FINAL SUBMISSION OF THE GOVERNMENT OF CANADA TO THE JUDICIAL COMPENSATION AND BENEFITS COMMISSION REGARDING DIVISION OF ANNUITY ON RELATIONSHIP BREAKDOWN

a) Introduction

1. As proposed at the oral hearings before the Commission on February 3rd and 4th, 2004, the Government and the representatives for the judiciary, as well as their respective experts, have engaged in a series of discussions and document exchanges in an effort to reach a consensus on the most effective and equitable mechanism for division of the judicial annuity. While agreement was not achieved, this exercise proved extremely useful in highlighting some of the specific issues to be considered and addressed in the context of the judicial annuity.

2. The judiciary expressed a strong preference to have the division mechanism included as part of the overall *Judges Act* scheme, rather than incorporated into the *Pension Benefits Division Act* ("PBDA"), and the Government has agreed.

(b) Government's Original Proposal

3. In its submission dated December 15th, 2003, the Government proposed that the mechanisms and procedures that operate under the PBDA be applied to the division of the judicial annuity. This approach would ensure that the judicial annuity would be handled in accordance with the same principles and practices as the division of any other retirement income provided by the Federal Government.

4. In developing its proposal in relation to judicial annuities, the Government has been guided by the overarching principles and policy objectives that apply to all other federal pension schemes. These include:

- To encourage a "clean break" and portability - the mechanism should facilitate the resolution of conjugal disputes by providing the parties with certainty and finality, without further financial ties to one another with respect to property;

- To facilitate an equitable division of the pension/annuity that is straightforward to administer;

- To ensure cost neutrality - the division of the pension/annuity should be cost-neutral to Government;

- To allow for flexibility - parties should remain free to enter into private agreements or be subject to court orders with respect to property equalization that include waiver of entitlement or modification of statutory division (subject to the limit of 50 per cent, as stated below);

- To encourage prudent retirement planning - where parties seek a division of pension/annuity, the maximum transferable amount will not exceed 50 per cent of the entitlement subject to division.

(c) Facilitative Mechanism versus Substantive Entitlement

5. Before describing the proposed amendments to the Government's proposal, we wish to offer clarification on an important issue that has not been previously addressed. The mechanism under consideration is intended only to facilitate a division of the annuity and would not itself create any substantive rights to a share in the judicial annuity. Any substantive entitlement to share in the annuity is governed by provincial law and by any court order or private agreement to which the parties would be subject.

6. Consequently, in determining the substantive entitlement, the parties and the court are free to base their calculations on any formula or actuarial assumptions they agree to be appropriate. They are not tied to the calculations underlying the framework of the PBDA. Furthermore, a court order or private agreement may provide that a spouse is entitled to any portion of the value of the annuity, recognizing that there may be limitations on the ability to recover this entitlement against the annuity asset itself, as set out in paragraph 8 below.

7. As previously indicated, it is the Government's position that the mechanism established to facilitate division should be consistent with the principles and policies of the PBDA to the extent possible. Two elements that are central to Government policy in this area are:

- the maximum amount transferable to a spouse under the division mechanism will be 50 per cent of the value of the judge's annuity benefit notionally accrued during the period subject to division; this is important for retirement planning purposes generally, but is particularly key for the judiciary in light of the constitutionally-protected principle of financial security; and

- the set of demographic assumptions used for the most recent Actuarial Report on the Pension Plan for the Federally Appointed Judges should be applied to calculate the actuarial present value of the amount subject to division.

8. Therefore, the parties may agree to, or a court may order, any value to be transferred to the spouse in accordance with provincial family law. However, the proposed division mechanism will limit the amount that can be transferred from the Consolidated Revenue Fund to the spouse to satisfy this order or agreement to 50 per cent of the value of the judge's annuity benefit, for the period subject to division, as determined under the relevant regulations. Any outstanding entitlement to the spouse will have to be satisfied by other means.

9. A key assumption in the development of the Government's proposal is that the mechanism should fit within the existing parameters of the *Judges Act* scheme and should not involve any changes to entitlement. The creation of this mechanism should not be taken as an opportunity to address other perceived "deficiencies" in the scheme.

(d) Notional Vesting Period

10. The *Judges Act* does not provide for an explicit vesting period, such as the two-year period found in most other federal pension plans. In its original submission to the Commission, the Government proposed that notional vesting for these purposes would be based on the existing early retirement annuity provision of the *Judges Act*, namely at the point where the judge attains age 55 and has served at least ten years of judicial office.[1] Where relationship breakdown occurs prior to this notional date of vesting, the

[1] *Judges Act*, section 43.1.

Government proposed that the former spouse would receive up to 50 per cent of the contributions made by the judge during the course of the relationship.[2]

11. On reflection and through discussion, the Government has recognized that the lengthy notional vesting period for the judicial annuity could produce unfair results for former spouses.[3] For example, under the Government's proposal a spouse could be in a relationship with a judge for a considerable period of time (such as 14 years), and be eligible for no more than a share of contributions.[4] The monetary difference between a share of contributions and a proportionate share of a notionally accrued annuity could be significant, as demonstrated in the examples attached at Tab B.

12. Accordingly, the Government recognizes that its original proposal requires modification to address this potential unfairness.[5]

(e) Modified Government Proposal – Option to "Wait and See" until Notional Vesting

13. The Government recommends that its original proposal be amended to introduce an option for spouses when the relationship breaks down prior to the judge reaching the notional vesting period. Spouses would have the choice of either:

- receiving an immediate lump sum transfer in the amount of their proportionate share of the contributions, or
- electing to wait until the judge notionally vests (or dies or terminates) and at that date receiving a lump sum transfer of either their proportionate share of contributions or of the actuarial present value of the notionally accrued annuity, as applicable.

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[2] This is consistent with the approach under the PBDA.

[3] Mr. Thomas Weddell, the expert for the judiciary, also pointed this out in the *Report of Eckler Partners Ltd*. (16 January 2004), Appendix F to the Reply Submissions of the Canadian Superior Court Judges Association and the Canadian Judicial Council, at 4-5, (hereinafter the Eckler Report).

[4] It is unusual for a judge to leave the bench prior to qualifying for an annuity. See, for example, the *Actuarial Report*, Federally Appointed Judges, as at 31 March 2001, at 27, which identifies the number of non-vested terminations for the 1998-2001 period as five (report attached at Tab A).

[5] Mr. Weddell indicated in his report that "[i]t may be that a more equitable way of settling under the annuity benefit would be to provide that no division would occur until the judge actually does become vested (i.e. at age 55 with ten years of judicial service) or terminates or dies." Eckler Report, *supra*, at 5. The Government's revised proposal adopts a variation on this suggestion.

14. This modified approach would address the inequity that may result from the lengthy notional vesting period in the judicial annuity scheme. It would create a mechanism that would operate within the existing structure of that scheme, while remaining generally consistent with the principles and practices of the PBDA. In particular, the benefits of a clean break would continue to be available.

(f) Notional Accrual Formula

15. The judicial annuity does not "accrue" in the manner of a conventional pension plan. However, reference to an accrual formula in the pension/annuity scheme is required in order to calculate the lump sum to be transferred to a spouse upon conjugal breakdown. Therefore, as with the creation of the early retirement entitlement within the *Judges Act*, it is necessary to provide for a notional accrual formula. The Government's proposal is to use the same notional accrual formula that has been developed for early retirement. This formula is based upon the date at which the judge becomes entitled to receive a full annuity -- that is, when the judge has a minimum of 15 years of service, and the judge's age plus years of service add up to 80 (the "Modified Rule of 80 date").

16. There are several reasons why the Government has proposed this date for the accrual period, including:

- as of this date the judge becomes entitled to the maximum annuity benefit of 2/3rds of final salary; the judge earns no further increases in the annuity after this date, apart from those based on salary increases[6]; and

- as of this date the judge ceases to make contributions in respect of the annuity in the form of 6% reservation of salary; the only ongoing contributions after this date are at a rate of 1% to the Supplementary Retirement Benefits Account in respect of indexation of the annuity after retirement[7].

17. The Eckler Report proposed that rather than transferring a lump sum at the time of conjugal breakdown, the division could occur at the time the judge actually retires, either

[6] *Judges Act*, s. 42.
[7] *Judges Act*, s. 50(2.1).

through a single lump sum payment or through periodic payments of the spouse's share of the annuity benefit.[8]

18. While this approach would provide certainty in terms of the actual benefit to be split, it would not further several of the goals of a pension division scheme, as identified above. Parties could be required to wait for a lengthy period of time – in some cases as much as 20 or 30 years – before their rights are finally determined, which would hamper the ability of the parties to make a clean break, interfere with their retirement planning, and increase the likelihood that the judge's former spouse will die before receiving any benefit.

19. However, the Government has an even more fundamental concern with this proposed approach. The judiciary proposes that the notional accrual formula upon which the spouse's share of the benefit should be determined should be based on the proportion the conjugal relationship represents relative to the judge's total years of service on the bench, rather than the number of years needed to reach the Modified Rule of 80 date. Under this approach, the longer the judge remains in service, the smaller the spouse's share will be.

20. Accordingly, the spouse's share of the annuity would be directly affected by the personal retirement choices of the judge. Experience shows that many judges will choose to remain on the bench after the Modified Rule of 80 date, in particular as a result of the attractive option of supernumerary status. This can delay retirement for up to ten years. As a result of this choice, spouses must not only wait longer, but would receive a reduced share of the annuity.

21. In the context of lump sum transfers upon conjugal breakdown, the Eckler Report suggested two alternatives. First, the parties would be allowed to agree upon a presumed retirement age. Second, a presumed retirement age, such as age 70, could be established for the purposes of accrual, rather than the Modified Rule of 80 date.[9] In response, the Government reiterates that no additional annuity benefit is earned during any years of

[8] Eckler Report, *supra*, at 4.

service after the Modified Rule of 80 date is reached. Consequently, there appears to be no reason why these years of service would be used to calculate the notional accrual period, especially given that in many cases this approach would significantly diminish the proportionate share of the annuity available for division.

22. The Government does not accept that members of the judiciary would face any inequities that would warrant adoption of an approach different from the Government's proposed notional accrual period. It is important to note that any dissatisfaction with the proposed notional accrual period arises from the fact that the current annuity scheme does not provide for additional entitlement for additional years that a judge may choose to serve, usually in supernumerary office. This complaint has been raised in a number of past proposals for reform, including the original submission of the judiciary to the Drouin Commission.[10]

23. Using "years of service" as the measure or benchmark in the division mechanism would not only create the potential inequities identified above, but would also create an internal inconsistency in the annuity scheme. Such an approach would create a situation whereby separating judges would be treated differently from single judges or judges who remain in a relationship. Separating judges would, in effect, be treated as having accrued a pension after the Modified Rule of 80 date, while other judges would not. Taking this approach would convert what is intended to be a purely facilitative mechanism into a tool that affects the judge's substantive entitlements under the judicial annuity scheme.

24. In the Government' s view, this will lead inevitably to pressure for this alleged "inequity" to be addressed for all judges, not just separating judges. The Government reiterates its position that any changes to key elements and assumptions underlying the *Judges Act* scheme should only be made in the context of comprehensive annuity reform, a step that the judiciary does not support.

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[9] *Ibid*. at 3.

[10] Joint Submission of the Canadian Judges Conference/Canadian Judicial Council to the 1999 Judicial Compensation and Benefits Commission, dated December 20th, 1999, at 3-25.

(g) Conclusion

25. The additional time the Government and the judiciary have had to explore the design of the division mechanism has permitted the Government to understand and respond better to a number of the judges' concerns with its original proposal. In the Government's view, this exercise has resulted in a more equitable proposal for a tool to facilitate division of this asset.

26. It is the Government's position that some of the concerns identified by the judiciary arise from the peculiarities of the annuity scheme under the *Judges Act*. As previously agreed by the Government and the judiciary, the mechanism is to be developed within the four corners of the existing annuity scheme.

27. The Government submits that its modified proposal, which adds to the general PBDA framework the option for the spouse to "wait until vesting" for transfer, strikes a fair and effective balance of the general objectives of pension division, while remaining consistent with the unique structure of the existing annuity scheme and the parties' view that no further modifications to the annuity will be sought at this time.

28. Specifically, the Government proposes that a division mechanism be put in place for the judicial annuity scheme that would provide as follows:

- benefits accrued during the conjugal relationship would be defined in terms of the pro rata portion of a full judicial annuity equal to 2/3rds of salary established using the "Modified Rule of 80".

- vesting for the purposes of deciding whether to share either the judge's contributions or the actuarial present value of benefits accrued during the relationship would be deemed to be attainment of age 55 and completion of ten years of judicial office.

- the maximum amount transferable to a spouse under the division mechanism will be 50 per cent of the value of the judge's annuity benefit notionally accrued during the period subject to division;

- the set of demographic assumptions used for the most recent Actuarial Report on the Pension Plan for the Federally Appointed Judges should be applied to calculate the actuarial present value of the amount subject to division.

- where the conjugal relationship breaks down prior to notional vesting, the spouse would have the option of either

  (a) receiving an immediate lump sum transfer in the amount of their proportionate share of the contributions, or

  (b) electing to wait until the judge notionally vests (or dies or terminates) and at that date receiving a lump sum transfer of either their proportionate share of contributions or of the actuarial present value of the notionally accrued annuity, as applicable;

- the mechanism would be established within the *Judges Act* and its associated regulations and administered through the Commissioner for Federal Judicial Affairs.

29. The Government looks forward to the Commission's recommendations in this regard.