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The Association of Canadian Pension Management
L'Association canadienne des administrateurs de régimes de retraite

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ACPM Response to Alberta Treasury Board and Finance Consultation Paper on Proposals for Changes to Pension Division Rules on Marriage Breakdown

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FOREWORD

The Association of Canadian Pension Management (ACPM)

The Association of Canadian Pension Management is the informed voice of Canadian retirement income plan sponsors, administrators and their allied service providers. We are a non-profit organization and our objective is to advocate for an effective and sustainable Canadian retirement income system. Our membership represents over 400 retirement income plans consisting of more than 3 million plan members, with assets under management in excess of $330 billion.

The ACPM promotes its vision for the development of a world-leading retirement income system in Canada by championing the following Guiding Principles:

- Clarity in legislation, regulations and retirement income arrangements;
- Balanced consideration of other stakeholders' interests; and
- Excellence in governance and administration

Introduction

We thank you for this opportunity to provide comment on the proposals regarding changes to pension division rules on account of marriage breakdown described in the Proposal Paper prepared by Alberta Treasury Board and Finance dated March 6, 2013 (the "Proposal Paper"). As you can no doubt appreciate, these are issues which our membership confronts on a regular basis in the course of administering pension plans and in providing assistance to pension plan administrators, whether it be in the form of actuarial calculations, recordkeeping services or legal advice. In this regard, we encourage the formation of rules which are unambiguous and transparent, and which do not impose additional or unnecessary administrative burdens on plan administrators. That the current rules are not well understood by plan members and their financial and legal advisors is attested to by the fact that a number of administrators report that the majority of marital property orders and agreements cannot be processed as originally filed, for lack of completeness and/or inconsistency with legal requirements.[1]

As a consequence, processing pension divisions resulting from marriage breakdowns is time-consuming, administratively complex and imposes costs which are generally borne disproportionately either by the employer or the other plan members rather than the parties on whose behalf the division is made (i.e., the member and non-member spouse) or the advisors whose inability to craft appropriate orders and agreements results in the expenditure of additional resources of time and money. In that regard, clear, concise rules which bring an element of finality to the division of pension benefits, enable administrators to deploy limited resources more fruitfully and ensure that costs are by and large borne by the benefitting parties rather than subsidized by plan members generally are to be encouraged. At the same time, we also recognize that there are significant public policy considerations involved which require a careful balancing of the interests of members and non-member spouses in order to facilitate the equitable division of marital assets, including pension assets which may be more valuable than all other assets of the member, apart perhaps from the marital home.

[1] To that end, some have suggested that the development of template form or forms requesting the division of assets on marital breakdown be prepared, to assist members and their advisors in presenting marital property orders and agreements which comply with the requirements of the Regulations and which can be acted upon by administrators without the need to seek additional information or clarification.

Our comments on each of the proposals contained in the consultation paper are set out below.

1. Total Entitlement Calculation – Defined Benefit Provisions

Proposal

The total entitlement calculation should be based on an assumption of termination of membership by the plan member, with no regard to an assumed retirement age or future salary increases.

In this fashion, the calculation of a commuted value for marriage breakdown provisions would be identical to the commuted value calculation had the member actually terminated membership in the pension plan.

ACPM members strongly believe that it is not appropriate to calculate total entitlements assuming retirement at optimal age, due primarily to the fact that very few members in fact retire at the optimum retirement age. As a consequence, calculations conducted on this basis typically result in a transfer of pension wealth from the member spouse to the non-member spouse. While no manner of calculating pension entitlements can result in a precise calculation in every circumstance given the number of variables involved, we feel that a more equitable approach is to calculate total entitlements based on the plan's normal retirement date, which is typically age 65. While this may result in a smaller benefit being available for division between the parties, it is the view of our membership that it is more appropriate to err on the side of paying too little out of the pension plan rather than too much, in order to ensure that the purpose of the plan in providing "guaranteed" (to the extent benefits in a DB plan can be characterized as guaranteed) retirement income is preserved to the greatest extent possible. This is consistent with the underlying purpose behind the establishment and maintenance of an occupational pension plan: to provide the foundation for secure retirement income on the part of the employee/plan member, rather than the accumulation of a pot of assets available for distribution in the event of a breakdown in a marital relationship.

That, of course, would not preclude the parties from assigning a greater value to the pension in the course of dividing their marital property, but would require that any additional value attributed to the pension beyond that assigned to it under the marital breakdown provisions of the *Employment Pension Plans Act* be satisfied with non-pension assets.

In recognition of the impact this mode of calculation would have on the non-member spouse, we do not seriously object to the plan administrator being required to disclose, in general terms, that (where applicable) certain ancillary benefits (such as bridging benefits, early retirement subsidies, etc.,) are not captured in the total entitlement calculation, and that the calculation provided may not as a result match commuted value calculations provided for other purposes. This disclosure would then put the parties (in particular, the non-member spouse) on notice that as there are alternate methods of assessing the value of the pension benefit which may be more appropriate under the circumstances for purposes of settling the division of family assets, the parties may wish to seek independent advice. However, any alternate valuation would not impact the maximum pension division available under the *EPPA*, and any additional value captured by such analysis would need to be satisfied by through the division of other assets.

However, recognizing that there are public policy arguments which can be advanced in favour of the use of optimal retirement age for calculation purposes, ACPM members nevertheless strongly believe that if the Regulation does not as we recommend specify that total entitlement calculations are to be measured as at the normal retirement date, that the marital breakdown rules nevertheless specify

unambiguously the date to be used for determining the total entitlement calculation, in the interests of clarity.

Finally, ACPM members strongly oppose any extension of the "if-and-when" orders to members not within ten years of the plan's pensionable age at the date of marriage breakdown. While we recognize that the proposal paper does not appear to contemplate any such extension, we wish to place such opposition firmly on the record. Such orders already place significant burdens on plan administrators; further increasing their use and adding to the administrative complexity faced by plan administrators is not in the interest of plan members generally.

2. Division of Pension on Marriage Breakdown – Defined Contribution Only

Proposal

In the case of a member who has earned an entitlement only under a DC plan, the Regulation will require an immediate division of the pension on a marriage breakdown.

In other words, "if-and-when" orders will not be available where the pension to be divided is determined solely as a DC plan.

This proposal is strongly supported by ACPM members. However, it has been suggested that some additional clarity be provided regarding the division of benefits in hybrid plans and the treatment of optional ancillary benefits.

3. Date of Determination

Proposal

The Regulation will contain a new definition, called Date of Determination, which means the date of calculation of a member's total entitlement.

- *For the purposes of calculating an estimate of the member's total entitlement, this definition will mean "on the date the request for the calculation is made".*

- *For the purposes of calculating the value of the total entitlement for the purpose of an actual division of the pension, it will mean:*
    - *on the date the MPO/A is filed, or*
    - *in the case of "if-and-when" MPO/A's, it will mean the date the crystallizing event occurs (i.e. retirement, termination, death, or termination of the plan),*

This date of determination will also determine the status of the member's total entitlement with respect to vesting, eligibility for early retirement, or other special benefits (if applicable and as spelled out in the terms of the pension plan), as well as the member's eligibility for immediate pension commencement. Also, the actuarial assumptions in effect for commuted value calculations as of that date would apply.

In calculating the total pre-division benefit, then, the calculation would be:

$$A = B \times (C/D)$$

Where:

A=total pre-division benefit,

B=member's total entitlement under the plan,

C=the period of joint accrual, and

D=the period during which the total entitlement accrued, beginning when the member joined the pension plan and ending at the date of determination.

Given the diversity of practice within the Alberta pension community on this particular issue, it is understandable and desirable that the Regulation would seek to provide clarity on this point. It is perhaps equally understandable that given this diversity in current practice, there are different views within ACPM membership regarding this proposal.

The majority (albeit not unanimous) view of our membership is that the date of determination for a defined benefit entitlement should be the date of marriage breakdown (i.e., the date on which the period of joint accrual ends), as opposed to the date a matrimonial property order or agreement is filed. Members who support this position believe that it is inappropriate to include earnings and service accrued after the date of marriage breakdown, notwithstanding the fact that the ratio between C and D will decrease the further from the date of marriage breakdown the marital property order or agreement is filed. It is not unusual for several years or more to elapse between the date of marital breakdown and the filing of the marital property order or agreement, and in certain cases there may be considerable changes in earnings over that period resulting in significant increases to a member's total pension entitlement. While some increase in value of marital assets (such as the value of a residential property or an investment portfolio) can be attributable primarily to market factors over which neither the member nor the non-member spouse has much, if any, influence, increases of this magnitude in pension entitlement are due primarily (if not exclusively) to the efforts of the member. Requiring that the associated rewards be shared with the non-member spouse, who cannot claim any contribution to this accretion in value, is inequitable.

Moreover, not fixing a Date of Determination until the very end of the process creates an opportunity to "game the system", as different dates can be evaluated with a view to either including or excluding certain events which impact total entitlement, such as eligibility for early retirement or COLA increases (an opportunity which, more often than not, would be used to the disadvantage of the non-member spouse, given the greater familiarity that member spouses typically have with the terms of the plan and the impact of certain events on pension entitlements). Requiring that a single, fixed date be used ensures that all calculations in connection with a particular marriage breakdown will be prepared on a consistent basis, and will prevent the parties from shopping for multiple estimates in order to land on the most favourable Determination Date (although the ability to seek full cost recovery for such additional estimates, as discussed below, will hopefully contribute to the prevention of such abuses. Basing the division on the estimate prepared at the date of marriage breakdown, updated with interest at the rate outlined in the estimate to the date of payout, will also be much easier to explain to the

parties than a recalculated amount based on what may be significantly different assumptions when the final payout is actually made, following the filing of a matrimonial property order or agreement.

Conversely, other members have expressed support for the proposal on the basis that it will promote administrative clarity and simplicity, particularly in circumstances where there is some uncertainty as to the date on which the marital relationship in fact broke down. While using the date of filing of the marital property order or agreement as the Date of Determination may not precisely reflect the value of the pension accrued during the marriage, the proposal provides a form of "rough justice" that is a reasonable trade-off for the administrative clarity and simplicity it provides.

Notwithstanding the divergent views on the proposal as it applies to DB benefits (as well as the DB portion of hybrid plans), ACPM members do support the application of the "water under the bridge" approach to DC accounts on the basis that obtaining a point-in-time calculation of account balances (or even a rough estimate thereof) can be very difficult, particularly in circumstances where a significant period of time has elapsed since the date of the marital breakdown (for instance, the necessary records may no longer be in the hands of the administrator if there has been a change in recordkeeper in the intervening period). The equities involved are also substantially different, in that unlike with a DB plan, variations in value are largely attributable to the investment performance of the assets in the member's account, and in the ordinary course the skill of the member has only a marginal impact on the performance of his or her investments (and which may be positive or negative) relative to the impact of market conditions. This will also prevent market downturns which occur after the date of marriage breakdown but prior to the date of division from catastrophically reducing the value of a member's account. In the wake of the 2008/2009 market downturn, declines in member account balances of between 30% and 40% were not uncommon; had a member's marriage broken down immediately prior to the downturn, he or she would face the possibility of surrendering almost the entire remaining value of the account if the division were to occur before the market recovered, if the amount to be distributed was to be based on the pre-downturn value of the account.

4. Disclosure and Fees on Marriage Breakdown

Proposal

The administrator will only be required to provide one estimate for the value of a member's pension to each of the member and the non-member pension partner, including information on the main components which were used in the determination of that value. Requests for additional estimates may be provided at the administrator's discretion, and upon payment of a charge not exceeding the reasonable costs incurred in making and providing the estimate. This amount will be determined by the plan administrator, and the amount charged for an additional estimate will be in addition to the maximum amounts calculated in (b).

The maximum fee an administrator could charge for marriage breakdown is:

- *DB provisions: $1,000*
- *DC provision: $300*
- *DB and DC provisions: $1300*

These maximum amounts will be adjusted annually in accordance with the Alberta Consumer Price Index, (January 20XX to January 20XX+1), subject to a minimum increase of $0.

ACPM members are largely supportive of the fee proposals. Administrators should not be required to provide more than one estimate, as these are generally expensive to produce and come at the expense of other plan participants (or the plan sponsor). Individuals in the midst of a marriage breakdown are generally required to pay the cost of any other asset valuations that are required in order to settle their affairs equitably, and all other service providers are able to charge all of their costs (along with professional fees) to the party requiring the valuation. We do not see any valid justification for treating pension assets differently. While a $1,000 fee is typically less than the actual cost of preparing an estimate, the fee is nevertheless reasonable and allows for a significant amount of the plan's cost to be recovered.

We do note that providing administrators the discretion to provide additional estimates may give rise to disputes over whether the administrator has appropriately exercised this discretion, should it decline to procure an additional estimate. Instead, it may be preferable to provide that the administrator shall procure additional estimates <u>if</u> the full third party cost of the estimate is paid in advance by the plan member; otherwise, the administrator shall not be obligated to obtain additional estimates on behalf of the member.

The Regulations should expressly permit administrators to deduct all fees (including fees associated with first and subsequent estimates) from amounts distributed from the plan. This would ensure that these costs are recovered, given that the administrator will typically have little recourse should the parties not pay any associated invoices received from the administrator (as the cost of obtaining and enforcing judgement will, in all likelihood, near or exceed the cost of the fees even where the administrator is successful).

In order to protect administrators and members alike, it may be beneficial to specify precisely in the Regulations what will be provided to the members in the initial estimate, so that the parties know exactly and in advance what they will receive prior to ordering the estimate.

One note of caution that has been expressed is that as fees escalate, members may be reluctant to proceed with the division of small benefits, given the size of the fee relative to the value of the pension benefit. While it is unclear whether the implications would be positive or negative for plan administrators, we do recognize that it may make it challenging for members with little in the way of assets (particularly liquid assets) to equally divide marital property. Consequently, rather than index the fees which can be charged on an annual basis, some of our membership would prefer that the fees be set at the proposed levels, without provision for annual indexing increases (which would have the benefit of maintaining round numbers), and be revisited every 4-5 years and adjusted as necessary.

5. Recalculation of Commuted Value – Split at Source

<u>Proposal</u>

Upon divorce of a couple, after the member's pension commencement date, the plan administrator will be required to implement the so-called "two pensions" approach.

Under this method, the monthly payment to the member and his non-member pension partner after the divorce will be recalculated as separate, life-only pensions with no guarantee periods for each person. The life-only pension will use demographic and other actuarial assumptions appropriate for each individual.

The Regulation will further require that the recalculation of the pension for each member will be subject to the provisions of section 3300 of the Actuarial Standards of Practice for Pension Plans as they apply to the assumptions applicable to benefits entitlement that are assumed to be settled by purchase of annuities, rather than the commuted value provisions of section 3500.

While ACPM members largely support the proposal and accept the equitable arguments which underline it, some concerns have been expressed about the administrative burdens that would result from requiring the interruption of an ongoing stream of pension payments and the implementation of a "two pensions" approach in every circumstance (for instance, there may be a significant delay in recommencing monthly payments where the administrator lacks sufficient demographic data regarding the non-member spouse in order to calculate the value of his or her life-only pension). Instead, it has been suggested that administrators be permitted to choose between the "two pensions" approach or an immediate lump sum payment, with the further flexibility (but not the obligation) to offer both options to the non-member spouse.

It has also been observed that the "two pensions" approach can result in *Income Tax Act* (Canada) compliance issues, where as a result of a significant age difference between the spouses there is an increase in the total value of the pension. It is not clear that the reference to the Actuarial Standards of Practice for Pension Plans will resolve this difficulty in every instance.

If the "two pensions" approach is adopted, the administrator should nevertheless retain the right to force the commutation of any small benefit which results. Additionally, the Regulation could enable an administrator to permit, in lieu of the calculation of two separate life-only pensions, a splitting of the pension into two streams, with the continuation of survivor benefits such that if the member predeceases the non-member spouse, the non-member spouse would receive a benefit increase in accordance with the form of benefit initially elected at retirement (e.g, if the parties had elected a 60% joint and survivor pension the surviving non-member spouse would receive a monthly pension equal to 60% of the original monthly benefit), while if the non-member spouse dies first the member's monthly pension benefit would be restored to its original value.

6. Adjustment of member-pension partner`s share

Proposal

- *Delete paragraph (a) [of section 60 of the current regulation]*

- *To the extent questions remain in the industry on how to perform the recalculation, the Superintendent's office will work with the actuarial community to provide more detail, in the policy bulletin, on the application of (b) [of section 60 of the current regulation]*

ACPM members recognize that, as a matter of practice, it is not possible to adjust the member's share precisely to avoid any gain or loss to the plan, and as such agree that paragraph 60(a) of the Regulation is awkwardly worded and difficult to interpret. However, the proposed solution strikes our membership as more likely to create additional ambiguity rather than resolve it, by leaving unexpressed the principles on which an adjustment calculation should rely. In order to remedy any confusion regarding the interpretation of the current regulation, ACPM would support the insertion of additional wording referencing specific principles of actuarial equivalence. The principle that the plan should not benefit or be harmed as a result of a division is an important principle that we believe ought to be explicitly referenced in the Regulation, rather than in a legally non-binding policy bulletin.

7. Past Service Purchases

Proposal

Where a member makes a past service purchase under a benefit formula provision of a pension plan, the purchase (in relation to the McCallister Formula):

1. *Will increase the value of the "B" variable;*
2. *Will increase the value of the "D" variable, and*
3. *The impact on the "C" variable will depend on the particular situation of the member.*
    a. *If the member was married during the time that the past service purchase is intended to cover, the "C" variable will increase, or*
    b. *If the member was not married, the "C" variable will not change.*

ACPM members strongly support this proposal, in recognition of the additional clarity it brings to the resulting entitlement calculations.

8. Target Benefits

Proposal

For the purposes of division of benefits on marriage breakdown under a target benefit provision, the calculation of the member's total entitlement (and thus, by extension, the non-member pension partner's share) would be subject to all the conditions applicable to the calculation of a member's benefits under a target benefit provision that would apply had that member simply terminated membership. In other words:

- *The commuted value of the pension earned by the member would be calculated using the going concern actuarial assumptions used in the valuation report, and*
- *The amount that may be transferred to the non-member pension partner would limited not only by the output of the McCallister Formula, but also by the ongoing concern transfer ratio. If the transfer ratio is less than 1.0, the amount payable to the non-member pension partner would be reduced accordingly, with no requirement for an additional top-up payment at a future date.*

ACPM members support this proposal, on the basis that there should be consistency between the calculation of the non-member's share and the member`s termination entitlement under a target benefit plan.