Division of Defined Benefit Pensions Upon Relationship Breakdown (and the effect of disability)

Collaborative Divorce Vancouver Webinar

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Agenda

1. Introduction
2. Methods for Division of Pension Assets
3. Key Differences in Pension Division Methods
4. Key Considerations When Choosing a Pension Division Method
5. Sample Actuarial Valuation Results – Pensioner
6. Sample Actuarial Valuation Results – Active Member
7. Significant Trends in Pension Valuation
8. Impact of Disability on Pension Valuation
9. Bill 17 - Family Law Amendment Act, 2023 Changes
10. Actuarial Advice & Services
11. Questions and Answers (Q & A)

Methods for Division of Pension Assets

1. Division inside the pension plan

- Also known as ***"Plan-Administered Credit Split"*** or ***"Part 6 Division"***
- Former Spouse becomes Limited Member of the pension plan and is entitled to pension benefits from the pension plan based on their proportionate share of the Member's pension

2. Division outside the pension plan

- Also known as ***"Compensation Payment"*** or ***"Capitalized Value"***
- Transfer of assets outside the pension plan from the Member to the Former Spouse
- Compensates Former Spouse for their entitlement from the Member's pension plan
- Member retains full value of their pension

Plan-Administered Credit Split

- Based on spouse's proportionate share:

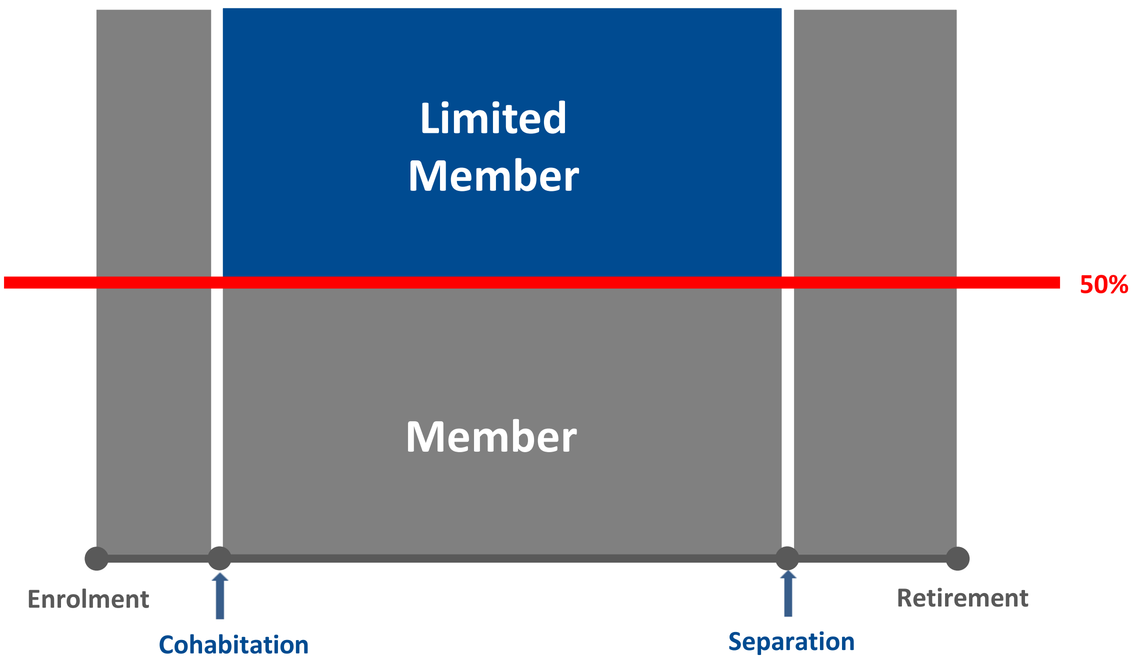
$$\mathbf{50\%} \times \frac{\mathbf{A}}{\mathbf{B}}$$

where:
A = years of pensionable service accrued during marriage
B = total years of pensionable service

- Separate lifetime pension or lump sum payout available to Limited Member when Member has reached earliest retirement age (age 55 for most occupations, age 50 for police, firefighters, correctional facilities, paramedics)

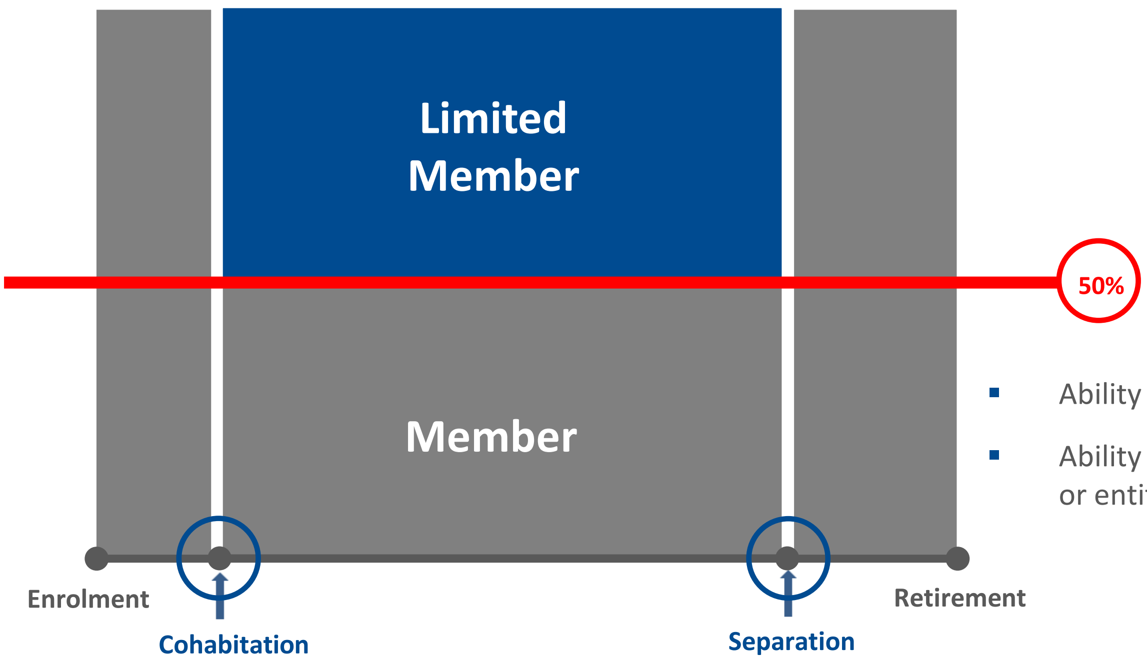
Plan-Administered Credit Split

- Standard proportionate share



Plan-Administered Credit Split

- B.C. Public Sector Plans
- Instructions through separation agreements or orders allow for additional flexibility



- Ability to adjust percentage
- Ability to adjust commencement or entitlement dates

Plan-Administered Credit Split

1. Lump sum payment to Limited Member's Locked-in Retirement Account (LIRA)
   - Proportionate share of the commuted value of the Member's pension at time of lump sum payment
   - Lump sum payment can be initiated after the Member's termination or when the Member reaches their earliest retirement age (generally age 55 for B.C. Public Sector Plans except public safety occupations) **[no longer available after Bill 17 changes under plans that do not allow commuted value transfer after member eligible for early retirement]**

Or

2. Separate lifetime pension for Limited Member
   - Simple conversion of the proportionate share of the commuted value for the Member's pension to a separate lifetime pension for the Limited Member on the same commuted value (either standard or adjusted) basis
   - Value of Limited Member's monthly pension depends on:
     - Dollar amount of the proportionate share of the commuted value of the Member's pension
     - Date Limited Member decides the monthly pension payments will start

Compensation Payment

- Lump sum transfer of assets outside the pension plan from the Member to the Former Spouse
- Based on Former Spouse's proportionate share:

$$\mathbf{50\%} \times \frac{\mathbf{A}}{\mathbf{B}}$$

where:
A = years of pensionable service accrued during marriage
B = total years of pensionable service

- Actuary will use the Canadian Institute of Actuaries Standards of Practice for Capitalized Value of Pension Plan Benefits for a Relationship Breakdown [Section 4500]
- Results presented on both pre-tax and post-tax basis

Capitalized/Commuted Value

- Canadian Institute of Actuaries have different standards and assumptions for calculating Capitalized Value of Pension Plan Benefits for a Relationship Breakdown [Section 4500] and Pension Commuted Value [Section 3500]
- Lump sum value in today's dollars that will provide enough money such that future pension payments can be drawn from the lump sum until the pension payments end
- Incorporates the following:
  - Exhausting fund principle (should be $0 when pension payments end)
  - Future investment earnings from lump sum
  - Future inflation increases to annual salary and monthly pension (if applicable)
  - Probability that person will survive to each month to receive pension payments

Plan-Administered Credit Split vs. Compensation Payment

	Plan-Administered Credit Split	Compensation Payment
Timing	Not available until Member has reached earliest retirement age	Any time settlement is reached between parties
Locking-In	Pension assets are locked-in as required by pension legislation	Not locked-in (using family assets, not pension assets)
Uncertainty	Higher (deferred settlement – change in interest rates may affect value)	Lower (current settlement)
Requirement	Default option if compensation payment settlement not reached	Agreement between parties

Plan-Administered Credit Split vs. Compensation Payment

Key Considerations

- Sufficient family assets for compensation payment purposes?
- Non-member spouse financially literate or comfortable with making investment decisions?
- Desire for immediate settlement between parties vs. deferred settlement through the plan(s)
  - Plan-Administered Credit Split – deferred settlement through the plan with both parties equally sharing the various risks (e.g. interest rate, salary increase, inflation, mortality, etc.) and rewards up to the time of actual division; or
  - Compensation Payment – immediate settlement using best estimates of future averages (e.g. interest rate, salary increase, inflation, mortality, etc.)
- Ages of spouses
  - Member many years away from early retirement eligibility?
  - Significant age difference between spouses? (plan administered credit split less feasible if large age difference between spouses)
- Actively employed versus already retired

Compensation Payment – Matured Pension Example

Matured Pension in B.C. – Joint & Survivor 75% Form; Fully CPI-Indexed

- Valuation Date = April 30, 2024
- Pensioner (husband): Age 70
- Spouse (wife): Age 65
  - Current annual pension: $36,000
  - Total credited service at commencement of pension: 30.0 years
  - Credited service accrued during cohabitation period: 18.0 years
  - Proportion accrued during cohabitation: = 18.0 / 30.0 = 60.0%
  - Spouse's proportionate share = 30.0%

Compensation Payment – Matured Pension Example

Matured Pension in B.C. – Joint & Survivor 75% Form; Fully CPI-Indexed

Pensioner (husband): Age 70; Spouse (wife): Age 65

Results as at April 30, 2024	Capitalized Value
Total (Joint Survivor 75% Form)	$689,700
Less Value of Survivor Pension	- $150,500
Total (Life Only Form on Pensioner)	**$539,200**
Total Accrued During Cohabitation (60.0%)	$323,500
Spouse's 50% Share (Pre-Tax)	$161,800
Average Tax Rate	20%
Spouse's 50% Share (Post-Tax)	$129,400

Plan-Administered Credit Split in BC - Administrative Costs

Maximum amount prescribed in Section 28 of the *B.C. Division of Pensions Regulation [Effective January 1, 2025]*:

- **$1,000 [previously $750]** for registering the spouse as a Limited Member (when filing prescribed Form P2 – Request for Designation as Limited Member)
- **$200 [previously $175]** for transferring a proportionate share of the member's defined contribution account to the credit of the spouse

Significant Trends

- Significant trends in recent years are mostly related to interest rates (discount rates) increasing over the last three to four years:

Discount Rates	Initial Period (20 Years) (% per annum)	Thereafter (% per annum)
Bottom (Jun/Aug 2020)	1.40%	5.50%*
Peak (Oct/Nov 2023)	4.50%	4.75%*
Current (Jan 2025)	3.90%	4.75%*

* Standards changed from 5.50% to 4.75% effective January 1, 2023.

- Discount rates and capitalized values are inversely related:
  - Higher discount rates result in lower capitalized values
  - lower discount rates result in higher capitalized values

Actuarial Valuation for Relationship Breakdown Purposes in BC
Salary Increase Assumptions

- The actuarial Standards of Practice requires the inclusion of future salary increases for earnings-related pension benefit in relationship breakdown actuarial valuation
- Subsection 27(3)(d) of the *B.C. Division of Pensions Regulation* requires the inclusion of future salary increases in the calculation of a “compensation payment”
- Due to the above requirements as well as the definition of the “proportionate share for spouse” as of a future date when the credit split is administered, relationship breakdown actuarial valuations in BC are based on projected salaries at assumed retirement date

Actuarial Valuation for Relationship Breakdown Purposes in BC
Sample Proportionate Share for Spouse for an Active Member

Scenario	Immediate Termination (Age 50) Pension Commencement at Age 60	Continuing Employment to Earliest Unreduced Age (Age 60)	Continuing Employment to Normal Retirement Age (Age 65)
Future Pensionable Service (Years)	0.00	10.00	15.00
Pensionable Service (Years) Accrued During Relationship Period (A)	7.00	7.00	7.00
Total Pensionable Service (Years) (B)	10.00	20.00	25.00
Spouse's Proportionate Share = 50% x (A) / (B)	35.0%	17.5%	14.0%

Actuarial Valuation for Relationship Breakdown Purposes in BC
Sample Valuation Results for an Active Member

Scenario	Immediate Termination (Age 50) Pension Commencement at Age 60	Continuing Employment to Earliest Unreduced Age (Age 60)	Continuing Employment to Normal Retirement Age (Age 65)
Pre-Tax Total Value Accrued During Cohabitation = (A)	**$150,000**	**$230,000**	**$180,000**
50% Pre-Tax Share for Spouse (B) = (A) x 50%	**$75,000**	**$115,000**	**$90,000**
Estimated Post-Retirement Average Tax Rate for Member = (C)	**16.0%**	**16.0%**	**18.0%**
50% Post-Tax Share for Spouse = (D) = (B) x [1 – (C)]	**$63,000**	**$96,600**	**$73,800**
	Generally the Lowest	**Generally the Highest**	**Generally the Middle**

Actuarial Valuation for Relationship Breakdown Purposes in BC
Valuation Process for an Active Member

1. Unlike pensioners, the actuarial valuation results for an active member do not produce only one set of numbers. The results produce a range of results under different scenarios, such as:
   a) Immediate termination of employment/membership as of valuation date;
   b) Continuing employment and retirement as at the earliest "unreduced" retirement date;
   c) Continuing employment and retirement when the maximum permissible credited service under the plan is reached; and
   d) Continuing employment and retirement as at the normal retirement date.
2. Generally, 1 b) above would produce the highest value and 1 a) or 1 d) above produce the lowest value.
3. Apply the spouse's proportionate share under the assumed termination scenario or the projected spouse's proportionate share at retirement under the assumed continuing employment scenarios to the total capitalized value of pension to determine the value of the spouse's proportionate share on a pre-tax basis for compensation payment purposes.
4. Estimate the average tax rate the member is expected to pay on the pension benefits by assuming post-retirement income equal to the sum of employment pension, CPP and OAS. Client may request additional tax rate scenarios assuming other income sources, e.g., significant investment income from non-registered funds, etc.
5. Determine the after-tax equivalent compensation of the pre-tax amount under the different scenarios.

Impact of Discount Rates on Capitalized Value - Example

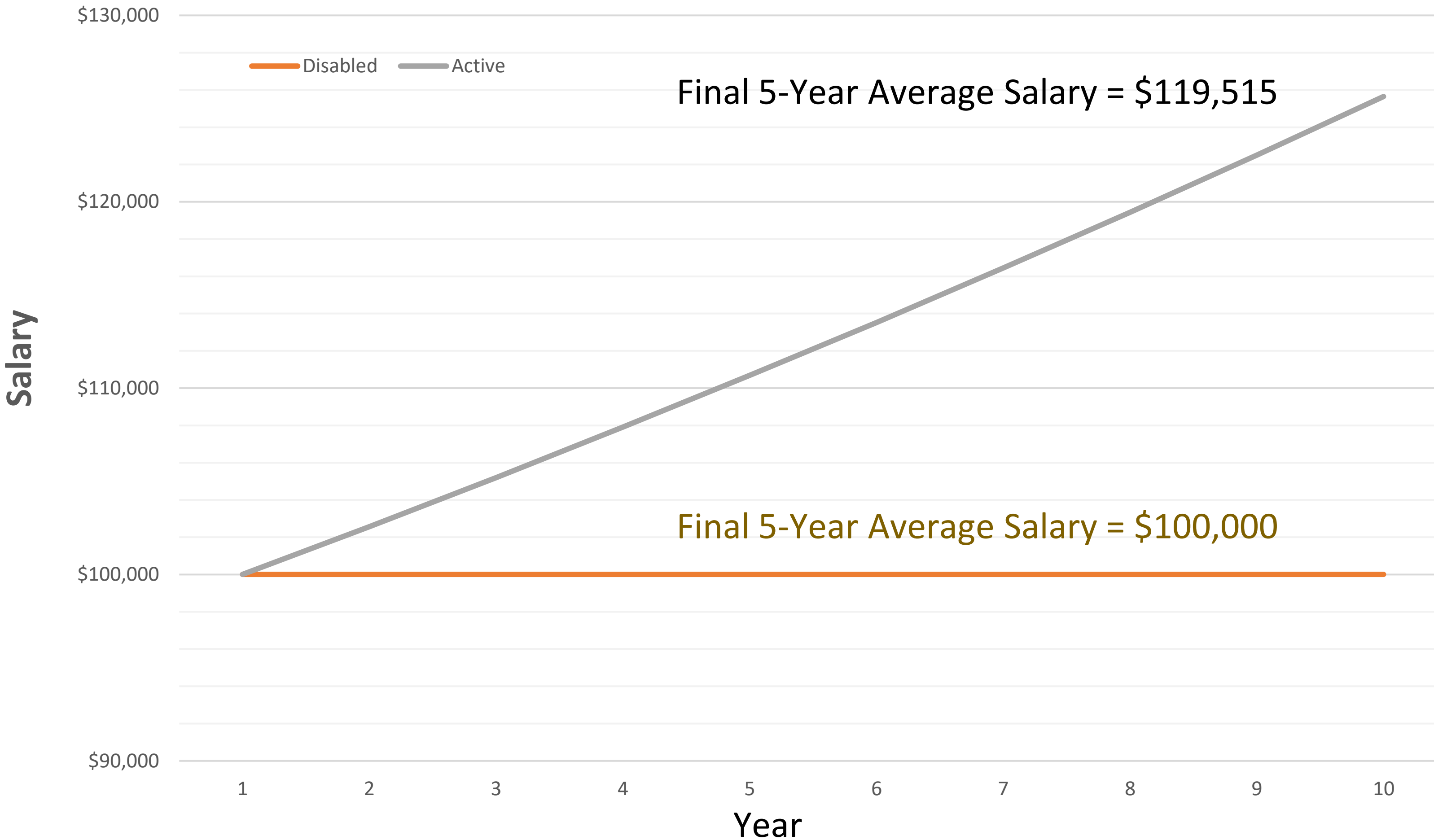
- Male, age 65, non-indexed annual lifetime pension of $50,000 payable for life only.
- Capitalized value:
  - **$932,300** June 2020 calculation (bottom of interest rate cycle)
  - **$689,300** October 2023 calculation (peak of interest rate cycle)
  - June 2020 pension value ~35% higher than October 2023 pension value

Note: Impact of discount rate changes on separate lifetime pension for spouse (limited member) on a Part 6 division is much less significant.

Impact of Disability on Value of Defined Benefit Pension

1. Generally, when a member is on Long-Term Disability (LTD) benefit:
    a) Member's required contributions are waived;
    b) Member continues to accrue pensionable service and contributory service; and
    c) Pensionable salaries are assumed to continue at pre-disability level.
2. If a member is assumed to remain on LTD benefits until retirement, the pension value is typically lower than the continuing employment scenario because:
    a) While on LTD benefits, pensionable salaries are assumed to continue at pre-disability level, i.e., no salary increases; and
    b) Under the continuing employment scenarios, the member is assumed to receive future salary increases in line with general wage inflation (0.75% higher than price inflation in the current actuarial standards).

Future Salary Growth - Active vs. Disabled
January 2025 Assumptions (Wage Increase of 2.57% per year)



Bill 17 - Family Law Amendment Act, 2023 Changes

Effective May 11, 2023 (Royal Assent)	Effective January 1, 2025
1) Designation of Limited Member After Spouse Passes Away	1) Commuted Value Option for Limited Members
2) Date for the Commuted Value Calculation When Member Dies	2) Spousal Waivers on Member’s Death After Pension Commencement
3) Disability Benefit Allocation	3) Changes to Administration Fees for Pension Division
	4) Division of Annuities, Locked-in Retirement Accounts (LIRA) and Life Income Funds (LIF)

Bill 17 – Changes Effective May 11, 2023

1) Designation of Limited Member After Spouse Passes Away
   - Allows for the personal representative of a deceased spouse's estate to file prescribed form P2 to designate spouse as a limited member provided the member's pension has not yet commenced at the time of spouse's death
2) Date for the Commuted Value Calculation When Member Dies
   - Aligns the calculation date referenced in the FLA with the date in the Divisions of Pension Regulation
3) Disability Benefit Allocation
   - Clarifies that a member's entitlement to disability benefits does not affect the manner or time in which other benefits are divided

Bill 17 – Changes Effective January 1, 2025 (Slide #1)

1) Commuted Value Option for Limited Members
   - A limited member will only be permitted the option to transfer their proportionate share of the commuted value of a defined benefit (DB) provision out of the plan if the plan text gives that right of transfer to the member.
   - Most pans with a DB provision (e.g., the B.C. Public Sector Plans) do not permit members to elect a commuted value transfer after becoming eligible for early retirement. In such cases, limited members will no longer be offered a commuted value transfer after the member reaches early retirement unless plan is amended to permit plan members the commuted value option after early retirement eligibility.
2) Spousal Waivers on Member's Death After Pension Commencement
   - Before changes, where a member dies after pension commencement and the member's spouse is entitled to receive, or is receiving survivor benefits, the spouse can elect to waive the survivor entitlement under the FLA by giving notice using Form P5 (Waiver of Survivor Benefits After Pension Commencement).
   - However, there is no obligation on the plan administrator to pay the benefits directly to another person. Many plan administrators do not pay survivor benefit to another person because of complications in verifying the recipient and due to concerns as whether the completion of the waiver was done on an informed basis.
   - After changes, the FLA will require the spouse to give the administrator notice of an agreement or order to pay another person all or part of the survivor benefits received by the spouse. A new Form P10 (Notice of Assignment of Survivor Benefits by Agreement or Order) is required. Form P5 has been repealed and should no longer be used.

Bill 17 – Changes Effective January 1, 2025 (Slide #2)

3) Changes to Administration Fees for Pension Division
   - Increased from $750 to $1,000 for registering a spouse as a limited member.
   - Increased from $175 to $200 for transfer from defined contribution accounts.
   - Plan administrator required to deduct the fee from the payment of benefits unless one or both of the member and the spouse pay the fee under a separate transaction.

4) Division of Annuities, Locked-in Retirement Accounts (LIRA) and Life Income Funds (LIF)
   - Annuities privately purchased by a member are subject to the applicable pension division provisions under the FLA only if the annuity is in pay.
   - Funds held in a LIRA or LIF will also be subject to the applicable pension division provisions under the FLA.
   - Generally, these changes will have no direct consequence to pension plan administrators.

Actuarial Advice & Services

- Actuarial valuation of capitalized value of pension plan benefits for relationship breakdown purposes:
  - Full written report for evidence purposes [BC Public Sector Plans - $2,000 for active, $1,500 for retired/terminated vested]
  - Consulting advice summary (1-page summary with ½ hour virtual meeting for actuary to present results and answer questions) – can be expanded to full written report later [BC Public Sector Plans - $1,100 for active, $900 for retired/terminated vested]
- Plan administered credit split estimates [BC Public Sector Plans – full written report or consulting advice summary same fee as actuarial valuation]
  - Spouse's lump sum commuted value at member's earliest retirement eligibility date (recommended only if member is within a few months of the earliest retirement eligibility date)
  - Spouse's separate lifetime pension as at a specific age / date
  - Member's pension as at a specific retirement date
- Actuarial assessment of the fair market value of life insurance, critical illness, or disability policy [Generally $2,000 to $2,500 per policy].
- Determine equivalent pre-tax income to non-taxable benefits for purposes of assessing spousal support [Fee for Service]
- Expert opinion on lifetime income provided by capital sum, generally non-registered funds [Fee for Service]

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Questions & Answers

Questions?

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