**PENSIONS AND DIVORCE IN THE UK**

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**Introduction**

Throughout the world a large number of marriages end in divorce. The most valuable personal assets of any couple will generally be the matrimonial home and the occupational pension benefits. The value of the pension may easily exceed that of the property, or other assets. As a result "pensions and divorce" has been subject to protracted scrutiny.

This subject was considered by the IACA in Munich. This paper looks at events since July 1988 and aims to extend the debate.

This paper consists of the following documents:

4. ACA draft proposals on pensions splitting.
5. Future Action
1. "A Policy for Labour"

* Registering a spouse’s interest in their partner’s pension contributions and benefits would ensure that their financial interest in and contribution to the pension is both recognised and protected.

* Where an interest is registered both partners would have a right to a half share of the pension’s value.

* On divorce, or separation in the case of cohabitees with a registered interest, the pension assets should be valued and split equally.

* Tightening up of the actuarial base for transfer values, improvements in inflation proofing and access to preserved rights will increase the value of split pensions.

* If both partners have equal independent pension assets, or if one can purchase rights of equal value for the other, the couple could waive their right to pension splitting.

* The partners should become equal and independent members of the scheme once the pension is split.

* The courts need the power to order pension splitting but couples should be able to arrange it on divorce and relationship breakdown by agreement without recourse to the courts.

* Legislation will be required to give pension schemes the power to vary their terms and conditions to facilitate registration of interest and pension splitting and without incurring losing the fund’s tax advantages.

* Legislation will be required to ensure that registration of interest and pension splitting do not incur additional tax liability and to allow both partners to use their tax allowance against their share of pension income in payment.
2. Family Law Committee Proposals (England and Wales)

The report entitled Maintenance and Capital Provisions on Divorce was produced in May 1991 by the Family Law Committee. The Committee is one of a number of Committees of the Law Society of England and Wales. The report covers the law and procedure relating to maintenance and capital provision on divorce. In particular it recommends the introduction of:

a) A system of pension splitting on divorce;
b) The recognition of marriage contracts;
c) The introduction of a formula for calculating child maintenance and
a) A set of procedural reforms.

We are obviously concerned with a). I am grateful to the Committee for kind permission to reproduce the relevant sections of the report.

Summary

The Committee recommends that

i) the courts should be given power to make pension adjustment orders in proceedings for ancillary relief brought under the Matrimonial Causes Act 1973;

ii) the courts should be provided with powers similar to those available under the Scottish legislation. In addition there should be a power to allow partners by a former husband into a personal pension scheme for a wife.

iii) Guidance should be issued on how and when a pension should be valued and in what shares it should be split.

The Full Text of the report is as follows:

For many couples contemplating divorce, particularly after a long marriage, the two most valuable assets they possess are likely to be the matrimonial home and any pension rights. Following legislation in 1985, 1986 and 1987 a myriad of different types of pensions exists. As a result the issue of pension splitting on divorce is one which has received a considerable amount of attention in recent years yet remains fraught with difficulties. The respective rights of the parties to any pensions are frequently not dealt with when an application for ancillary relief is brought - not least because the court's powers are limited in this area and this attitudes to it are unclear. It is assumed for the purposes of this document that in most cases a husband will have greater pension rights than a wife.
Under Section 25 of the Matrimonial Causes Act 1973 the court must consider, inter alia:--

"the value to each of the parties to the marriage of any benefit (for example a pension) which by reason of the (divorce) that party will lose the chance of acquiring".

The benefits which the court will have to consider under this provision fall into the following categories:-

a) the payment of a lump sum on retirement;
b) the pension the husband will become entitled to on retirement;
c) a widow's pension which may be payable following the husband's death after retirement;
d) a lump sum which could be payable to the husband's estate should he die in service;
e) a widow's pension payable should the husband die in service; and
f) the possibility of substantial life cover which would be payable to the husband's estate in the event of his death.

The courts have experienced difficulties in the interpretation of this provision for a number of reasons:-

a) Under Section 25(1)a of the Matrimonial Causes Act 1973 the court must look at what will occur in the foreseeable future. The court seems to limit the foreseeable future to about four or five years following the divorce, or at most ten - thus, if a couple divorce more than ten years before a pension is due, the wife is unlikely to benefit.

b) The court does not have the power to order a husband to take out life or term insurance, assign pension benefits, or continue pension or insurance premiums. It is also not possible to order that a service gratuity be split (see section 203 of the Army Act 1955). As a result most arrangements for pensions for divorcees are made by consent.

c) It is very difficult to value a pension accurately before it has accrued as the value will either depend on the final salary of the contributor or the amount of contributions made to a personal scheme and the performance of the investment. Traditionally reliance has been placed on transfer values, however, it appears that these tend to underestimate the benefits accrued.
d) It has been suggested in relation to family trusts (see J G Miller "Trusts and Financial Provision on Divorce" (1990) Trusts Law and Practice (May 42)) that orders contingent on an event occurring i.e. a pension accruing should be made. Although this approach has been used in the past (See Milne -v- Milne (1981) 2FLR 286) it leaves a former wife dependent on a series of events occurring over which she has no control. It may be that her former husband becomes unemployed or dis-entitled to his pension or that he manages to avoid liability to his former wife by some other means.

e) Often the terms of the pension schemes do not allow the assignment or commutation of benefits.

f) Under the present system the only solution is often for a former husband to consent to taking out a policy for his former wife’s benefit. This will often not be possible because of a lack of resources.

g) Again, a sheer lack of resources often means that it is virtually impossible for a husband to compensate his wife adequately in some other way for the loss of pension rights, particularly when it is combined with the fact that women, whether married or divorced, tend to earn less (and therefore have lower pension entitlements) than their male counterparts.

Despite this, in certain county courts an informal system already exists to deal with three types of benefits available under a pension, namely:-

a) a widow’s pension

b) a lump sum available on retirement; and

c) a husband’s pension on retirement.

Under this system the possibility of a widow’s pension is ignored as by definition on divorcee cannot be the widow of her former husband. The possibility of death in service is also not dealt with. The proportion of the lump sum is calculated according to the length of the marriage and the anticipated date of retirement of the husband. An attempt is also made to compensate the wife for the fact that she will be unable to benefit from any periodical payments received from a pension fund during her husband’s retirement.

While these guidelines are valuable the system is unsatisfactory due to the fact that it is informal, limited in scope and can only apply to those women whose former husbands are within, at most, ten years or retiring.

This state of affairs has produced a number of proposals for reform starting with the Law Commission’s consideration of the subject in 1969. ("Report on Financial Provision in Matrimonial Proceedings" (1969) Law Com. No 25). A more recent review of pension splitting on divorce commenced with the proposals produced by the Lord Chancellor’s Department in 1985 contained in a consultation paper entitled "Occupational Pension Rights on Divorce". The consultation paper suggested a system whereby, on the death of the former husband, the former wife could make an application for pension provision. The
Lord Chancellor’s Department recommend that any changes could be achieved by means of secondary as opposed to primary legislation. These proposals were widely criticised and the Committee in its response stated that it thought that the issue of pension rights should be judged according to the position on divorce not death. The Lord Chancellor’s Department’s proposals were also thought to be unsatisfactory as they would leave both parties to the marriage in a very uncertain position.

Since the emergence of the Lord Chancellor’s Department’s consultation paper, the Government’s view, as reflected in subsequent parliamentary answers, has been to suggest that the problem lies in the hands of the pension schemes involved and does not need the intervention of central Government through legislation.

The Committee has also considered other proposals from the Institute of Fiscal Studies (I.F.S.) those recently presented to the Shadow Cabinet by Mr Michael Meacher, Shadow Secretary of State for Social Security, the system used in Germany and that introduced by the Family Law (Scotland) Act 1985.

The proposals from the I.F.S. were designed to become part of their plan for a system of community property during marriage and they, like the Labour Party, recommend that on divorce pension rights should be divided equally. The Committee believes that both these sets of proposals are an improvement on those produced by the Lord Chancellor’s Department. However, Committee members fear that the proposals (particularly those produced by the Labour Party) fail to take account of the limited powers of the courts in this country to deal with pension splitting.

The German system makes use of a detailed set of regulations which provide for the splitting of all pension rights, whether private or public which have accrued during the marriage. The Court will automatically look at pension splitting if a divorce petition is presented unless the court consents to the parties entering into an agreement; often where they have very similar pension rights.

The first step is for the court to gather as much information as it can about the parties about the relevant pension schemes and the current and future rights of the parties to a pension or pensions. Having done this the actual transfer takes place. This is relatively straightforward if both spouses are members of the same pension scheme or if one or both work for the State. However, if the husband has a private pension it has been held that this cannot be split at the time of the divorce - the wife has a claim against her husband, not the pension scheme, which she can raise when her husband reaches retirement age. (See deferred pension splitting below).

If the above provisions do not achieve the full pension split because a private pension or pensions is involved then four other methods can be used. Each method must be tried before going on to the next.
a) **Extended Splitting** - This compensates the former wife by transferring a maximum of 2% of the average monthly account of a former husband’s pension to his former wife’s pension account.

b) **Compensation in the form of contributory payments on the part of the former husband to the former wife’s social security pension account** - This method can only be used where the husband is in a good enough earning position to be able to afford to do this.

c) **Deferred Pension Splitting** - This method is designed to protect a former wife whose former husband dies before reaching retirement age. Upon reaching retirement age the wife receives an independent right against the private employer’s scheme to bring her up to the full level of entitlement. This is dependent upon her proving that, if she was still married, she would, under the terms of the scheme, have been entitled to a widow’s pension.

d) It is only if none of the above procedures work that the husband is obliged to transfer a sum from his private pension to the wife’s social security pension scheme. If the pension has been transferred and the wife then dies before being able to take advantage of the pension rights, the rights are re-transferred to her former husband.

Where a couple divorce after the former husband’s retirement but before the former wife’s the husband’s pension is not reduced provided he continues to pay maintenance.

Clearly the subject of pension splitting on divorce is not one that can easily be clarified due to the current complexity of pension provision, the difficulties in the valuation of individual policies and the lack of a coherent legislative framework. It is also important when considering the alternatives to recommend the introduction of a system which is consistent with other legislative provisions and social conditions in Britain. The German system, for instance, operates in the context of a legal system much more focused on the use of rules than of discretion. It also operates in a country where awareness of the importance of pension rights is much greater than it is currently in Britain.

The Family Law (Scotland) Act 1985 also makes some provision for pension splitting on divorce. As noted above, under the terms of Section 10 of the Act, pensions and life assurance benefits are included in the definition of matrimonial property which should be split on divorce. The courts also possess greater powers to deal with this issue than they do in England, for instance, the courts have power on divorce to order payment of a lump sum, payment of a capital sum by instalments or deferred payments and the power to vary the date of method of payment at a later date.

In general terms it seems that the effect of these provisions has been to direct the attention of all involved to the question of pension splitting to a much greater degree than in England, or previously in Scotland. However, the Scottish Courts and solicitors seem more ready to use the existence of pensions as a bargaining counter then to proceed to full valuations and the splitting of pensions.
The typical view of solicitors can be demonstrated by the comments of one interviewed by Wasoff, Dobash and Harcus (op. cit. at para 2.17): "As far as pensions go, I would recommend you use that as a bargaining counter because generally people do not like their pension rights to be interfered with". A number of reasons for this diffidence about proceeding to a full valuation are highlighted in an article by R Andrew Scott ("Pension Rights on Divorce 'Clean Break' or 'Dirty Break'" (1991) Journal of the Law Society of Scotland, February 45).

Among the problems identified are how and when to value a pension. If a pension is part of a final salary scheme should it be valued according to the salary of the husband at the time of separation, at the date of the settlement or hearing, or on the basis of estimated final salary of the husband? Equally, how should a pension be valued i.e. should a transfer value be used or would some other basis be more appropriate? It is also clear what benefits should be included within the valuation i.e. should a wife be able to benefit from a share of all or any of her husband’s pension, part of any widow’s benefit, any cash benefit and death in service benefits? The legislation also leaves open the question of the shares in which a pension should be split - this gives further scope for uncertainty.

Wasoff, Dobash and Harcus (op cit at para 2.17) also identified the problems of cost in valuing pensions; particularly when a client is in receipt of legal aid and it is necessary to instruct an actuary or accountant.

The Family Law Committee believes that if consistency is to be achieved in arrangements for pension splitting on divorce it can only be done by the use of primary legislation. The Committee thinks that this legislation should provide that the courts have the power to make a pension adjustment order at the time of the ancillary relief hearing. Clearly, for this to be effective the courts will need to be provided with a full (or perhaps fuller) range of powers than in Scotland. Specifically, the Scottish legislation does not allow payments to be made by a husband into a personal pension scheme for a wife which would ensure tax advantages for both parties. If the problems described above, which have been encountered in Scotland, are to be avoided it would also be necessary to make guidance available on how and when to value pensions. It is to be hoped that if this type of system is introduced some of the hardship currently experienced by former wives on retirement will be avoided.

At the time of writing it is understood that this report has not been taken up by the Lord Chancellor with a view to legislating.

The UK debate on 'Pensions and Divorce' is being taken forward by a working group very recently established by the Pensions Management Institute (PMI). Actuaries, lawyers, Government and the pensions industry are all represented. A report in early 1993 is expected.
3. Family Law (Scotland) Act 1985

Purpose

The purpose of this paper is to provide all actuaries with the opportunity to:-

1. Learn about the legislation.
2. Comment on the valuation approaches.
3. Comment on possible future action by the profession eg. a guidance note.

The paper has deliberately been kept short and is split into the following sections:-

a) Legislative background
b) Actuarial involvement.
d) Information
e) Valuation Approach (Pensions)
f) Valuation Approach (Life Assurance)
g) Considerations
h) Case Law
i) Actuarial Action
j) Bibliography

Legislative Background


Before the 1985 Act financial provision on divorce was discretionary under S5(2) of the Divorce (Scotland) Act 1976. The 1976 legislation enabled the court, on application, to make:-

"Such (an) order, if any, as it thinks fit, having regard to the respective means of the parties to the marriage and to all circumstances of the case, including any settlement or other arrangements made for financial provision for any child of the marriage".

The 1976 Act did not provide guidance as to how discretion was to be exercised. Following the Scottish Law Commission Reports the 1985 Act was introduced to correct and clarify matters. The post 1985 situation is covered in Thomson's book [6].
Matrimonial property is the assets of the marriage acquired during the period of marriage. The 1985 Act introduced a specific element of such property:-

"Any rights or interests of either party under a life policy or occupational pension scheme or similar arrangement".

All matrimonial property is valued at the Relevant Date, the date of separation or the date of serving a summons in the action for divorce. As actuaries will appreciate the capital value of pensions (in particular) may be substantial. In practice the value of a pension entitlement is often greater than the value of the matrimonial home.

The Act applies equally to approved and unapproved arrangements and, in the latter case funded or unfunded.

Jurisdiction extends to actions raised in Scotland, but no reference is made to the location of the pension scheme or the service that gave rise to it. Pensions accrued from service in England appears eligible and may bring a new dimension to Gretna Green.

**Actuarial Involvement**

Consulting actuaries have been involved with the Act since the first cases were considered in 1986. Consideration of the value of pension rights etc. was however initially slow, with many in the legal profession unaware of the financial significance of the above new explicit element of matrimonial property.

It should also be appreciated that divorce is not a quick process. For example the Muir case [8], with actuaries instructed in July 1986, came to court in May 1987. The decision was given in September 1987. The case was formally reported in the Legal Journals in 1988. The result (from the position of the aggrieved pension owner) was front page news in a Sunday newspaper in March 1989.

The first element of publicity of the actuarial side of such matrimonial property arose from an article in the Journal in the Law Society of Scotland in November 1987 [5]. The article briefly outlined the legislative background, practical difficulties of information gathering, alternative valuation approaches as well as various practical matters. Subsequent articles have followed in Scotland [17] and the UK [18].

There was no "consultation process" when the legislation was drafted. Also after enactment the Law Society of Scotland and the Faculty of Actuaries did not consult to prepare standard actuarial input, common valuation approach, bases etc. Consulting actuaries were left to interpret the legislation individually. However an informal sub-committee of the Pensions Standards Committee was convened in 1988, following the Law Society Journal article. The group consisted of three consulting actuaries. Consideration was given to an "Information Note" for actuaries as well as to professional conduct. A paper was presented to the Munich I.A.C.A conference in July 1988 [10] and the subject was considered at the NAPF conference 1990 [14]. The subject has also reached the political stage [13].
Last year recently the Faculty discussed matters directly with the Law Society of Scotland, both sides being represented by Council members as well as active practitioners. A seminar on the subject was considered, however, apart from a brief report in The Actuary [15] the main outcome of these recent discussions was this brief paper. The Glasgow Actuarial Students’ Society considered the subject last February [16].

Provisions of the Act

It is appropriate to consider exactly what the Act is trying to achieve and how. The overriding aim is to achieve a 'clean break' for both parties. Section 8 of the Act allows the court to make orders for financial provision:-

1. For the payment of a capital sum or the transfer of property;
2. An order for periodical payments; and
3. An incidental Order.

An important aspect of such orders is that regard must be had to the "reasonable" resources of the parties at the time of settlement. In practice capital settlement (reflecting the value of life assurance and pension rights) may be achieved either by an immediate capital payment (or transfer of other assets) or a capital settlement by instalments (from income) or deferred capital payment(s) e.g., from a future tax free lump sum on retirement. In practice a common outcome is one party keeping his/her pension and the other party getting the house proceeds. Problems obviously occur if there is no other 'liquid' matrimonial property.

Section 9(1)a of the Act outlines the key principle that "the net value of the matrimonial property should be shared fairly between the parties of the marriage". The use of the word "net" is intriguing. It was designed to cover the value of the matrimonial home after the repayment of mortgage debts. The word does however have potentially important applications in respect of the taxation of emerging pension benefits!

Information

Legal practitioners generally experience difficulties in obtaining the necessary details for the assessment of the value of life assurance and pension arrangements. Despite the Disclosure Regulations even basic information about a pension entitlement is often difficult to obtain, with recourse to the pensions administrator being frequently required. For life assurance policies the availability of a policy document is generally less troublesome, however, up to date details of bonus additions, unit prices etc. may still give rise to difficulties.

Information about and understanding of individual pension arrangements is perhaps the most troublesome area for practitioners. An element of sympathy is necessary for solicitors receiving replies from life offices to the effect that "this policy has no value until age 60". Legal practitioners may also experience difficulties in correctly interpreting and processing the illustrated "values" of policies where "initial units" or "capital units" disguise the extent of the front end expenses of the contract.
Although surrender values (or transfer values to personal pension contracts) may reveal a more realistic (cash) value the understanding of such matters may be a difficult process.

The court can make an order to have an item of matrimonial property valued, although this is a last resort, if the scheme member and administrator are uncooperative. An order for provision of financial details (eg. a P60) can also be made.

Pensions - Valuation Approach

Two approaches were initially considered. For practical purposes the easiest value to consider was the transfer value (cash equivalent) available in lieu of leaving service benefits. For legal practitioners this was particularly attractive as being available (free of charge) direct from the pension administrator. The practice of providing such transfer values on benefit statements also increased attention. Actuaries will of course be aware of the potential difficulties for legal practitioners associated with using cash equivalents - apportionment to period of marriage, level of scheme funding, treatment of pension increases etc. The availability of an "expert witness" is also a particular problem.

The second main approach was to consider the actuarial reserve or continuing service value of entitlements. Such an approach would take account of future salary increases, the incidence of death, withdrawal, ill health retirement, early retirement as appropriate. Depending on the age of the pension scheme member withdrawal would be a potentially significant factor. In practice the majority of cases have concentrated on this "continuing service" approach, not least because few individuals actually left service at the Relevant Date, or indeed in the period prior to settlement.

A Sheriff commented in one case [9] (where both cash equivalent and continuing service approaches were considered) that a range of values for different dates of withdrawal from the scheme could be sought. The cash equivalent was (deemed) zero (presumably a non-contributory contracted in scheme; separation in 1985 with less than 5 years service) and continuing service value £2,652. Pragmatism however applied in the end due to fears regarding potential additional valuation costs!

Differences between consulting actuaries have also arisen in connection with the approach to taxation. Actuaries will of course be aware that approved pension schemes exist in a very favourable taxation environment - tax relief for employee and employer on the contribution input, tax free build up of funds retirement with pensions taxed as earned income. This tax free build up and tax charge on payment is reflected in one approach. (This reflects underlying principals of Scots Law, that is, a £10,000 (cash) money purchase fund is worth £10,000-before consideration of tax deduction (if any) on payment.) Other actuaries take the view that the pension asset should be considered on the basis of what personal saving would be required for replacement. Valuating a £10,000 contribution via net roll up at say £11,000 may lead to ridicule.

The judiciary have commented on the appropriateness of the "share of funds" implicit in the "gross"approach.
However a definitive Court of Session consideration of this difference is still awaited. A December 1989 case involving actuaries on both sides (with differing taxation approaches) was unfortunately settled out of court (after 6 days!).

**Life Assurance - Valuation Approach**

The valuation of life assurance arrangements (by legal practitioners) almost universally rely on the life office surrender value quotation. The discounted value of projected maturity values (with or without terminal bonus) has however been considered on occasions by (instructed) actuaries. However the availability of surrender values (free and independently calculated) generally means the only additional consideration is the possible auction of the policies. The availability of borrowing on the basis of the surrender value is also an important factor.

**Considerations**

For convenience the various actuarial considerations are outlined below and briefly discussed. Actuaries will undoubtedly be able to add to the list.

**Earnings** - not all earnings will necessarily be pensionable. Fixed deductions e.g. basic state pension may apply in determining the ultimate benefit. Establishing pensionable earnings with (lay) individuals may be difficult.

It is widely recognised that earnings generally outpace prices etc. Utilisation of an additional salary scale may be difficult to justify as it could be argued as an event after the Relevant Date.

**Retirement Age** - many schemes provide benefits at a range of retirement ages or after a set period of service. Benefits at the earliest time will (generally) be the more valuable whilst a (valuation) assumption of uplift at the latest time may arguably depress the emerging value for divorce purposes. A definitive statement of this valuation assumption will be appropriate. For example in the Police Scheme a 2/3rds index-linked pension may be available at age 50, but with leaving services benefits being payable at 60 significant differences in value can emerge.

**Mortality** - may be considered in two stages, pre and post retirement. Before retirement any mortality allowance must be considered along with the scheme death benefits. In many cases a lump sum payment and spouse’s/dependent’s pension benefit will apply reducing the significance of the underlying assumption. Often aggrieved pension scheme members will say that they (personally) will get nothing if they die tomorrow. That is of course true but they similarly personally receive no benefit from their £100,000 house, but it’s still valued at £100,000.

Post retirement mortality is usually applied from standard tables. It would take special circumstances (and probably medical evidence) for anything else to be accepted. Few schemes are large enough for meaningful scheme mortality experience to be applied although theoretically there is no reason why such statistics should not be used.
Real returns - assumptions regarding investment returns, earnings inflation and price increases generally follow familiar pension fund valuation rates. Adjustments to reflect market conditions at the Relevant Date are also made (as appropriate given the valuation approach and method).

Taxation - as mentioned above the approach of consulting actuaries differs on this subject. Irrespective of the approach it is appropriate to ensure the court and the legal practitioners are fully aware of the assumptions and also the effect of those assumptions. The potential problem involved with unapproved schemes should not be underestimated!

Withdrawal - as previously mentioned withdrawal assumptions may crucially affect the valuation figure. Incorporation of the underlying average scheme decrement is one (theoretically sound) way to make allowance for withdrawal. Courts and legal practitioners are increasingly aware of the two approaches - leaving service transfer value and continuing service reserve. Getting to an appropriate figure in between and justifying it is the actuarial practitioner’s problem.

Pension Increases - with many schemes still leaving pension increases to the trustees discretion difficulties may arise in valuing prospective but unguaranteed benefits. Leaving service transfer values may or may not make full allowance for such increases. The Social Security Act 1990 of course adds a new dimension to this problem. Is the certainty of pension increases heightened by a scheme in surplus?

Early retirement - schemes may provide early retirement benefits from, for example, age 50 with the employer’s consent. Allowance for such benefits on an individual basis is very difficult to explain in practice (although theoretically similar to a mortality decrement). Again a clear statement of any assumptions would seem appropriate. Given availability of early retirement at age 50 much greater significance is place on benefits of individuals of 50 or over due to the potential immediacy of benefits.

Ill Health - as with early retirement this is a difficult assumption for non actuaries to accept on an individual basis. Without medical evidence it is generally ignored as benefits at least equal to past service reserve are payable making the exact assumption/rate less "geared" than applicable to decrements in a tontine!

Pension mortgages - although pension benefits cannot be assigned numerous pension mortgages are taken out each year. Individual policies are more popular than scheme entitlements, although this probably has more to so with commercial realities than anything else. The prospective tax free lump sum gives "ability to pay" and lenders are generally happy with interest only payments pre-retirement, life cover and physical security. The use of, indeed existence of, pension mortgages is seen by legal practitioners as tangible evidence of the pension value and frequently arguments of "liquidity" centre on it. Interest payments may however be equated with what one party may be able to afford from income by way of capital settlement by instalments. Physical security is crucial and imposing unmanageable debt on one party is not something courts do!
Spouse's benefit - legal practitioners say divorce is a very stressful and traumatic time. Giving half your pension to your spouse is generally viewed unfavourably (understatement of the year). Allowance for the scheme benefit of a (new?) spouse's benefit and or dependents' pension is therefore an equally delicate subject. Actuarial practitioners generally take solace in the general proportions married. It is however quite valid but usually futile to debate the chances of remarriage at various ages given various periods of marriage, given current "habitation" and background details (previous education, age of children, social life history, etc). Ultimately some assumption is necessary which the actuarial practitioner is willing to justify as reasonable. Certainly the value of the spouse's benefit should be included in the calculation as it must come within the definition of "the interests of either party".

AVC's - free standing or main pension scheme AVC's may add a new tranche of benefit to a valuation. Money purchase or added year benefits may apply. A devious mind may wonder whether a salary scale or withdrawal assumption should be varied where added years have been consciously accepted or rejected!

Case Law

The majority of cases now concentrate on continuing service (rather than leaving service) values. Very limited case law is available on the subject however Muir [8], Little [11] and Carpenter [12] indicate 37.5% - 50% as the "going rate" (the share given to the spouse). Few cases have involved actuaries on both sides but at least some progress has been made since 1986, [7], where the Sheriff personally completed the valuation of the pension rights when neither side submitted actuarial evidence (good idea for one side, only!). More recently a Sheriff stated he was not an actuary and threw out a case where an actuarial valuation was not submitted [20]. Generally the actuary will rarely be aware of all the circumstances of a case and the full details should be considered with expert legal advice.

In all cases matrimonial property values must be compared with the individuals "ability to pay". The courts will not force one party into (unserviceable) debt because for example a significant pension asset exists. Immediate settlement from house (or other matrimonial property) proceeds is generally the first preference. A capital settlement by instalment is often the next best thing followed by deferred payment from retirement (or death) benefits. The latter alternative risks falling foul of the "clean break" principle underlying the legislation.

Developments in England and Wales, additional case law and comments of the actuarial profession will be welcomed by all practitioners.
Bibliography

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20. George -v- George Scots Law Times (Sh Ct) 4 : Feb 1991
4. Pension Splitting

The ACA Sub Committee (Damages, Reversions & Divorce) (draft) response to the Family Law Committee Paper (May 1991) outlines a potential method of pensions splitting.

Credit for this draft must go to Chris Long, who provided the original idea and drafted the following:-

**PENSION RIGHTS ON DIVORCE**

This paper is to comment on the suggestions on pensions made by the Family Law Committee of the Law Society, in their consultative document "Maintenance and Capital Provision on Divorce".

1. Introduction

The Association by Consulting Actuaries welcomes the contribution made by the Family Law Committee to the debate on divorce, and broadly endorses their recommendations. In particular-

(i) We agree that the courts should be given power to make pension adjustment orders, which we define as any statutory or voluntary amendment or redirection of an entitlement to occupational pension. As we will show below, we believe that such orders can be made to work very well, given the appropriate primary legislation.

(ii) We agree that the courts should be provided with powers to split pensions similar to those available in Scotland, together with the further power to allow payments into a personal pension scheme. However, we would go further, and argue that there is also a strong need for the courts to be able to order part of the husband's accrued pension rights to be surrendered in favour of a pension in the same scheme to the wife. This is an important requirement, without which major difficulties will still remain, and it should become the normal procedure in divorce cases.

(iii) We agree that guidance should be issued on the valuation and splitting of pensions, when the general direction of new legislation is clear. We propose that this guidance should be prepared by the Institute and Faculty of Actuaries, working in conjunction with the Law Society. At a later date, it could lead to mandatory guidance being laid down for actuaries to follow when they are involved in such calculations.
The remainder of this paper concentrates on supporting details for the suggestions made in (ii) and (iii) above, in order to show how they would work.

The discussion is couched for clarity in terms of a husband with pension rights, whose wife is to be provided with rights on the divorce. However the recommendations apply equally to the reverse situation.

2. **The Clean Break**

   The principle of making a clean break at the time of divorce is implicit in the recommendations by the Family Law Committee, and we support this. Compared with the alternative of leaving pension benefits to be sorted out on subsequent retirement or death, it allows much more certainty for both sides to the divorce (as well as to the pension scheme), and allows them to plan their future. The concentration on the position at the time of separation/divorce would allow similar arrangements to be extended to non-married partners if so desired.

   We believe that a claim by an ex-wife at retirement (suggested by some) may prove impracticable. The pension fund would have difficulty in planning later changes without knowing what claims would arise, and the husband would have difficulty planning his retirement without knowing what the size of his pension would be. Very detailed restrictions on the pension scheme would be necessary, to stop the husband frustrating the claim by moving jobs, opting out of the scheme, emigrating, etc.

   Primary legislation would be required to support our proposals. In particular, courts would need the power to order pension schemes and life assurance companies to split pensions, as described below.

3. **Pension Splitting**

   The Scottish system, though a good concept, has a significant drawback that it relies on other assets being available to finance the splitting of pensions. It seems to be common for the husband to keep the pension while the wife is granted the house, unless there are other substantial assets. It would be preferable if the pension accumulated to date can be split between the two parties in a way which does not require any large lump sum payments to change hands, and which leaves the capital available to both partners.

   This can be achieved by valuing any pension rights accumulated during the period of the marriage, by both partners, and attributing to each one a half of the other’s accumulated rights. If there has been a previous divorce, the benefits valued for that party would be the benefits accrued since the previous settlement.

   If they both have pension entitlements, the two values would be netted off against each other, and the residual value taken from the entitlement of whoever has the higher value (for example, the husband).
This share of the husband’s value would be used to secure to the wife an amount of pension within the Pension Scheme from which the share is being taken. The Scheme would be given legislative authority to reduce the husband’s pension accordingly. This process would remove the necessity for any cash payments to be made, and would result in two smaller pensions becoming payable (e.g. half each) to the parties, where there was one larger pension in existence previously. Of course, the future accumulation of further pension rights in that Scheme would proceed in favour of the husband, quite unaffected by the division of past accrued benefits.

This division of pension assets should be clearly laid down as the normal method to be applied by the courts, with discretion to use other routes only in difficult cases (e.g. overseas pension schemes). There is a natural desire in most people for a reasonable share of any liquid capital available, to alleviate immediate needs, rather than just an unrealizable expectation of a large pension at retirement.

If the divorce takes place after the pension has commenced, exactly similar procedure could be used to split the pension in payment.

4. Valuation of Accumulated Rights

The normal procedure should be for the Actuary to the Pension Scheme concerned to carry out the splitting calculations on the basis he judges to be appropriate. However, the methods and assumptions used to calculate the new pension to be secured, should be exactly the same as those used (in reverse) to value the original pension given up. This would ensure that, given exactly the same personal details and conditions, the amount of new pension would be exactly equal to the amount of old pension given up; so, in practice, any difference would be solely due to differences in age, etc. This is important to all sides, because it would mean that the precise assumptions used would have relatively little effect on the calculation of the ultimate pension, thus minimising one source of grievance and dispute.

Actuarial guidance may be given on the type of assumptions appropriate to such calculations. In particular, on the use of unisex mortality and other tables, which could have some bearing on the resulting calculations. It may be appropriate for the assumptions to be the same as those used for transfer value calculations.

It would be logical to value the whole of the benefits accrued to date, including in particular the husband’s pension and lump sum retirement benefit, prospective widows’ pensions on death in service and death after retirement (as if remaining married), and any expectation of discretionary benefits such as pension increases. Allowance would not be limited to widow’s pensions and other death benefits which would have become payable directly to the wife if she had remained married; this follows from the “clean break” principle.
It remains to be decided whether the valuation of accrued benefits should be based on the husband's projected salary at retirement (where benefits are based on final salary), or on the latest salary available at the date of calculation, as if the husband had left service at that date. The latter would have the advantage of greater certainty (because benefits based on an unknown future salary are more difficult to predict) and would not need any further adjustment to allow for the possibility of the husband leaving service at a later date. The former on the other hand would make a fuller allowance for the possibly greater benefits which would ultimately become payable, provided that realistic allowance is made for the probability of surviving to retirement age. The practicality of using projected salary at retirement is one of the elements on which further guidance could be issued. There seems to be no case at all for basing salary on an earlier figure such as that at the time of separation, if the husband is still in service at the time of the hearing.

Another area for decision is whether the wife's replacement pension should come into payment to her at the husband's retirement date, or (suitably adjusted by the actuary) at a retirement date of her own choosing. This has something on which the court might rule at the hearing, based on further guidance to be prepared.

5. Other Requirements

Once a new frozen benefit is set up, it should be governed by existing pensions legislation in the same way as other frozen pensions. In particular, the wife would have the usual statutory right to ask for a transfer value payment to be made to a personal pension scheme or to another pension scheme which she may join.

The Regulations governing disclosure of information to pension scheme members, should be extended to include the assumptions used by the scheme actuary for pension splitting.

Inland Revenue controls on the size of pension benefits permitted should be lifted for the purpose of the new benefits. Schemes should be permitted to set up the form of the benefits in such ways as are normally permitted, including allowing 25% of the benefit to be commuted for cash at retirement; 100% commutation of trivial pensions or an ill-health retirement; early retirement permissible after age 50; and discretionary pension increases up to the level of RPI increases.

6. Unfunded Pension Schemes

Where there is no pension fund set up, the husband's security for his promised pension would have been the ability of the employer to pay his pension. It seems appropriate that the same security should be available to the wife for her replacement pension, and so the same procedure as above should be followed. This would result in the wife having a claim on the employer, in the same way as employees leaving service would have a claim on the employer for a frozen pension at retirement age.
7. **Contracted Out Pension Schemes**

A pension scheme which is contracted out of the State pension arrangements has as part of its benefit a guaranteed minimum pension (GMP), which is controlled by Social Security legislation. Special consideration would need to be given to this in any new legislation, to consider whether for the GMP entitlement should be split between the two parties in the same way as the remaining pension.

However, it may be argued that the GMP merely corresponds to a State Pension which would be payable if not contracted out (and which is not affected by these proposals). On this basis, perhaps the GMP should remain the property of the husband, and the allocation to the wife should be limited to a maximum of the pension in excess of GMP.

8. **Example**

Mr X is entitled to a pension which, at age 62, will be half of his final salary, together with a widow’s pension of half that on death after retirement. All pensions in his Scheme increase at 5% p.a. when in payment. He is currently aged 42 and his salary is £20,000 p.a. Mrs X is aged 39.

Mr X’s accrued pension is based on his completed pensionable service of 10 years, and (including statutory revaluation) amounts to £8,844 p.a. payable at age 62. However, he has only been married for 8 years, to which £7,075 of this pension is attributable; and so the pension to be given up for his wife’s benefit is half this figure, or £3,538 p.a.

When the value of a frozen pension of £3,538 p.a. is applied to benefits for Mrs X, the result is to secure a pension from her age 60 of £3,442 p.a. with 5% p.a. increases.

This calculation was based on an interest rate of 10% p.a. If interest rates had changed and 9% interest had been appropriate instead, the amount of pension secured is £3,439 p.a., almost identical to the £3,442 p.a. above.

9. **Economic Effects**

There are about 150,000 divorces each year in England and Wales. It is difficult to know whether the pensions of such people are representative of those in the population as a whole, but a reasonable guess might be that their combined pensions have a value of some hundreds of millions of pounds.
If half of these sums are transferred into personal pension policies, it would clearly have some effect on the cash flows of pension funds and on those insurance companies which benefit. However, these figures should be seen in the context of total pension funds thought to be some £300 billions; and of gross transfer payments already made in 1987 (Government Actuary's Survey of Occupational Pension Schemes) amounting to £2.4 billions pa. The effect of any additional transfers on Stock Exchange investment values is unlikely to be great, since most of the money would in any case be reinvested by the receiving fund.

10. **Guidance to be Issued**

We have touched on a number of areas where further guidance would need to be issued, and summarise these and other points below:

(a) What pension scheme benefits should be valued for splitting purposes?

(b) Should the valuation of the accrued benefits be based on projected salary at retirement or on frozen benefits at the time of the hearing?

(c) What considerations should determine the assumptions to be used in the valuation; and in particular, should unisex mortality and other tables be adopted?

(d) What considerations should govern the date at which the new pension should come into payment?

(e) The form of the actuarial certificate to be issued by the actuary who splits the benefits.

We suggest that co-operation between the actuarial and legal professions would be desirable to settle these points, once the outline of any proposed legislation is known.

The Association of Consulting Actuaries
February 1992
5. Actuarial Action

Readers, practitioners and in particular participants are invited to comment on the following (deliberately, provocative) points:-

a) Should publicity be given to the calculation basis (and anomalies) of transfer values?

b) Should the actuarial profession not be "getting its act together" by pro-actively lobbying the legislators on the problems of potential legislation and in particular the basis of valuation.

c) Should the profession not prepare standard actuarial tables for the valuation of pension benefits?

d) Should the Inland Revenue allow the payment of spouse's capital settlements in lieu of pension entitlements to be invested in personal pensions?

e) Should be rules on assignation of benefits be waived for the purposes of divorce settlement?

f) Is a system of pension splitting feasible?

g) Should life office actuaries be allowed to "dabble" in occasional consultancy work by involving themselves in this type of work?

A.C. Martin
February 1992

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