DIVISION OF PENSIONS ON MARRIAGE BREAKDOWN, Then and Now,

The Family Law Perspective

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How to handle pensions has been an ongoing source of problems for separating spouses in Ontario`s matrimonial property law. Pensions have been treated as any other asset in the equalization calculation. That is, they are valued and their value included in the member spouse’s net family property. This has generated a whole host of problems related to valuation and liquidity. The need to comply with the provisions of the Pension Benefits Act if the pension held is provincially regulated has in the past also added a layer of difficulty. Parties have had to address:

-- how to calculate the value of a pension? (and they have had to incur actuarial costs for that purpose);

--what assumptions should be made in determining the value of the pension: what retirement age should be used? What adjustments should be made for a member’s reduced life expectancy? What adjustments should be made for the potential insolvency of the pension plan?

-- how can a member spouse finance an equalization payment based on an illiquid asset?

--if a member spouse cannot finance an equalization payment how to design an “if and when” division that provides security to the non-member spouse and does not breach the Pension Benefits Act’s 50% rule?

--how to protect a payor from a “double dip” whereby the non-member spouse receives an equalization payment at separation based on the capitalized value of the member’s pension and then seeks a spousal support payment after retirement based on the same pension in pay?

After more than two decades of struggling with these issues and many hours devoted to lobbying for law reform we now have the significant legislative amendments contained in Bill

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133 and its newly minted regulations which will institute a new matrimonial property regime for pension interests. The legislation will come into force with the regulations on January 1, 2012.

The new provisions leave largely undisturbed the overall scheme of equalization but they will have a significant impact on the process and substance of valuation and how payment against the obligation is satisfied. This paper provides an overview of the new scheme.

1. **Pensions in the Equalization Calculation**

Pension interests, whether vested or non-vested, are included as property for equalization. The interests are to be valued pursuant to the new Regulations pursuant to the Pension Benefits Act. For provincially regulated plans, these valuations are to be carried out by the plan administrator who can, and presumably will, charge a fee to a prescribed maximum for the service. The regulations establish a formula to determine the preliminary value as of the family law valuation date which is the valuation date under Part I of the Family Law Act. This value will then be adjusted to calculate the portion of the pension that accrued during the marriage. That amount is the imputed value for family law purposes of the member’s interest in the plan. This amount is included in the member spouse’s net family property for equalization purposes. Any contingent liability for income tax is treated separately as a debt to be included in the member spouse’s net family property.

If a spouse has retired by the separation date then the non-member spouse will have an interest in survivor benefits which are also a pension property interest and must be valued in the same manner, and in such cases the preliminary value as of the family law valuation date for the survivor benefits will be the imputed value for family law purposes.

2. **Extension of rights to Cohabitees**

A new addition in this legislation is that non-married spouses may choose to equalize the value of a pension although those spouses do not otherwise have equalization rights. This option is solely at the election of the member spouse. The family law valuation date for unmarried spouses is the date on which the parties’ separate with no prospect of resuming cohabitation. This option may also be exercised by married spouses who wish to share in a pension accrued in part during any pre-marital cohabitation. These provisions are found in Part IV of the Family Law Act and apply to cases resolved by domestic contract and arbitration.
3. **Exclusion of Canada Pension Plan benefits**

CPP pensions are subject to credit sharing on relationship breakdown. As a practical matter spouses have typically not been valuing these or including them in the equalization calculation. Under the new regime these benefits are expressly excluded from equalization.

4. **Valuation**

Provincially regulated pension interests are to be valued by the plan administrator in accordance with a valuation method set in the *Pension Benefits Act* regulations. Defined Benefit Plans and Defined Contribution Plans have distinct treatment. Hybrid plans that are in part defined benefit and in part defined contribution are valued separately with the appropriate method applied for each part. Under the regulations the parties must apply to the plan administrator for a calculation of the value of the pension interest. The regulations prescribe a form to be filled out with the necessary details which include names, contact information, proof of dates of birth, date of marriage, date of cohabitation, if applicable, and the family law valuation date (which is either the valuation date under Part I of the *Family Law Act* or the date of separation for non-married spouses). If the spouses cannot agree on a valuation date then they may request calculations by the plan administrator as of two dates. The regulations require a joint declaration from the spouses for this request for two calculations and the plan administrator will charge more for the service.

The plan administrator is required to produce the valuation within 60 days of receipt of the application.

(a) **Defined Benefit Plans**

The regulations prescribe the hybrid termination method that had become standard under the old legislation. This approach takes into account some, but not all, post separation events. It assumes continued membership in the plan and includes early retirement benefits and mandatory indexing. It does not take into account post-separation career advances or increases in salary. The prescribed valuation method does not take into account *ad hoc* indexing provisions, whose inclusion was a source of dispute in the past, nor does it take into account voluntary contributions.
The regulations permit consideration of shortened life expectancy in a narrow range of cases. To qualify the member spouse must have made an application to the plan under the Pension Benefits Act before the family law valuation date based on shortened life expectancy. The only exception to this is if the application for shortened life expectancy is made within six months of the family law valuation date and before an application has been made for a valuation of the pension. The application must be accompanied by a statement from a physician confirming that the member spouse has a health condition limiting life which existed at the time of separation. In these limited circumstances the administrator is directed to value the pension at a reduced value.

The regulations permit consideration of a wind up of a plan as long as the effective date of the wind up is on or before the family law valuation date. If so, the preliminary value of the pension benefit is the commuted value.

The regulations do not permit consideration of solvency problems in the plan.

The plan administrator will not consider the contingent taxes payable by the member on the pension interest. A member spouse will need to retain an appropriate expert to calculate contingent taxes based on his or her financial circumstances.

(b) Valuation of Defined Contribution Plans

Defined contribution plans are more like RRSPs. The regulations provide that the preliminary value is the total amount of the contributions and any interest on the contributions as of the family law valuation date. If the data is not available as of that date, the value is to be calculated as of the last day of the prior month. If the value of the contributions and any interest can also be determined as of the date of marriage (or date of cohabitation if applicable) then that is a deduction and the imputed value of the pension benefit is the difference between the value at the family law valuation date and the start date. If the value cannot be determined at the start date but information is available for a period from 45 days before the start date to 45 days after the start date then that is the amount used as a deduction from the preliminary value to calculate the imputed value of the pension benefit. If this information is not available then the interest will be calculated using the method of valuation for defined benefit plans.

(c) Valuation of pension interests not governed by the Pension Benefits Act

The Family Law Act requires that pensions are valued pursuant to the regulations of the Pension Benefits Act. There are many pensions that are not governed by that act including federally regulated pensions, pensions regulated in other provinces, and foreign pensions. In those cases the statutory requirement is to have the interest valued in the same manner as prescribed by the regulations to the extent possible. Of course the administrators of such plans
are not required to undertake the valuation. For these plans it will likely still be necessary to hire a private actuary.

(d) Non-vested pension interests

The regulations impose a 50% discount on the value of all non-vested pension interests. This includes situations in which the member has less than two years of plan participation. It also includes interests in Supplementary Employment Retirement Plans (“SERPS”) which may be quite substantial assets held by high earning executives.

5. Satisfaction of the Equalization obligation

Separating spouses who hold a pension will receive access to special forms of payment under the Family Law Act. Payment may still be a simple equalization payment from other assets. However, it will now be possible for there to be an immediate transfer of a lump sum out of a pension plan. A court has discretion to determine whether to make an order for an immediate transfer and how much should be transferred. The new s. 10.1(4) of the Family Law Act provides an open ended list of relevant considerations including:

(1) the nature of the assets available to each spouse at the time of the hearing;
(2) The proportion of the spouse’s net family property that consists of the imputed value for family law purposes of the pension interest;
(3) The liquidity of the lump sum in the hands of the recipient spouse;
(4) Any contingent tax liabilities related to the lump sum that would be transferred;
(5) The resources each spouse has to meet his or her needs in retirement and the desirability of maintaining those resources.

There are two categories: pre-retirement interests and those where the pension is in pay.

Pre-Retirement Pension Interests: Pension interests held by a party pre-retirement must be satisfied by a cash payment but some or all of that payment may come from an immediate transfer out of the pension plan itself under certain rigorous conditions. The funds are to be transferred into a prescribed retirement investment, either a life income fund or a locked in retirement account. If and when divisions will no longer be permitted.

Pension in Pay: If a member spouse has already retired before the family valuation date then the only option is for the pension in pay to be divided pursuant to the regulations. The regulations require a calculation and payment of lump sum arrears
to the non member spouse for the period from the family law valuation date to the date that the pension is actually divided in pay. This could be a considerable amount if a lengthy period of time has elapsed.

Where the pension was in pay at separation, the non-member spouse will have survivor’s benefits and may choose to receive a blended amount of the survivor’s benefit and his or her share in the member spouse’s benefit.

**The “50% Rule”**

Under the old regime no pension plan could pay out more than 50% of the pension accrued during the marriage to the recipient. The amendments to the Pension Benefits Act now state that a transfer is capped at 50% of the imputed value for family law purposes of the pension benefit, calculated according to the regulations. The regulations provide that this imputed value is updated to the date of the transfer. This will provide some leeway in situations in which considerable time has elapsed between the date of separation and the settlement date.

6. **Transition Provisions**

As of January 1, 2012 the new regime will apply to all separating spouses whether the family law valuation date falls before or after that date *unless* a domestic contract or court order has already resolved equalization on a final basis. In any case in which there is a pension interest in the mix, parties will have to consider whether it is better to settle under the old regime or the new regime. It is a difficult assessment to make.

The transition provisions will still permit orders to correct implementation problems arising from pre-existing “if and when” settlements.

7. **What does the future hold?**

The new legislative and regulatory regime differs in many respects from the old. It has resolved some of the problems of the past, failed to resolve others and, no doubt, will have its own quirks at least in the first few years as parties and plan administrators start to work through the new arrangements. At the outset I listed some of the issues that had given rise to the most concerns under the old system. In review:
(a) How to calculate the value of a pension has now been fixed, at least for provincially regulated pensions. The new certainty has a real value. Parties will no longer incur any transaction costs arguing about the proper retirement age, or whether there should be a discount because of ill health or threatened insolvency of the plan. The answers are fixed by the regulations. Of course, in fixing the answer some individuals will have better or worse results under the new system. The exclusion of certain factors such as consideration of ad hoc inflation increases and also voluntary contributions will also have a significant impact on the quantum of equalization payments in some cases.

The problem of financing an equalization payment derived from a pension interest which is an illiquid asset has been resolved. The court will have discretion as to whether or not to access the pension by immediate transfer. We will no longer see so many cases in which the pension holder walks away with only a future income stream and the non member spouse walks away with the family home.

The abolition of “if and when” arrangements has rather dramatically ensured that no one needs to worry about security concerns for enforcement. On the other hand, there is no mechanism now for spouses who separate pre-retirement to share the income stream in pay. That is regrettable as in many cases that would be a sound result from a family law perspective. It would protect the non-member spouse from the risks of investing on his or her own and it would avoid double dipping and its related litigation.

Some non member spouses will still receive an equalization payment without a portion reserved for retirement assets. Even those non-member spouses who do receive a portion of their settlement in a retirement asset, such as a LIRA, will likely not achieve as good returns on that investment as the member spouse who will be receiving a pension that has been managed professionally. As a consequence, we will continue to see spousal support claims after the parties have retired which involve a double dip into the pension asset. This problem has not been solved.

Permitting access to pension sharing for non-married spouses and allowing married spouses to share in the value of pension interests accrued pre-marriage will be welcome to parties and counsel by providing a new tool for settlement.

What we cannot know yet is how the courts will interpret and apply the factors set out in s. 10.1(4) to determine whether to order that an equalization payment be satisfied in part by a pension pay out and, if so, to what degree. The case law will evolve but in making these arguments counsel will have to consider what their clients’ needs are. The focus of the legislative amendments appears to have been to protect the interests of the member spouse but there will still be non-member spouses who will prefer to receive as much of the
equalization as possible up front and without restriction. The statutory factors include consideration of the nature of the assets of each spouse at the time of the hearing and that may be relied on by non-member spouses.

This reform initiative has taken many years to come to fruition. It does not resolve all the problems that have arisen in the past. There is no question that there will be winners and losers, particularly as a result of the decisions taken in setting the valuation method. As a whole, the changes are an improvement and the flexibility that has been left in the system in the discretionary factors and the decision to leave so much of the substance to the regulations means that there is hope that there will be room for modification and adjustment over time.