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Pensions and Divorce in Canada

A pension can be the most valuable asset to be divided in a divorce. Here are a few key points you should know about pension division in Canada.

By Jack Patterson

In Ontario and certain other provinces, when a couple is divorcing, each person must figure out his or her net worth. This is done by adding up the value of assets (what you own, such as the family home), and the value of liabilities (what you owe, such as the mortgage on the home). Then the total applicable liabilities are subtracted from the total applicable assets to get the net worth. The person with the largest net worth pays half the difference to the other person so that they both have the same net worth. This is known as equalization of family assets.

The advantage of equalization of family assets is that pension-plan aspects are cleared up at the date of separation. Any other treatment of pension ties the couple together financially for years in the future. Ontario and Saskatchewan tend to favor equalization of assets. Other western provinces treat equalization as one of a number of alternatives. In any province, a couple may agree on a lump sum equalization payment, but in provinces such as Newfoundland, this would happen less frequently.

The value of the part of the pension plan accrued during the marriage is frequently the largest single asset. However, there are many ways to calculate this value. The value of the same pension can range from $50,000 to $200,000 depending on the method chosen.

It is essential to retain a good lawyer who knows the wording of the law dealing with pensions, who has tried similar cases in court, and who can argue the best method on your behalf.

It's also important to retain a good actuary who has years of experience doing such valuations and who has successfully explained actuarial valuations to the court on many occasions over a long period of time.

You will see by the following key points that this is a complicated matter. You'll need the services of an experienced and knowledgeable actuary, and this involves paying actuarial fees. The pension plan member usually pays these fees, but the non-member spouse may want his or her own actuarial valuation done.

Here are a few of the key points you should know about pension-plan division.

Pre-Retirement Inflation

The most common type of plan is the final average-salary plan where the pension is based on the average of the best five years' or six years' salary.

Another common type of plan is one negotiated by a union with the employer. Pension benefits are flat benefits; that is, the amounts are not tied to salary amount and are calculated in a form such as $35 per month for each year of credited service.

Pension plans reward long-time employees who stay with the employer to retirement, and so take into account the fact that your dollar will buy less in the future because of inflation. Union members who have flat-dollar pensions now providing $35 monthly per year of service can depend on their union to make sure that this value is adjusted every few years to reflect inflation.

However, once an employee quits, the employer is no longer concerned with that person. Except for public-service pension plans, the employer will give the employee who quits only the minimum pension, starting at age 65, that is required by the Provincial Pension Commission.

In fact, the employee who quits is encouraged to transfer the value of this minimum pension to a self-directed RRSP so that it is no longer the employer's responsibility.

This transfer value can be much less (often 50% less) than the amount that the pension plan is required by law to hold for continually active employees.

In a divorce case, many pension plans will suggest this low transfer value as the value of the pension. The spouse of the plan member should never accept this value for purpose of equalization of assets.

Public-sector employees, including teachers, share in a pension that fully reflects inflation both before and after the date the pension starts whether or not they terminate employment early.

This is important because inflation has been substantial over the years. Over the last 30 years, it has averaged 5 1/2% per year. If inflation continues to average 5 1/2% over the next 30 years, a 30-year old plan member will see the pension increase by a factor of 5.0 by age 60. If you need $100 weekly for groceries today, you may need $500 weekly for groceries 30 years from now.

Now, no one can forecast inflation. It could be higher or lower than 5 l/2% per year, but it still has a substantial effect.

When it comes to the members of final average private-sector plans, those who terminate employment early receive no indexing for future inflation, while those who stay employed until retirement will receive full indexing to allow for inflation. Should the value for equalization reflect no pre-retirement indexing, full pre-retirement indexing, or a combination?

In some provinces, the law states that full pre-retirement indexing be used. However, early case law in Ontario chose no pre-retirement indexing.

Ontario case law has only recently chosen to reflect full pre-retirement indexing. If the non-indexed method is used at the time of the divorce, and the plan member continues to work and gets a full pension based on average salary at retirement, the equalization payment the spouse received earlier would not have taken into account that a dollar could buy less at the date of retirement than at the date of separation. However, the spouse who is married to a member of a public-service plan that does provide full indexing to the date of retirement would have received an equalization payment reflecting inflation. So the private-sector spouse would not have been dealt with fairly.

The spouse of the plan member should insist that the actuary show the results of both calculations, no pre-retirement indexing and full pre-retirement indexing. The first result should be used if it is likely that the plan member could be laid off soon after the date of separation. The second is appropriate if it is likely that the plan member will stay employed until retirement. The final settlement discussions or arguments should try to reach a compromise between these extremes.

Commencement of Annuity

All pensions specify a normal retirement date. This is usually age 65, but in certain occupations -- such as police, fire fighters, and aircrew -- it is usually age 60. In the Canadian Forces, the retirement age varies by rank. A plan member can retire early, but often the normal retirement-age pension is reduced because the pension will be paid for a longer period. Nevertheless, more and more pensions are giving a full unreduced early retirement pension once the plan member meets certain requirements such as total age plus service equalling 90 years. In fact, hourly employees in the automotive industry with 30 years' service can retire on an increased pension for the first few years.

For pension valuation for equalization purposes, we are only considering the part of the total pension for service from the date of marriage to the date of valuation. It does not reflect any service earned after the date of valuation.

The value of the pension, assuming it starts at the earliest unreduced early retirement age, which may be age 50 or 55, can be twice the value of the pension had the member waited until the normal retirement age or later. Under family law, the annual amount of the pension is the same in both cases, but the earlier pension is payable for a much longer period.

In fact, many pension plans increase the pension paid from the early retirement age to age 65, by an extra "bridging" pension until the OAS and CPP start at age 65.

All actuaries who are Fellows or Associates of the Canadian Institute of Actuaries will quote pension values for a range of ages from the earliest unreduced early retirement age to the normal retirement age. It is then left to the divorcing couple and their lawyers to negotiate a compromise value depending on a retirement age, which may have been already chosen, and other facts of the case.

Value of Pension at Marriage

If the marriage occurred before the date the member joined the pension plan, the date of marriage is not used when calculating pension values.

However, if the marriage occurred after joining the pension plan, the value of the part earned before the marriage must be subtracted from the total earned to the valuation date. There are two methods of valuing such pension accrued to the date of marriage.

The added value method looks at historical records of the terms of the pension plan and the amount of the accrued annual pension as of the date of marriage. The present value is then calculated as of the date of marriage.

The pro-rata method simply calculates a proportion of the value of the plan at the date of separation, the proportion being the ratio of the period from plan entry to marriage divided by the period from plan entry to separation.

In both cases, the result is subtracted from the value of the pension at the date of separation.

The added value method is specified in the Ontario Family Law Act but creates several problems for actuaries. The marriage date could be 30 or 40 years prior to the separation date. A dozen eggs that cost $2.00 at the date of valuation might have only cost $0.40 at the date of marriage. Because of differences in inflation, there is no logic to subtracting amounts in the dollars of 30 years ago from today's dollars. Once the actuary has determined the value in the dollars at the date of marriage, he or she would prefer to adjust this by a factor of 5 to represent 30 years' inflation before subtracting it from the value of the pension at the valuation date. However, another serious problem is that it is difficult to find records of the terms of the pension plan and the amount of accrued annual pension at the date of marriage. There is hardly ever enough data on which to calculate using the added value method.

The pro-rata method favors the plan member as it takes off a larger value for the pension earned before the marriage.

It is our practice only to present results based on the pro-rata method, dictated by the Supreme Court of Canada in "Best v. Best."

Other Types of Pension Plans

The two most common types of pension plans are the final average-salary plan and the flat benefit plan usually negotiated between employers and unions.

Another common type of plan is the career-salary plan. In theory, this plan provides a lower pension because it is not based on the final average salary at the time of retirement but on the career salary earned over the working lifetime. However, many of these plans turn out to be equal to or better than final average salary plans because from time to time they are updated to reflect the average salary of the last few years instead of the career salary earned to the date of the update. In the case of the Toronto Transit Commission Plan, updates are usually based on the last four-year average-salary and are higher than most final average earnings plans, which usually reflect earnings for periods of five years or longer.

In the case of a plan such as the TTC's where there is a history of frequent updates to a current earnings basis, we present results that expect frequent updates in the future.

There are pension plans that do not give amounts of any benefits to be provided by the plan but only define the annual rate of employer contributions. These are called defined-contribution plans. The fund, including any employee contributions, is invested and interest accrues to the member regularly. At retirement, the funds are usually transferred to a life-insurance company to buy an annuity for the member's lifetime. The plan administrator can supply the figure for the accumulated contributions plus interest at the date of valuation and as of the date of marriage (if applicable). Where the law permits, serious consideration should be given to requesting the transfer of the spouse's share in the member's accumulated funds to a locked-in RRSP for the spouse. This solves the tax problem in a situation where it is impossible to forecast the appropriate tax rate after retirement.

Now and then you will find a defined-contribution plan where the employer matches the employee's contributions but where a minimum defined benefit is applicable. The Sears pension plan is an example. Have the actuary check whether or not the present value of the minimum pension is more than the amount in the accumulated fund.

Where one or both parties have RRSPs, the value of the RRSPs are determined as of the date of valuation and one-half the difference earned during the marriage is transferred to the spouse with the lower value.

In the case of Canada Pension Plan benefits, you simply advise the Canada Pension Plan authorities of the date of the marriage breakdown, and they will automatically transfer part of the Canada Pension Plan from the one spouse to the other.

There are a few special extra pension plans involved with star athletes or star performers or highly placed executives. It is important to determine if these apply and advise the actuary.

You also need to consider severance benefits. Many employers provide severance benefits to the employee, on top of pension benefits, either in a lump sum or in instalments for a limited period.

The value should be determined as of the valuation date and, after a tax adjustment, should be included in the employee's net family property.

These benefits can be deferred profit-sharing, unused accumulated sick leave credits, accumulated vacation leave, and many other forms.

The plan administrator should be consulted on this point.