

If & When Approach – An agreement or court order that requires that once the plan member reaches retirement or leaves active service for any other reason, the spouse is entitled to a part of the pension benefits that are payable to the plan member. The pension payments are shared once the person retires and the pension comes into pay. The share is normally expressed as a percentage. Upon retirement, the member pays to the nonmember spouse a portion of each annuity payment according to the allocation formula agreed upon at time of divorce, or the pension administrator may make a separate payment to each of them.

Definitions

Indexing- 1. to adjust (wages, pension benefits, interest rates) automatically to changes in the cost of living (inflation).
2. a number used to measure change in prices, showing percentage variation from an arbitrary standard (usually 100) representing the status at some earlier time.

Joint & Survivor Pension – a mandatory reduced pension that will continue after the member’s death for the lifetime of the spouse. In most cases if, at the date of commencement of pension, the member has a spouse, the pension must be in the form of a joint and survivor pension paying at least 60 percent of the pension to the survivor. These benefits are not assignable. The rights to these pension benefits may be waived, but the spouse cannot be compelled to do so.

Long Term Disability – disability benefits that start after 6 months and end on recovery, age 65, or death.

Matrimonial Home – where the family or legally married couple have resided. Common law spouses never have them (as recognized in law) because they have no statutory property rights. It is possible to have more than one matrimonial home at a time.

Mortality Tables – tables that measure the probability of a person at each age living exactly one more year – a pension pays a benefit from retirement to the death of the plan member and a mortality table is required to calculate its value. The two types of tables are: 1. Canada Life Tables, developed by Statistics Canada from census data. They show mortality rates for the general population of Canada; and 2. Group Annuity Mortality Tables, developed by life insurance companies. They show mortality rates based on the lives of people who owned group life insurance.

Non-Contributory Plan – the employer provides all of the funding that is required. The employees are not allowed to contribute.

Pension Benefit – this term implies that it is the periodic payment provided under the pension plan for the lifetime of the member.
Definitions

Property – almost everything is property, including rights. The only thing specifically excluded in current case law is a person’s professional degree.

Pension Benefits Act – This is Ontario legislation that regulates employment pension plans. It specifies minimum benefit provisions, funding and solvency requirements, and investment guidelines.

Pension Benefits Division Act – this Act provides a system for dividing government pensions on marriage breakdown.

Pension Benefits Standards Act – This Act sets minimum standards for federally operating companies (e.g. airlines, trains, banks).

Short Term Disability – Disability benefits start right away but only last 6 months or less.

Valuation Date – The earliest of 1.) the date the spouses separate with no prospect of reconciliation, 2.) the date a divorce is granted, 3.) the date the marriage is declared nullity, as outlined by the Family Law Act. In Ontario courts of law, the valuation date usually is considered to be the date of separation. It is very important to remember that all property is valued as of the valuation date and events subsequent to valuation date are not considered in the value.

Year’s Maximum Pensionable Earnings –(Y.M.P.E.) this term refers to earnings from employment on which Canada Pension Plan contributions and benefits are calculated. The amount changes each year according to a formula based on average wage levels. The Y.M.P.E. is often taken into account in establishing the bridge benefit.

Equalization of Property

The equalization of property is often misunderstood to mean that
each party gets one-half of each other’s property. This is not true. In fact, many properties could not be divided in half. The term actually means that each party must list the properties, or assets, that they own at the date of separation and place a reasonable value on each. They must then list their liabilities at the date of separation. Deducting the amount of their liabilities from the value of their property will give their net property at the date of separation. From this they deduct their net assets that they owned at the date of marriage. However, they are not allowed a deduction for the value of the matrimonial home if they owned it at the date of marriage. The result of this calculation is called their net family property. Whichever party has the higher value of net family property must transfer property to the other party until the value of each party’s net family property is the same.

It is important to keep in mind that the values are as at the date of separation. It doesn’t matter that the values change after the date of separation but before the date of settlement when the equalization amount is being calculated. It may be necessary to consider such change in value if the particular property is being used to satisfy the payment of the equalization amount.

Disability Benefits

There are several possible sources of Disability Benefits. It can be a disability policy that is maintained by the employer, or it may be a policy that is owned personally. It could even be part of a life insurance policy. It may be from Workers’ Safety and Insurance Board (WSIB) or its predecessor Workers’ Compensation, or from the Canada Pension Plan. It could even be a part of the normal pension plan since most pensions do provide for benefits payable on disability. It may be that the disability Benefits being received are as a consequence of an
automobile accident. The source of the benefits is not really important but it may give some indication of whether or not the benefit is exempt under the Family Law Act (FLA). The disability payments may be paid for various reasons, such as pain and suffering, lost past wages, lost future wages, or future medical care required because of the disability. The payment may even be for a combination of these reasons and it may become necessary to know the breakdown. Again the reason for the benefits may give an indication of whether or not the benefit is exempt as being for damages.

In determining whether or not a disability benefit has to be valued and included, it is first necessary to determine whether or not it is property. It is not really the benefit that is to be considered. It is the right to receive that benefit. Since almost everything is property and since rights are property, it is clear that the right to receive disability benefits is property. So the answer is “yes”, disability benefits are property.

Disability Benefits

Having determined that they are property, we must then consider the possibility that they may be exempt property under the Family Law Act. The Act does provide an exemption for property that represents “damages”. Some disability benefits will qualify as damages and some will not. Therefore, it is necessary to find out why the payments are being received. If they are for damages they will be exempt. What qualifies as damages is a little more complicated and will not be dealt with here. If the disability benefits are not for damages, they could also be exempt if, “it would be unfair to include them”. This is a decision that would need to be made by a judge. This section of the Family Law Act is rarely applied.
Pensions

Of the 80,000 divorces a year in Canada. About 40% of divorces will involve at least one party who has a pension. Therefore, you can see how important it is that you understand pensions and the valuation of pensions. Most clients, lawyers and judges do not understand them. If you do, you will have an advantage.

Counting Teachers Pension Plan and OMERS as one pension plan, there are thousands of different pension plans just in Ontario alone, each with their own little differences that can affect the value.

Often the plan will provide that the pension will be 2% of the person’s highest average earnings for each year that they have been a member of the plan. They may only allow retirement at age 65 without a penalty. Or, they may have early retirement provisions that allow the person to retire on an unreduced pension when they meet certain criteria. For example, Ontario teachers can currently retire on an unreduced pension when the total of their age and qualifying years is at least 85.

Some, like the teachers’ pension plan, provide full annual indexing of the pension benefit. Others provide some or no indexing. In some cases, the indexing is decided on an ad hoc basis, depending on the results of the plan’s investments. Those with the best provisions usually require higher contributions from the members.
Pensions

It is not part of the pension, but a teacher may also have accrued sick leave gratuity to be valued. That is because they are sometimes allowed to have a certain number of sick days each year and if they do not take them they are paid extra for them when they retire.

Government Pensions

“Government” pensions also provide that the pension benefit will be 2% of the highest average earnings for each year of service and are also fully indexed. They can retire on an unreduced pension when they complete 30 years of service. Because their benefits are generous they pay more in contributions. Government employees will have another asset called accrued retiring allowance.

C.A.W. Pensions

C.A.W. pensions (for companies such as General Motors, Ford, Chrysler, etc.) are a little bit different. They are what is generally called a “flat rate” pension plan. The flat rate is updated periodically. The pension benefit is the flat rate times the number of years of service. These pensions provide 90% indexing or “cost of living allowance”. They apply to hourly employees and provide that the employees can retire after 30 years with a generous pension. The employees do not contribute to this pension plan.
Tradesmen’s Pensions

Tradesmen, such as carpenters, electricians, bricklayers, etc. all have a plan that pays a pension benefit of a flat rate times the number of hours worked in a year. Some are indexed and some are not. The tradesmen do not contribute anything. The employer pays the all of the contributions into the pension fund. Although most pensions qualify for protection under the Ontario Pension Guarantee Fund, these pensions do not.

Pension Benefit

All pensions provide a pension benefit that is payable to the member for life. They also provide a continuing pension to the spouse of the member, generally 60% of the member’s lifetime benefit.

Some pensions provide a “bridge” benefit in addition to the lifetime benefit. The “bridge” benefit is payable from retirement to age 65. It is intended to supplement the person’s pension until such time as they qualify for Canada Pension Plan and Old Age Security. This “bridge” benefit does not continue to the spouse on the death of the member.

Some pensions are fully indexed to the rate of inflation, some are partially indexed, and some provide no indexing.

Two types of Pensions

There are basically two types of pension plans: defined contribution pensions and defined benefit pensions. In many respects, defined contribution pensions are simpler.
Defined contribution pension plans set out who pays contributions and when, just like defined benefit plans. However, in defined contribution plans the contributions made by and for each member are kept separate and accumulate like a bank account.

The defined contribution pension plan does not have a formula for determining how much pension benefit a person will receive on retirement. They merely say that whatever amount has been accumulated for a member when they retire it will be used to buy them a pension.

The value of a person’s defined contribution pension is usually the accumulated contributions and interest to the exact date of valuation, less a reasonable allowance for income taxes.

**Defined Benefit Pension Plans**

Defined Benefit pension plans have some similarities to defined contribution pension plans but some important differences. Like defined contribution pension plans, defined benefit pensions do set out who pays what contributions and when. The major difference is that while defined contribution pensions do not set out how much a person’s pension will be when they retire, defined benefit pensions do have a formula for determining the amount the pension payments will be.

Many defined benefit pension plans provide that the member's pension on retirement will be 2% of their highest average salary for each year that they are a member of the plan. They often have provision for retiring before age 65.

Valuing a defined benefit pension is more complicated. Basically, the value is the present value of the future pension payments to the extent that they were earned during the marriage. There are many different types of defined benefit pensions and
they can have many different provisions. Some are contributory (meaning that the members are required to make contributions) and some are non-contributory. In both, the employer is responsible for ensuring that the pensions are fully funded.

**Defined Benefit Pension Plans**

All provide a formula for calculating the pension benefit. Some are a percentage of wages and some are a flat rate times the number of years of service.

They may be fully indexed, partially indexed, or not indexed at all.

If the pension formula provides a pension benefit that is in excess of what is allowed by the Income Tax Act, the employer provides a separate unregistered pension called a “top up” pension, for the balance.

**Dividing The Pension**

Many people would like to avoid dealing with the pension and would prefer just having the pension split in two and provide a separate pension for each of them. This is not possible under the current Pension Benefits Act that applies to most pensions in Ontario.

If it is a Federal Government pension it qualifies for special treatment under the Pension Benefits Division Act. This allows the parties to apply to have part of the value of the pension value transferred to a retirement vehicle for the non-member spouse. Certain other pensions qualify for special treatment under the
Pension Benefits Standards Act. This applies only to pensions for federal type operations such as banks, airlines, trains, etc. This Act allows a member to transfer up to the full amount accrued during the marriage to a spouse on marriage breakdown.

If & When Agreements

As I said earlier, most pensions in Ontario do not allow splitting the pension into two. This has led to the development of what has come to be known as an “If and When Agreement”. These agreements are complicated and can give rise to many problems later.

We are often asked to assist in deciphering the terms of a poorly drafted agreement. It is difficult to draft such an agreement so as to provide for every possibility. I have provided a suggested form of agreement and a checklist in my new book. This type of agreement should only be entered into as a last resort when there is absolutely no other way to satisfy the payment of the equalization amount.

How a Pension Is Not Valued

Some people suggest that the value of a defined benefit pension can be determined by simply taking the total contributions and interest at the date of separation. They may even say you take double that amount. This is not true. In fact, some of these pensions do not have contributions. Does that mean they have no value? Of course not.

Some people will find out the commuted value of their pension from their employer and try to use that as the value for marriage
breakdown. Any similarity between the two would be purely coincidental.

Another suggestion might be to just calculate a simple present value of the projected future pension benefit payments. This will not give the proper value either. The valuation of a pension for marriage breakdown purposes is more complicated than that.

How a Pension Is Valued

The value of a defined contribution pension is indeed the present value of the expected future pension payments. However, we must take into account the possibility that the member may die at any time. This is done with the use of Life Expectancy tables. We do not just project the payments ahead for the life expectancy of the person. We actually consider the possibility of the person dying each year in the future. In determining the present value of the future payments we need a discount or interest rate to use in our calculations. The method of choosing the proper rate is set out in standards set by the Canadian Institute of Actuaries. When we do these calculations we are estimating the amount of money that must be set aside now that, with interest earned thereon, there will be just the right amount to pay all of the future pension payments.

Note: In the third video in this series Mr. Burrows will discuss pension valuation at it relates to a specific case study in Module Three of the course.

Additional information on pensions can be found in the resource section of this DVD.