Draft Regulations Regarding Pension Asset Division on Marriage Breakdown

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Submitted to: **Ministry of Finance**
Ministry of the Attorney General

Submitted by: **The Ontario Bar Association**

ONTARIO BAR ASSOCIATION
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The Ontario Bar Association ("OBA") appreciates the opportunity to provide comments on the draft regulation regarding pension asset division on marriage breakdown (the "Draft Regulation"). We strongly support the objectives of the new legislative scheme, including making the equitable resolution of family disputes faster and more affordable. We appreciate that developing guidelines to fit two complex areas of law is a difficult job and are delighted to bring the OBA's expertise in both family and pension law to bear in assisting with this task.

Below, we identify a number of provisions of the Draft Regulation that require clarification or amendment in order to ensure that the government's goals of fairness and affordability are met and that guidelines are clear. While it is impossible to predict all of the permutations in circumstance, it is always important that a legislative and regulatory scheme recognizes, and deals fairly with, a wide variety of circumstances. This is particularly crucial here because, in the context of net-family-property division, there is *virtually no* opportunity to deviate from the legislation and regulations to cure inequities as they arise on a case-by-case basis.[1]

The OBA

Established in 1907, the OBA is the largest voluntary legal association in Ontario, representing 18,000 lawyers, judges, law professors and law students. The OBA's active Pension & Benefits and Family Law Sections have approximately 1,000 members who are the leading practitioners in those two fields and count among their clients virtually every stakeholder in the pension-valuation issue, including separating spouses, children, plan administrators, plan members, pension and benefit consultants, investment managers and other advisors. The OBA has assisted in virtually every pension and family law reform initiative in the last decade.

Introduction

In order to assist in achieving the goal of developing a clear, equitable, fast and affordable process for valuing and dividing pension on marriage breakdown, we offer comments and recommendations in the following areas:

I – Valuation Issues;

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[1] The *Family Law Act* provides the ability to deviate from the legislative and regulatory scheme only where an unconscionable result would flow if the legislation was followed. This has been interpreted to be an extremely high threshold that is not met by showing significant unfairness or inequity alone.

II – Post- Valuation Issues; and

III – Administrative and Jurisdictional Issues, including issues regarding the information to be provided on a Statement of Imputed Value and assets not covered by Ontario's *Pension Benefit Act* ("PBA").

I - Valuation Issues

Pro-Rata Valuation Issues

(a) Defined Contribution Benefits

The "pro-rata" valuation approach outlined in s. 16 of the Draft Regulation is used to value benefits accumulated during the period of a relationship both for defined-benefit pension plans and defined-contribution pension plans. Although consistency of approach is desired where possible, the OBA notes that the fundamental differences between defined-contribution plans and defined-benefit plans dictates that consistency in this case is not appropriate. For the purposes of net-family-property valuation, defined-contribution plans are more like Registered Retirement Savings Plans ("RRSP") than defined-benefit pension plans. The failure to recognize this in the valuation process could lead to significant unfairness. One spouse's RRSP could, *in reality*, have the exact same value as the other spouse's defined-contribution pension plan. However, given that they will be valued differently by operation of the Draft Regulation, the two *equal* assets may be reflected with *different* values on the Statement of Net Family Property. This entirely notional difference in value could lead to a requirement to pay equalization where none, in fact, is owed.

The inequity outlined above would be cured by the adoption of a "value-added" approach to the imputed value calculation of defined-contribution plan benefits. The valuation under a value-added approach corresponds to the difference between:

(i) the value of the defined-contribution account on the valuation date; and
(ii) the sum accumulated as at the date of marriage (or the date cohabitation began),

increased by net investment returns in respect of the imputed value for the period from the valuation date to the date of settlement or division.

Other provinces with similar legislation generally adopted a value–added approach for defined contribution accounts.

(b) Additional Pro-Rata Concerns

The pro-rata calculation for determining the pre-marriage value is based loosely on service or membership. The OBA seeks clarification of how the calculation will apply in the many plans which have both contributory and non-contributory portions (with different formulae) or plans that calculate benefits on a different basis than years of service (such as on contributions to the plan etc.)

We note that a proposed solution may be to break the member's period of participation into different periods, pro-rating each period and then adding up the different periods. In essence, instead of valuing the two periods, adding up the two values and then pro-rating the total, the plan administrator could value and pro-rate each distinct period then add up the pieces.

Shortened Life Expectancy – Application Requirement

In section 11, the Draft Regulation recognizes that a shortened life expectancy, as defined in the PBA, will significantly change the value of the pension plan asset. However, the Draft Regulation fails to properly accommodate this circumstance in a way that will provide any real assistance in practice. As currently drafted, section 11 only deals with a situation where a Shortened Life Expectancy ("SLE") application has been made under section 49 of the PBA but the SLE payment has not yet been provided to the plan member. Given the seriousness with which administrators take SLE applications, the time between an application and payment is likely to be only a few weeks. There would be very few situations in which the family law valuation date falls within that extremely short time frame. *There is a much broader potential inequity that must be remedied.*

If, on the family law valuation date, a plan member has less than two years to live and, therefore, satisfies the substantive requirement for an SLE payment under the PBA, the reduction in pension value ***is a fact*** regardless of whether or not the member has satisfied the technicality of actually submitting a section 49 SLE application. It is certainly conceivable that when one is dying and his marriage is falling apart, he may not seek immediate advice on what he must do in order to receive an SLE pension payment. If the plan member seeks legal advice prior to the family law valuation date, he could be told to file an application. However, it is extremely rare to seek family law advice before the marriage breakdown – even in the best of circumstances. By allowing for a potential over-valuation of the pension plan based on a technical application requirement, Section 11, as currently drafted, would lead to an inequity for a member spouse who is already, by definition, in horrible circumstances.[2]

[2] Note that we are referring only to situations in which the member could have made a successful SLE application but failed to actually do so. We are not attempting to broaden, or move beyond, the PBA definition of shortened life expectancy.

This potential for unfairness is remedied by an amendment to section 11 of the Draft Regulation, similar to the following:

11. (1) This section applies if the member, former member or retired member:

(a) on or before the family law valuation date, has, or could have, submitted, to the administrator, a successful application for the withdrawal of the commuted value of pension benefits, a deferred pension or a pension from the pension fund in circumstances of the shortened life expectancy of a member, former member or retired member; and

(b) does submit such an application within two years of the family law valuation date and before applying for a Statement of Imputed Value.

(2) The preliminary value for family law purposes of the pension benefits, deferred pension or pension is the same as their commuted value as determined for section 49 of the Act if, on or before the family law valuation date, the administrator has, or could have, approved the application for the withdrawal but the commuted value of the pension benefits, deferred pension or pension has not been withdrawn from the pension fund.

(3) where the application referred to in subsection (1) is received after the family law valuation date, it is deemed, for valuation purposes, to have been received on the family law valuation date.

Disclosure and Value of Non-guaranteed Indexation

Many pension plans provide non-guaranteed indexation on a relatively reliable basis. As currently drafted, the regulation does not provide any way to include the value of non-guaranteed future inflation increases, even where such increases are highly likely. In an immediate settlement context, particularly in cases where a spouse is a member of a stable pension plan that is likely to provide future inflation increases, this will lead to a significant undervaluing of the pension asset on marriage breakdown. Non-guaranteed indexation has made a significant difference in both settlement agreements and in the courts' valuation of pension assets.

It is recommended that subsection 20(5) of the regulation be amended to add something akin to the following paragraph:

(5) Related financial matters: The following additional information about related matters must be included in the statement:

...

> 3. the dates and amounts of any non-guaranteed indexation payments provided by the pension plan in the three years prior to the family law valuation date.

This disclosure will allow the litigants to determine whether, from a family-law perspective, there is value in the potential for future *ad hoc* indexation payments, such that an addition to the member-spouse's net family property would be warranted. We recognize that the purpose of the pension-valuation legislative scheme is to allow for certainty. However, in this particular case, where a significant inequity would result, the regulation must allow for flexibility – specifically, the ability for the non-member spouse to argue for the inclusion of *ad hoc* indexation as an addition to the member spouse's net family property. It should be noted that we are not suggesting that the pension plan administrators be required to change the Statement of Imputed Value to reflect *ad hoc* inflation payments. Further, we are not suggesting that the *ad hoc* indexation value change the maximum amount of the equalization payment that can be satisfied from the pension plan – this amount would still be calculated based on the administrator's valuation. We are suggesting only that there be appropriate flexibility to include the value of *ad hoc* indexing in the member spouse's net family property.

Preliminary Value: 80% Consent Test

Subsection 6(4) of the Draft Regulation provides:

> (4) For the variables "C" and "T" in subsection (2), if the administrator's consent is an eligibility requirement for an unreduced pension before the normal retirement date and if the administrator is not otherwise deemed to have consented for any other purpose under the Act, the administrator is deemed to have consented for the purposes of the preliminary valuation if all of the following conditions are satisfied:
>
> 1. The member would meet all of the other eligibility requirements for his or her entitlement to be paid the unreduced pension, if he or she continues his or her employment or membership in the pension plan on the same terms to the earliest date on which the unreduced pension could commence.
>
> 2. ***The administrator has consented in respect of at least 80 per cent of the instances where consent was required within the three fiscal years of the plan before the family law valuation date*** (emphasis added)**.**

The 80% test will be impossible to program from a systems perspective and difficult to administer.

We recommend that the deemed administrator consent provision of subsection 6 (4) of the Draft Regulation be amended to more closely mirror subsections 40(3) and (4) of the PBA (which provide for deemed employer consent). This amendment would essentially provide that the Preliminary Value shall include the value of subsidized early retirement benefits where all eligibility requirements, other than administrator consent, have been met. The 80% test should be removed.

Calculations where the Valuation Date is in Dispute

Regardless how a pension is valued, difficulties could arise where the family law valuation date is in dispute. This happens in a significant, but not overwhelming, number of cases.

In order to facilitate settlement of a dispute about valuation dates, the parties must know the value of the assets for each of the two proposed dates. The parties can then determine if the difference in value justifies litigation of the valuation date issue. It is important, for settlement purposes, that the two values being compared come from one consistent source. If the parties cannot obtain these two values to compare, they could be forced to litigate the valuation-date issue even in cases where it is not actually financially worthwhile to do so. Determining two values for other assets, such as a house or bank account, is relatively easy. Also, in the current environment, pension valuators regularly provide pension values for two different dates. In order to meet the purposes of this legislative scheme – allowing for quicker and less expensive resolution of family matters- the Draft Regulation must be flexible enough to allow for the administrator, with proper remuneration, to provide more than one pension value. Section 18 of the Draft Regulation should be amended as follows:

> **18.** (1) An application under subsection 67.2 (6) of the Act for a statement or statements of imputed value must be made on a form approved by the Superintendent and must be accompanied by the material that is specified in the form.
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> (2) The application form must require the applicant to provide the following information and material:
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> .....
> 7. The spouses' family law valuation date or, where that date is in dispute, the two proposed dates. Proof of the family law valuation date must be provided. The only acceptable forms of proof are a joint declaration, signed by the spouses, attesting to their family law valuation date or a certified copy of a domestic contract indicting their family law valuation date. Where the family law valuation date is in dispute, the spouses must provide a joint declaration attesting to the fact that the date is in dispute

and outlining the two potential family law valuation dates or a domestic contract that outlines the two potential family law valuation dates.

Section 19 of the Draft Regulation should have the following corresponding amendment:

19. The following is the maximum fee that may be imposed by an administrator for an application for a statement of imputed value:

1. $200, for each family law valuation date provided on the application, if the pension plan provides defined contribution benefits to the member, former member or retired member.

2. $500, for each family law valuation date provided on the application, if the pension plan provides defined benefits to the member, former member or retired member.

II- Post-Valuation Issues

Transfer to Locked-in Account

Section 23 of the Draft Regulation limits a spouse's transfer options to locked-in accounts. The OBA urges the Financial Services Commission of Ontario to maintain a list of eligible locked-in accounts, similar to the list maintained by the Alberta regulator. This would provide a valuable service to spouses, who are searching for available transfer vehicles. It would also be of assistance to plan administrators, who must ensure that pension funds are transferred to eligible locked-in accounts.

In the Consultation Paper that was released along with the Draft Regulation, the Ministry of Finance states on pages 2-3, as follows:

> Further, amendments will be required to clarify that locked-in accounts and annuities covered by the PBA will be available for immediate settlement and will continue to be subject to the '50% rule'- that is, that the former spouse cannot receive more than 50% of the value of the retirement vehicle's assets, accrued during the period of marriage or cohabitation, as applicable, as part of the equalization payment.

The OBA wishes to clarify whether the policy objective is to subject all pension funds, whether in a pension plan or in a locked-in account, to the 50% credit-splitting limit.

Revaluation of Member's Pension Following Transfer

Sections 29 and 30 of the Draft Regulation provide calculations for the adjustment of the pension of an active or deferred plan member following settlement by way of transfer.

The revaluation calculation must be actuarially neutral and must comply with section 8503(3)(l) of the Income Tax Regulations. This section requires that the "present value of benefits provided under the provision with respect to the member … is not increased as a consequence of the individual becoming so entitled to benefits." The Ministry of Finance must ensure that the current provisions of the Draft Regulation will yield values that meet these requirements.

Updating the Imputed Value

Section 26 of the Draft Regulation instructs the plan administrator to update the imputed value of pension benefits from the family law valuation date to the beginning of the month in which a lump sum is to be transferred. The OBA acknowledges the necessity of updating the amount but makes the following observations:

a. Section 26 of the Draft Regulation makes it clear that a plan administrator is not required to recalculate the imputed value in order to update it, but simply to add interest from the family law valuation date to the transfer date. However, the wording of subsection 67.3(6) of the PBA is not as clear. We recommend that subsection 67.3(6) be amended to clarify that the maximum amount payable is 50% of the imputed value and the interest that accumulates on the imputed value. Until such an amendment is possible, the Ministry of Finance should provide guidance regarding the operation of that section in the family-law valuation context;
b. It should be made clear that the spouse's vested survivor pension is not subject to updating under section 26 of the Draft Regulation;
c. For defined contribution benefits, the use of the CANSIM rate (as prescribed in paragraph 26(3)1), rather than the fund rate, can adversely affect the member, where the fund has experienced losses between the family law valuation date and the transfer date; and
d. For defined-benefit plans, the rate of interest to be applied should be more accurately described as the "nominal rate of interest used to calculate the preliminary value of the pension benefits or deferred pension".

Clarification of Options Available for Division of Pension in Pay

The OBA notes that there appears to be an inconsistency between subsection 67.4(8) of the PBA, which provides for waiver of a joint-and-survivor pension, and the corresponding section in the Draft Regulation. It is clear under the Draft Regulation that there are at least two options available for a spouse who is applying to divide a pension in pay. Those options are:

a. Standard - Division of the member's retirement pension only, during the member's lifetime. Any vested spousal survivor pension remains intact and is payable to the spouse, should the member pre-decease the spouse. This option is provided for in section 67.4(2) of the Act and sections 31(1) and 31(2) of the Draft Regulation.

b. Combining Payments - Division of the member's retirement pension, combined with the spousal survivor pension and payable as a single stream for the spouse's lifetime. This option is provided for in section 67.4 (10) of the Act and sections 31(4) and 34(2) of the Draft Regulation.

However, it is unclear from the Draft Regulation whether there are two additional options available:

c. Section 67.4(8) of the PBA states that it is possible for an eligible spouse to waive his or her entitlement to a joint and survivor pension after payment of the first installment of the former member's pension is due. Section 31(3) of the Draft Regulation reinforces the point that a survivor pension can be waived. It is unclear, however, whether the waiver of the spousal survivor pension constitutes a third, stand-alone, option available to the spouse of a member. If it is to be an option, the Draft Regulation must include guidance to the plan administrator on how to revalue the member's retirement pension in order to include the entire value of the forfeited survivor pension. We caution that care must be taken to ensure that increased payments to the member following this revaluation do not violate the ITA regulations.

d. It is also unclear from the Draft Regulation whether a fourth option is available to spouses applying to divide a pension in pay. Clarification is required as to whether or not it is possible for a spouse to elect a division of the member's retirement pension during the member's lifetime while waiving the vested survivor pension. This would be a variation of the first option and would again require guidance to the plan administrators on how to revalue a member's retirement pension.

Impact of Death on Pension Division

The Draft Regulation is silent as to what would occur upon the death of a non-member spouse who is in the process of a "standard" division as described above. Since payments are to be made during the member's lifetime, we assume that such payments would continue to the spouse's estate until the retirement pension entitlement ceases upon the member's death. Also, the Draft Regulation does not contemplate what is to occur should the member die very shortly after the commencement of a standard pension division.

III – Administrative, Jurisdictional and Scope Issues

Information to be Provided on the Statement of Imputed Value

Paragraph 20(2) 1 of the Draft Regulation requires a plan administrator to include the name of the employer on the Statement of Imputed Value. We note that this information is not required on the annual statement of benefits, may not be relevant for pension valuation purposes and may, in fact, create confusion. For multi-employer pension plans, it is possible for a plan member to have more than one employer. For example, a plan member may work part time at each of the public and separate school boards for a region or for multiple employers in a construction-industry plan. It is also unclear whether a plan administrator is required to provide the name of the employer at the valuation date or at the statement date.

Paragraph 20(2) 3 requires a plan administrator to provide a chronology of a plan member's status – from active member, former member to retired member. We submit that it is unnecessary to include a complete plan membership history on the statement. Rather, we suggest that the only relevant status for valuation and settlement purposes is the member's status on the family law valuation date. We note that Bill 236 introduces a new defined term to the PBA, namely, a "retired member". The definition includes not only a plan member who is in receipt of a pension or an early retirement pension but also incorporates the concept of 'deemed retirements'. If a chronology of plan membership is required, it will become even more complicated following the application of the new definitions of 'retired member' and 'former member' as it will then be possible for a plan member's status to fluctuate between 'retired member' and 'active member'.

Paragraph 20(5) 1 requires the statement to provide the Additional Voluntary Contribution ("AVC") amounts and the dates on which AVCs were made. We note that these dates may not be available to administrators in all cases, especially where AVCs were made prior to the effective date of this Regulation.

Also, as outlined above (at pages 5-6), an additional paragraph needs to be added to subsection 20(5) to provide for the disclosure of non-guaranteed indexation payments.

We also note that while subsection 67.2(2) contemplates the calculation of a preliminary value of the spouse's vested survivor benefits, the framework of the Statement of Imputed Value does not expressly contemplate the provision of two imputed value numbers – one for the plan member's pension benefits and another for the spouse's vested survivor benefits.

We therefore recommend that the Draft Regulation be amended as follows:

- To remove the requirement that the name of a plan member's employer be included on the Statement of Imputed Value;
- To remove the requirement to provide a chronology of a plan member's status as an active, former or retired member;
- To remove the requirement to state the dates on which AVCs were made;
- To add a requirement for non-guaranteed indexation payment disclosure; and
- To clarify the reporting of the imputed value of pension benefits and vested survivor benefits on the Statement of Imputed Value.

Valuation Issues Regarding Plans not Governed by the PBA

(a) Federalism and Extra-territorial issues

The Constitutional division of federal/provincial powers would dictate that the provisions of the *Family Law Act* will govern the valuation of extra-provincial and federally-regulated pensions on the marriage breakdown of spouses subject to Ontario law. This seems to be contemplated by subsection 10.1(2) of the *Family Law Act*, which provides:

> (2) The imputed value, for family law purposes, of a spouse's interest in any other pension plan is determined, where reasonably possible, in accordance with section 67.2 of the *Pension Benefits Act* with necessary modifications. 2009, c. 11, s. 26.

However, the new disclosure and valuation duties imposed on plan administrators by the PBA and the Draft Regulation (which is a regulation under the PBA), would not apply to the administrators of extra-territorial and federally-regulated plans, as they are not subject to the PBA. Thus, these plans will have to rely on private valuators. What is not yet clear is whether administrators of extra-territorial or federally-regulated plans are currently equipped, or willing,

to provide valuators with the raw data and other information necessary to value these plans in accordance with the Draft Regulation (as required by the *Family Law Act*). In the context of federally-regulated plans for example, the information that administrators would need to provide is considerably more elaborate than the information they are now providing. This could, in the early stages at least, lead to, at a minimum, delay in the provision of information. It may also lead to expensive and time-consuming litigation to compel production of the necessary information or to argue over the meaning of "reasonably possible" in subsection 10.1(2) (i.e. does the refusal of a federal plan administrator to provide the necessary information make it "not reasonably possible" to value the federal plan in accordance with the Draft Regulation?)

The Ministry of Finance must work with its federal and provincial counterparts to ensure the necessary education and cooperation from the administrators of non-PBA plans.

(b) Supplemental Employment Retirement Plans

It is not clear whether subsection 10(2) of the *Family Law Act*, outlined above, is intended to refer to non-registered Ontario plans, such as Supplementary Employment Retirement Plans (SERPSs). If it is not intended to include these plans, guidance should be given by the Ministry of Finance in that regard.

If subsection 10(2) of the *Family Law Act* is intended to include SERPs, the following issue arises.

Section 10 of the Draft Regulation provides that if a plan member is not vested in his or her pension benefits, the value calculated under the formula is arbitrarily reduced by 50%. Where the vesting date is close and there are very few contingencies remaining that would interfere with vesting, this arbitrary reduction will not approximate reality. This will lead to a significant under-valuing of the pension asset, with a resulting substantial inequity for the non-member spouse.

This is not likely to be as significant an issue for registered plans, particularly given Bill 236, which will provide for immediate vesting of registered plans. However, for SERPs, the 50% reduction could arbitrarily and illogically yield unfair results, particularly because these benefits tend to have a high value. One example provided is that of an executive who has worked for the same employer for decades and is entitled to a $500,000 per year supplementary pension if he or she remains employed for one more month following the valuation date. Absent extraordinary circumstances, this benefit would be all but certain to vest or, more likely, would have vested by the time the valuation was actually completed. In this situation, the contingencies associated with the vesting of the asset are negligible and the asset should be valued at close to 100%. Depending, of course, on the constellation of other assets, the non-member spouse could, in this example, be deprived of hundreds of thousands of dollars in equalization by virtue of an arbitrary, universally-applicable 50% reduction.

If subsection 10(2) of the *Family Law Act* is intended to include SERPs, it is recommended that section 10 of the Draft Regulation be amended as follows:

> 10 (1) Except as provided in subsection (2), if the entitlement to the pension benefits is not vested under the pension plan on the family law valuation date, the preliminary value of the pension benefits as otherwise determined is reduced by 50 per cent; and
>
> 10(2) For the purpose of a calculation under section 10.2 of the *Family Law Act*, subsection (1) does not apply to benefits provided under retirement plans that are not registered pension plans under a federal or provincial statute.

Conclusion

Once again, the OBA appreciates the opportunity to assist with the drafting of this important regulation. We are delighted to be able to make available the combination of family and pension law expertise that is necessary to strike the appropriate balance with this Regulation. We look forward to continuing to work with the Ministries of Finance and the Attorney General to ensure the success of this important reform.

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