Mathieson Consulting Ltd
actuarial and expert witness services

Pensions & Divorce

Is it just Common Sense?

George Mathieson

May 2017

Agenda

- Why we cannot use CEVs in any case involving Defined Benefit pensions
- Offsetting and Cash Equivalent Values
- Discounts

Pensions

Defined Benefit ***(Final Salary)***	**Defined Contribution** ***(Money Purchase)***
Large company schemes (Mainly closed to new entrants)	Personal pensions, RACs, S 32 ("*Usually*" straightforward)
Public sector schemes	Majority of company schemes (Can be straightforward)
Career Average Earnings Schemes (CARE)	Self Invested Personal Pensions (SIPP) (On alert)
	Small Self Administered Schemes (SSAS) (Potential nightmare)

CEVs – Offsetting DB v DC

- **How is the CEV calculated?**

- **DC – simply number of units x unit price (usually). Like any Unit trust, or ISA, or share valuation. No reference to likely pension**

- **DB – Actuary considers promised benefits, and calculates how much is needed to pay out benefits.**

CEVs – Offsetting DB v DC

- **The fundamentally different way the CEV is calculated for a DB scheme and for a DC scheme renders any comparison of the CEV of a Defined Contribution scheme with the CEV of a Defined Benefit scheme, at face value, utterly pointless.**

- ***Not Apples and Pears (they are similar) , but Apples and Jumbo Jets***

CEVs – Offsetting DB v DC

- **W** aged 60 (just before retirement) has Public Sector pension CEV **£300,000**
- **H** aged 60 (just before retirement) has Scottish Widows pension CEV **£300,000**
- Already have Equality of CEVs, therefore should there be no offsetting on basis we already have equality of pensions?

CEVs – Offsetting DB v DC

- **W** will receive pension of **£12,800** pa, plus a lump sum of **£38,400**, plus a widowers pension of **£6,400**
- **H** may be able to secure index linked pension of **£7,800** pa with no lump sum, or pension of **£6,809** pa with a lump sum of **£38,400**
- Is a pension a capital asset to be judged on CEV (in which case no difference) or is it a future income stream (in which case substantial difference)?

CEVs – Offsetting DB v DB

- **H** aged 59, member of defined benefit scheme, CEV **£750,000**
- **W** aged 59, member of different defined benefit scheme, CEV, **£500,000**
- Both parties wish to retain their pensions.
- Therefore offsetting is chosen remedy, with **W** to receive **£250,000** more of non pension assets

CEVs – Offsetting DB v DB

- Closer examination of schemes reveal:
  - Both H and W will receive a pension of c. **£20,000** pa from age 65.
  - Therefore, pensions are almost identical – just that the CEVs have been calculated differently by two different schemes.

CEVs – Change of actuarial basis

	January 2016	January 2017
Preserved Lloyds Bank Pension	£35,000 pa	£35,420 pa
Increase in Pension	1.2%	
CEV	£796,657	£1,162,453
Increase in CEV	45.6%	

CEVs – Change of Actuarial Basis

- Has H's Pension increased 45.9%? **No – just the actuarial value placed on it.**

- **But if we used CEVs as basis of Offsetting:**
  - **If case settled in 2016, W receives £796,657**
  - **If case settled in 2017, W receives £1,162,453**

Offsetting – Consistent Approach required

- **But not only to the Answers, but also the Questions:**
  - **What is the value of H's pension for offsetting purposes?**
  - **If the case were settled by means of offsetting, how much non-pension capital would W need?**

Offsetting – Consistent Approach required

- But not only to the Answers, but also the Questions (cont):
    - What is the open market value of H's pension for offsetting purposes?
    - What is the true value of H's pension?
    - If there were to be no pension sharing orders, how much non-pension capital would W require to give her the same income in retirement as H by reference to Duxbury / Ogden etc?

Offsetting – Consistent Approach required

- H aged 50 and W aged 45

- H preserved pension of £35,000 in Lloyds DB scheme, payable at age 60

Offsetting – Consistent Approach required

	H	W
Preserved Pension for H of £35,000 pa at age 60		
Open market value using annuities	£1,182,452	£1,086,704
Open market value using drawdown	£985,376	£905,586
Duxbury	£498,400	£468,826
Ogden Tables	£438,200	£415,800
CEV 2016	£796,657	
CEV 2017	£1,162,453	

CEVs – Guaranteed Pensions

Mrs H	CEV	Mr H	CEV
Aviva Section 32	£18,818	Scottish Life PP	£18,731
		Axa PP	£33,502
Total	**£18,818**		**£52,233**

On face of **H** has greater pensions than **W**, for either offsetting or pension sharing.

But **W**'s Aviva pension contains obligation on scheme to pay a Guaranteed Minimum Pension (GMP) of **£4,444** pa at age 60

True comparable value of this pension is **£85,053** not **£18,818**

What about discounts?

- **Tax**

  From W's Perspective

  - W receives non pension funds by way of offset may be able to re-invest capital into a pension fund and increase its value as it is "grossed-up"

  From H's Perspective

  - Even if W does not invest offset capital in pension fund, H's income will all be taxed. W' income from a non-pension portfolio may be structured so less tax is paid.

What about discounts?

- Needs / Utility:
  - If offsetting is to equalise incomes, but at such a level that income is superfluous to needs, should discount apply to all offset value or just surplus?
  - **H** retired in receipt of pension of **£75,000** pa.
  - Case being settled by **Offset**.
  - **W** aged 65, offset value (to give **W** same income) **£2.3m**
  - But **W**'s needs only **£50,000** pa
  - Should discount apply globally or just to **£760,000**, which represents that amount to give income of **£25,000** pa.

What about discounts?

- Needs / Utility:
  - H has pensions valued at £150,000 for offsetting purposes
  - W retaining equity in FMH which meets basic housing need
  - Both have unrealisable assets, with no access to capital.
  - Any discount?
  - Will expert be aware of what is on offer?

What about discounts?

Tax and Utility – Mutually exclusive?

- If Offset capital discounted for tax (W assumed to recycle offset capital into pension), argument for discount for utility disappears as utility is lost.

What about discounts?

I hold a very firm view that a formulaic approach to quantifying discounts is not possible, because it ignores the individual circumstances of each case. For the same reason I very firmly believe that any discount, if there is to be one, should be quantified by the lawyers and their clients, and ultimately the courts, and not be within the purview of the pensions expert who simply is not in possession of all of the facts of a case to adjudicate. Any pensions expert who thinks he can quantify an appropriate level of discount when offsetting, or any lawyer who thinks there should be a simple formulaic process, misunderstands the rationale of discounts.

And finally…

Mathieson Consulting Limited
Seymour House, 15A Frederick Road,
Edgbaston, Birmingham, B15 1JD

T 0121 455 7222
F 0121 455 0099

E george@mcact.co.uk
W mcact.co.uk