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Pension Commuted Values

When someone leaves a pension plan, they may be able to take a lump sum amount of money instead of receiving future pension payments from the plan. This is called their pension "commuted value," which is the current value of what they could have received in the future if they had chosen a monthly pension at retirement. An example might be someone who is leaving their employer but is too young to retire; instead of waiting to receive a monthly pension payable from the plan in the future, they can choose to take the commuted value at the time they leave their employer (and must usually transfer at least some of it into a locked-in retirement account). An employee who is retiring from their employer is sometimes also given the option to take their commuted value at the time they leave their employer (and will usually need to transfer at least some of it into a locked-in retirement account), or to receive their monthly pension from the plan instead.

Making estimates for the future

To figure out how much someone's commuted value might be, a pension expert has to estimate several factors about the person's pension as if they had stayed in the plan. For example, the expert will make estimates or "assumptions" about the person's likely age at retirement, what kind of pension payments they might have received, and how long they and their spouse might live. This helps figure out the amount of the pension they would have received and how long their pension would have been paid.

The pension expert will also use assumptions about interest rates. The lump sum amount will reflect the value of monthly pension amounts that would have been paid many years into the future. Interest rates are used to discount these monthly payment amounts back to the date that the person receives their commuted value. These interest rates change every month, depending on the rates that can be earned on publicly traded bonds that are issued by the Government of Canada, provincial governments, and corporations. These rates are available from an index published by FTSE Russell (monthly yield values) and the Bank of Canada.

Commuted value calculations can be affected by all of these variables; for example, interest rates change over time and can be volatile, expected rates of mortality change based on many factors, and the retirement age for someone leaving a pension plan is not always easy to predict. The commuted value may end up being higher or lower than the value of the pension payments that a plan member would actually have received from their plan.

Fairness and consistency

Commuted value calculations must be fair and consistent, and should consider the interests of all stakeholders including both members staying in the plan and those leaving. Therefore, the assumptions and methods that

must be used are set out in federal and provincial pension legislation, which relies on the *Standards of Practice* published by the Actuarial Standards Board (ASB) of the Canadian Institute of Actuaries.

The ASB sets out the standards of practice very carefully to make sure that the rules are objective, of high quality, and serve the public interest. The process to establish or revise the standards of practice includes several notice periods, consultations with actuaries and with public stakeholders, and sharing at least one draft with these groups before publishing the final standards. These steps can take many months or even years to make sure everyone involved has a chance to share their input and to ensure that the ASB ends up with the most appropriate outcome.

Recent updates to calculations

The pension standards of practice for commuted values were most recently updated in January 2020 following a multi-year review process, and the changes took effect on December 1, 2020. The changes were originally set for August 2020, but the ASB decided to delay the effective date, partially because of COVID-19 disruptions in the industry.

The key changes include the following:

- The way interest rates are calculated. This was originally linked only to Government of Canada bond rates, but now also reflects provincial and corporate bond rates. This makes sure that the commuted value interest rates are based on up-to-date market-based bond rates.
- The way someone's likely retirement age is estimated. It used to be based only on what age would result in the highest commuted value, but now, it balances that age with the earliest age someone could have started getting their full lifetime pension. This change better reflects the reality of the age at which people choose to start their pension.
- For certain target benefit pension plans and multi-employer pension plans, the commuted value assumptions are now based on the assumptions used to fund the pension plan.

The goal of these revisions was to make sure that calculations continue to be as fair and unbiased as possible to everyone, including those leaving a pension plan, those who are staying, as well as employers and other plan stakeholders.

Learn more

Seeing Beyond Risk podcast episode, Changes to commuted value standards

Actuarial Standards Board of the Canadian Institute of Actuaries, *Standards of Practice Section 3000 – Pension Plans*