

## **Thousands of People are Not Getting Their Fair Share of the Assets on Marriage Breakdown**

By G. Edmond Burrows, F.C.A.

There is an average of 80,000 divorces a year in Canada. In addition to this, many marriages and common-law relationships breakdown every year and do not go through the formal process of a divorce. On the breakdown of the marriage, each party is required to disclose their assets and the value of each asset. The values of each party's assets acquired during the marriage are then totaled and the party with the higher total value must transfer assets to the other party until the two have equal total values. This equalization of assets will often involve the necessity to place a value on a future pension to be received and on other employment-related assets. While the law provides for this equalization of assets it does not explain how they are to be valued. Because of this, many people make an effort to under-value or hide their assets in order to share less with their ex-spouse. Therefore, thousands of people do not get their fair share of the assets when they are equalized. The under-valuation of assets is especially prevalent with regards to valuing a future pension or other employment related asset. This is true for many reasons.

### **Reasons Why**

Pension valuers, lawyers and judges have been struggling to understand how pensions should be valued for marriage breakdown purposes. Pension valuers have been disagreeing with each other and in many cases producing widely divergent values for the same pension asset. Often the pension valuator acting for the member has produced a very low value, while the pension valuator acting for the non-member spouse has produced a high value, even though both valuers are working from the same basic facts. Lawyers will then either argue the extreme or try to negotiate a value somewhere in the middle, often resorting to the courts to settle the matter. The courts, in their attempt to consider all of the facts presented to them, have often arrived at a value that is not fair to either party and the decisions have not been consistent.

If each party to a marriage breakdown is to receive their fair share of the assets, the pension value must be determined properly, as it is often one of the largest assets involved.

### **Attempts at Standardization**

There are many reasons why different values are presented for the same pension, and some attempts have been made to standardize the valuation process. In 1993 after five years of extensive study and debate and after

discovering that different actuaries were producing widely divergent values for the same pension, the Canadian Institute of Actuaries issued standards for their members to follow in valuing these pensions. Unfortunately these standards are ambiguous and poorly written and do not cover all facets of the valuation. These standards also allow a member to vary from them, as long as she/he discloses that she/he has done so. Although there is a general requirement that the values produced are fair to both parties, I have seen many cases where this general requirement has been ignored. These standards are currently being reviewed and amended.

In 1995 the Ontario Law Reform Commission studied this area of pension valuation intensely and identified many problem areas in the valuation process. They did produce some excellent recommendations. However, Mr. Harris has been too busy with Health and Education and other matters to deal with these recommendations so far. The recommendations are clear and should help if they are ever introduced into law.

There have been many short articles published dealing with the valuation of pensions for equalization on marriage breakdown. However, to my knowledge there have been only three books written, one being *Pension Division and Valuation, a Family Lawyers' Guide*, by Jack Patterson of Actuarial Consultants of Canada Limited. Another being *Division of Pension* by Pask and Hass, and the third being a recent publication *Getting The Most Out Of Your Divorce Financially*, which was written by myself.

The Law Society of Upper Canada has presented several seminars dealing with the legal aspects of pension valuations. I myself have given several seminars to lawyers explaining the mathematical methods and how to ensure that their clients are treated fairly.

## **Reasons for Confusion**

One reason pension valuations have been misunderstood is because the process is complicated and difficult to understand. It involves determining how much pension benefit has been earned during the marriage, projecting that benefit to payments in the future after retirement and predicting the future without taking into account post-separation events.

Unfortunately short phrases have been penned to describe some pension valuation methods. In the process these descriptive phrases have been used to mean different things. This has led to considerable confusion, particularly in the courts.

Another source of the confusion as to the proper value of a pension for marriage breakdown purposes is that a pension, like other assets, has a different value for

different purposes. A pension may have three or four possible values for equalization on marriage breakdown, which are difficult enough to calculate and explain. It has another and often much different value for literal termination of employment or for division of the pension.

Many employers issue a letter stating the “commuted value” or “termination value” of the employee’s pension earned during the marriage. The member’s lawyer suggesting that this is the value for equalization presents these letters. This would very rarely be true. Normally this commuted value on termination of employment is much less than the proper value of equalization on marriage breakdown. This is because the two values are calculated quite differently. When the employer is calculating the commuted value he uses every legal means to keep the value to the lowest amount possible in order to reduce the amount that will be transferred out of the employer’s pension fund, when the employee terminates.

Another source of the confusion as to what constitutes the proper value of a pension for equalization is the fact that many valuation reports are based on estimates or are prepared on a biased basis. Even though these facts are disclosed in the report, the values produced are often used in the equalization process without having read the report carefully.

There are even simple computer programs available for calculating the value of a pension for equalization. While the programs may do the calculations properly it is important that the operator feed in the proper information and facts. I have seen some cases where people fed in different information and facts until they got the end answer that they wanted.

## **Considerations in Valuing a Pension**

Besides knowing all of the methods used to value a pension, being familiar with all of the appropriate legislation and being aware of all of the court decisions, before proceeding to do a particular pension valuation, it is necessary to gather all the details of the particular pension plan and the appropriate details of the particular individual.

There are thousands of pension plans, many of, which have there own nuances, which can affect the value. Of course each individual has his or her own particular details to be considered in the valuation. It is important that the proper information and details be used in the valuation process.

## **Estimates**

Many pension valuation reports are prepared based on estimates, which may be arrived at from a recent annual pension statement. Of course, the end values shown in the report can only be as accurate as the estimates used. Using estimates rather than accurate information can affect the value of the pension substantially. I have seen many cases where the value of the pension was overstated or understated because the basic information was not confirmed and improper estimates were used in the valuation. It is important to confirm the information with the pension administrator in order to ensure that the right information is being used.

## **Income Tax Allowance**

When the person retires and the pension payments are received they must be included in income for income tax purposes. Therefore, it has been generally recognized that the value of a pension should be reduced by a reasonable income tax allowance. The amount of this allowance can affect the value substantially. There is considerable disagreement among pension valuers, lawyers and judges, as to what constitutes a “reasonable” allowance.

Sometimes an arbitrary flat rate of 20% or 25% is used for the income tax allowance with little justification for the rate, other than the fact that this rate was used in some reported cases and considered reasonable by the presiding Judge. There have been many other approaches to estimating a reasonable allowance. Some valuers even attempt to allow for proposed income tax changes that are being considered by the Federal Government but may never become law.

In my opinion, the tax allowance should be based on known facts and the Income Tax Act, as it existed at the date of valuation. The rate of tax allowance deducted from the value should be established and proved by extensive detailed calculations.

## **Horror Stories**

I won't explain in this article the long complicated process of valuing a pension for equalization on marriage breakdown. In fact, due to the proliferation of pension plans and the different details of the different individuals, covering all of the possibilities would be far too lengthy. I will give a few short examples of some actual cases that I have seen in practice.

One case I saw involved a member of the INCO Hourly Paid Employees Pension Plan. We were acting for the non-member and wanted to be sure that the values had not been understated. The valuation report presented by the member's

lawyer, showed four possible values ranging from \$15,800 to \$95,000. Unfortunately, the pension valuator ignored a provision of INCO's pension, which guarantees a minimum pension benefit. We were able to issue a proper report showing that the value could be as high as \$142,500.

In another case I was involved in, someone had used a simple computer program to prepare a two-page valuation report and arrived at the conclusion that the value of the pension was only \$29,500. In doing so, they used the wrong benefit rate, the wrong income tax rate, the wrong contributions and interest, and they ignored the early retirement provisions of the pension plan. Again I was acting for the non-member, and I was able to show that the proper value could be as high as \$60,000.

In another case involving the president of a large company, the report presented by his lawyer suggested that the value could be as low as \$49,500. I was able to show that the value could be as high as \$382,000.

These are just a few examples of the many cases I have seen where someone would have lost thousands of dollars if they had not insisted that the pension be valued properly.

## **Canada Pension Plan**

The Federal Government has made it easy for couples to share their Canada Pension Plan credits when their marriage breaks down. A person need only inform the Canada Pension Plan of their divorce and the matter will be taken care of automatically. This is accomplished by transferring Canada Pension Plan credits from one of the parties to the other, so that they both have the same amount of credits accumulated during the marriage.

According to the Canada Pension Plan department, very few people avail themselves of this equalization of Canada Pension Plan credits. This may be because people are not aware of this possibility. In fact, in a divorce there is often no discussion of Canada Pension Plan credits accumulated during the marriage, and they are not considered in the equalization of assets. This asset should be considered to be property but should not be included in the accounting of marriage period assets.

Many people lose thousands of dollars, because they do not have the Canada Pension Plan credits equalized.

There are frequently other assets to be considered in the equalization process. These days many people have an R.R.S.P. This can sometimes have a substantial value. Cases have been fought over whether or not the value of the R.R.S.P. should be reduced by an income tax allowance. There is no doubt that

when the money is taken out of the R.R.S.P. it will be taxable income to someone. I believe that good arguments can be made that a reduction for income tax should be included in the valuation of an R.R.S.P. This can affect the value substantially. It is also important to ensure that if it is a spousal R.R.S.P. it is included in the spouse's assets.

The existence of an R.R.S.P. would also indicate that the pension member would have other income in retirement that should be considered in establishing the income tax allowance in valuing his/her pension.

## **Other Employment-Related Assets**

Besides the pension that a person earns during their marriage, they may also have earned several other employment-related assets, which must be valued and included in the equalization calculation. This could include assets such as the following:

- Accrued sick leave gratuity for a teacher or a municipal employee.
- Severance or termination pay for an Ontario or a Federal Government employee or an employee of a quasi government organization.
- Accrued paid vacation for any employee.
- Stock options, both exercisable and non-exercisable.

A list of possible other employment-related assets goes on and on and one must be extremely careful and knowledgeable in order to ferret out all of the assets and have them included in their ex-spouses list of assets.

## **Division of Pensions**

Many attempts are made to settle the equalization debt, by either dividing the pension at source or dividing the pension payments when they are received. This is generally very attractive to the person with the pension, but it is often disastrous for the non-member spouse.

The Pension Benefits Division Act became law a few years ago. This Act provides for the division of certain Federal Government pensions into two pensions on marriage breakdown, so that each party has a pension. This may be an appropriate way to satisfy the equalization payment in some cases. However, there are many reasons why the value calculated by the Government for this purpose is probably not the proper value for equalization on marriage breakdown. I had one case where the value of the pension accrued during marriage according to the Pension Benefits Division Act was \$80,000. On acting for the spouse of the member I was able to prove that the true value earned during the marriage period as determined for marriage breakdown purposes, was

\$150,000. I have also had cases where the proper value was less than the value calculated under the Pension Benefits Division Act.

Most other pensions cannot be divided prior to retirement of the member. This leaves the drafting of agreements or orders to divide the pension payments, if and when they are received. It is very difficult to draft such an agreement or order in such a way that the non-member spouse will be guaranteed to receive exactly what they are supposed to receive on marriage breakdown.

## **Other Benefits Lost by the Non-Member Spouse**

Even the most diligent person can do nothing about the fact that the non-member spouse loses many things in the equalization process just because of the operation of law. This could include the following:

1. The equalization value of the pension is often based on a pension being paid in the future in deflated dollars. While the value is settled on this basis, the member normally receives a pension in dollars that keep pace with inflation to at least the date of retirement. The non-member spouse has to settle for a value in deflated dollars.
2. These days many employers provide dental and other health benefits. The value of these is not included in the equalization of assets. Even though the member continues to benefit from these plans, the non-member spouse is cut off from them.
3. Many pensions include a provision that on the death of the member after retirement, a portion of the pension payments must continue to the person who was the spouse when the member retired. The non-member spouse gives up this very valuable asset when the marriage breaks down before retirement of the member. The loss of this asset for the non-member spouse is not considered in the equalization process. This alone can cause one of the parties to lose thousands of dollars of value.

In order to ensure that you receive your fair share of the assets on the breakdown of your marriage, I suggest that you do at least the following:

1. Become familiar with the provisions of your pension plan and/or your ex-spouses plan.
2. Do not attempt to settle the equalization of your assets without having a proper valuation report prepared that you understand. The report should be prepared by someone who specializes in preparing this type

of report and issues such reports as their only business and their full-time business. The cost of having such a report prepared is minimal in comparison to the thousands of dollars that you could lose if the pension is not valued properly.

3. Review your ex-spouses list of assets carefully, in order to ensure that all assets have been included and that all assets have been valued reasonably.
4. Make sure you apply to have the Canada Pension Plan credits equalized, if your spouse has accumulated more than you have.

You must be most diligent if you want to be sure that you are not one of the thousands of people who do not receive their fair share of the assets on marriage breakdown.