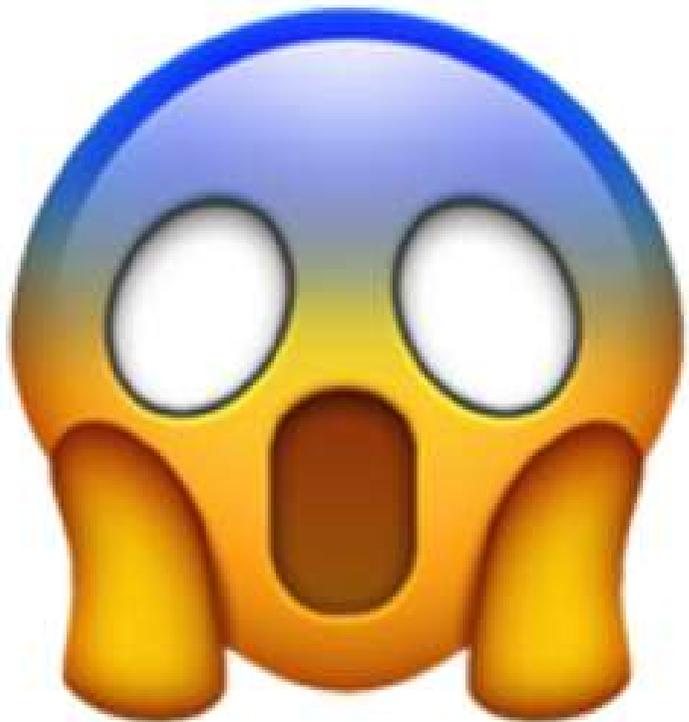




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PENSIONS ON DIVORCE

WHITE PAPER
MARCH 2024

Pension Advisory Group 2

What are the implications of the PAG2 report on pension sharing on divorce?

How do you get it right for clients and protect yourself from claims made against you?

<https://www.nuffieldfoundation.org/wp-content/uploads/2023/A-guide-to-the-treatment-of-pensions-on-divorce-2nd-edition.pdf>

UNDERSTAND THE BENEFITS

..and remember to draft bespoke disclaimers

1. Capital or Income
2. Needs or sharing? (Apportionment)
3. Offsetting
4. Age difference and income/deferral gap
5. Letter of instruction (identifying the issues)
6. McCloud
7. Disclaimers

UNDERSTAND THE BENEFITS

Private Final Salary Pension

CETV - £600,000

DC Personal Pension

CETV - £600,000

Public Final Salary Pension

CETV - £600,000

GAR Pension

CETV - £600,000

Assumptions: (including growth in DC funds)

Individual is aged 50 and pensions to be taken at 60

All pension incomes CPI linked once in payment

Annuity rate of 4.44% from age 60 for DC schemes

GARs assumed to give uplift of c. 55% from standard annuity rates

Private Sector Defined Benefits Pension

Income at age 60: £38,800 per annum with no lump sum or

Lump sum of £188,800 and reduced income of £28,300

Defined Contribution Personal Pension

Income at age 60: £33,000 with no lump sum or

Lump sum of £185,700 and reduced income of £24,700

Public Sector Defined Benefit Pension

Income : £30,000 with no lump sum or

Lump sum of £79,600 and 'reduced' income of £26,500

This is an NHS pension and to compare to others the Actuary has assumed that the lump sum which comes on top has been used to buy an annuity to top up the income

Guaranteed Annuity Rate Pension

Income: £50,900 with no lump sum or

Lump sum of £185,700 and reduced income of £38,200

Capital vs. Income

“There is, however, one area of controversy. I have read with great interest the discussion....about the tension between equality of division and equality of outcome when making a sharing order. For my part I am firmly in the former camp as the latter exercise must surely bring into account the inestimable benefit of being actually alive when the other party is dead! In my book, it is an equal outcome for the husband to receive £20,000 annually for 10 years and for his younger wife to receive £10,000 for 20 years. But I acknowledge that my view is not shared by all, and we may have to await a decision from a higher Court to resolve the issue. Both sides of the divide are very fairly put by the authors in this edition”.

Mostyn J in the preamble to Pensions on Divorce 2013



UNDERSTAND THE BENEFITS

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PAG 2 Consideration

Paragraph 6.12 - 6.29 at pp 35-38

Key points:-

- Majority of cases are needs, where objective is to divide pension assets in order to ensure income needs in retirement are met
- CEVs can be very misleading in that very different incomes will result from identical CEVs if the underlying nature of the pensions differ, BUT
- There can be (rare) cases where the parties are of such similar age, and there is only 1 pension to be divided, or the pensions are all DC with no GAR, but simple capital division works.

BUT:

- TWO MORE HIGH COURT JUDGES WHO BOTH PREFER CAPITAL DIVISION

SJ v RA [2014] EWHC 4054 (Fam) - Nicholas Francis QC sitting as a Deputy High Court Judge (now Francis J and Co-Chair of PAG2)

CMX v EJX (French Marriage Contract) [2022] EWFC 136 - Moor J.

SJ v RA [2014] EWHC 4054 (Fam)

“Why should someone receive more just on the basis of gender? There may have been an explanation when rules required the purchase of an annuity. However, to give the wife more than the husband, on account of either age or gender would seem to me to be unacceptable discrimination unless it is a case which is governed solely by needs. If a person should receive more of a pension fund under the modern rules simply because she (or he in the case of a marriage where the husband is much younger) is likely to live longer, then such an approach would logically extend to all capital assets. Moreover, European Union Judgments and rules are rapidly outlawing discrimination on account of gender. In cases where distribution is being made on a basis which is not by need it is, in my judgment, incorrect to distribute the pension fund on the basis of equality of income”

CMX v EJX (French Marriage Contract) [2022] EWFC 136 - Moor J

“I could not agree more. If assets are to be divided equally, they should be divided equally. In general, there is no justification for awarding more to one party because they are younger or have a longer life expectancy.”

(Quoting Nicholas Francis QC from SJ v RA)

What does Equality of Pension Capital mean [2023] 2 FRJ 128

Analysis by George Mathieson of Moor J's suggested Duxbury paradox:

Contrary to the blanket suggestion made by Moor J, younger wives do not necessarily get more when using the equality of income method. This is because a woman, for example, in her 40s, will have pension assets **invested in the market for a longer period of time**. The investment growth accumulated by the younger wife will actually result in her receiving an actuarially reduced amount, if each party is to have equalised incomes from, for example, 60.

Valuing pensions on Divorce CMX vEJX

Paul Cobley FRJ Dec 2022

<https://financialremediesjournal.com/content/valuing-pensions-on-divorce-cmx-v-ejx.a17d55f14b974e97bd16383d46ffa9b2.htm>

- Example of why a PSO of >50% may be required to achieve equality, even if no age difference
- H is member of a private sector DB scheme which doesn't allow internal transfer.
- W has to use her pension credit to buy annuity on money market, with (much) lower return.

THE MOST IMPORTANT (ONLY?) POINT IS
TO

UNDERSTAND THE BENEFITS

BEFORE DECIDING WHETHER TO RELY ON A CEV

BUT

Always remember that any PSO will be based upon the stated CEV, and not any higher bespoke value which has been calculated by the PODE by reference to the actual benefits that will be produced from any given pension fund.

Finally (to recap) on capital v income.....

- There is no one size fits all
- The majority of cases are based upon needs, such that it is essential to calculate the likely future income benefits from a PSO in order to ensure whether those future income needs can be met.
- Simply equalising the capital value of the funds may very well, in a “needs” case, be completely insufficient.

NEEDS OR SHARING (Apportionment)

- No real difference between pension assets and capital assets when considering what is “matrimonial” in nature.
- There is no “one size fits all”
- Neither PAG nor PAG2 have asserted either that all cases of pension sharing must be on the basis of equality of income in retirement or that all pensions which have accrued by the date of the settlement/Final Order will be brought into account.
- But

PAG 2 PART 4 pp 24-26

- Historic dilemma of “*all in*” or “*apportioned*” (and if apportioning, must it be on a ‘straight line’ basis?)
- If apportionment is justified, then the date for commencement of apportionment will (almost without exception) be the date of commencement of seamless co-habitation, and not the date of marriage. (GW v RW [2003] EWHC 611 (Fam) and Co v Co (Ancillary Relief - Pre-Marriage Co-Habitation) [2004] 1FLR 1095)
- Post separation accrual - there remains room for debate and some conflict in the Authorities.
- Key case W v H [2020] EWFC B10 (HHJ Hess)

METHODOLOGIES OF APPORTIONMENT

- Identify the benefits that had accrued pre-marriage
- CEV at date of marriage
- Straight line (chronological)

(See Joe Rainer “Non-Matrimonial Pensions: The Forgotten Discussion” January 2020) Fam Law

SUMMARY OF CONCLUSIONS THUS FAR

- No one size fits all
- In much larger money cases, where needs are very comfortably already met by reference to other assets, capital division may be perfectly fair.
- In the much more common “needs-based” cases, equality of future income benefits is likely to be fairer
- Apportionment (pre-co-habitation and *possibly* post-separation) is little more than identifying the “non-matrimonial” element, but
- It is very often necessary to invade the non-matrimonial element in order to ensure that needs are met.

BUT THERE IS NO ONE SIZE FITS ALL

OFFSETTING

- The dominant practice: PAG 2 Part 7 pp 40-51

- *“You need the house, love. Let him keep his pension”*.
Grant Lazarus Family Law 2019 April, page 373-379

- Offsetting is the process by which the right to receive a present or future pension benefit is traded for present capital or “money now”
- The difficulty of comparing very different types of asset
- Essential to understand the benefits - CEV can be very misleading
- Various methodologies of applying investment assumptions to discount the flow of future benefits back to a present lump sum
- For example: should we calculate the capital benefit of pension income lost by the donor, or pension benefits that would have been gained by the pension donee?

- Discount for future tax
- Reduction (if any) for “utility” to reflect the usefulness of “cash now” rather than “income for life”
- Don’t forget the possibility of partial offsetting, where there are insufficient capital assets fully to offset a PSO
- Duxbury, Ogden and The Galbraith Tables (and their detractors)
- Annual updates to the Galbraith Tables
- The objective is fairness, in accordance with the views of the parties, and not an impossible search for mathematical exactitude

AGE DIFFERENTIAL (INCOME GAP)

PAG2 - Part 10 p 59-65

- No real change in PAG2 from 1st Edition, but a recurring question
- The issue arises when the pension donor already has benefits in payment or will access them at a significantly younger age than the pension recipient will be able to after receiving a PSO
- Obvious examples: Armed Forces, Police and Fire Service

- In fact, in all cases, it is necessary to clarify in advance of pension sharing the terms of shadow membership, as a pension recipient may well not have access to pension benefits from the normal date of retirement for the pension donor
- The result is that the pension donor enjoys “equality” from an earlier date, whereas the pension recipient has to wait (sometimes very many years) for the pension “equality” to begin
- A flipside to the same issue is that in some cases, a PSO may result in an immediate drop in income for the pension holder with no corresponding increase in income for the pension recipient for many years

- 10 ways (and counting) of possible mitigation of the problem - see PAG2 pp 61-65 (only 6 in PAG 1)

The most common mechanisms:

- Capital compensation
- Altered percentage PSO
- Spousal Maintenance for the period until “equality begins”

LETTER OF INSTRUCTION

PAG2 - Appendix E p 105

IDENTIFY THE ISSUES

- Do you really want the PODE to address equality of capital as well as income?
- Do you really want the PODE to address apportionment from the date of marriage as well as co-habitation?
- In fact, do you really want the PODE to address apportionment at all?
- Do you really want the PODE to address the offsetting calculation?

McCLOUD

- Historical move from “final salary” to “career average” public sector DB schemes in 2015, with loss of lump sum and deferral of commencement
- Lord Chancellor & Another v McCloud & Others and Secretary of State for the Home Department & Others v Sargeant & Others [2018] EWCA Civ 2844
- The Court of Appeal ruled that the younger members of the Judicial and Firefighters’ pension schemes had been unlawfully discriminated against because transitional protections had been introduced for older members but the protections did not apply to the younger members

McCLOUD

- There will be/have been changes to all public service pension schemes that provided transitional protection
- 1st October 2023 was the date from which the public sector McCloud remedy came (should have come) into force

Simple rules:

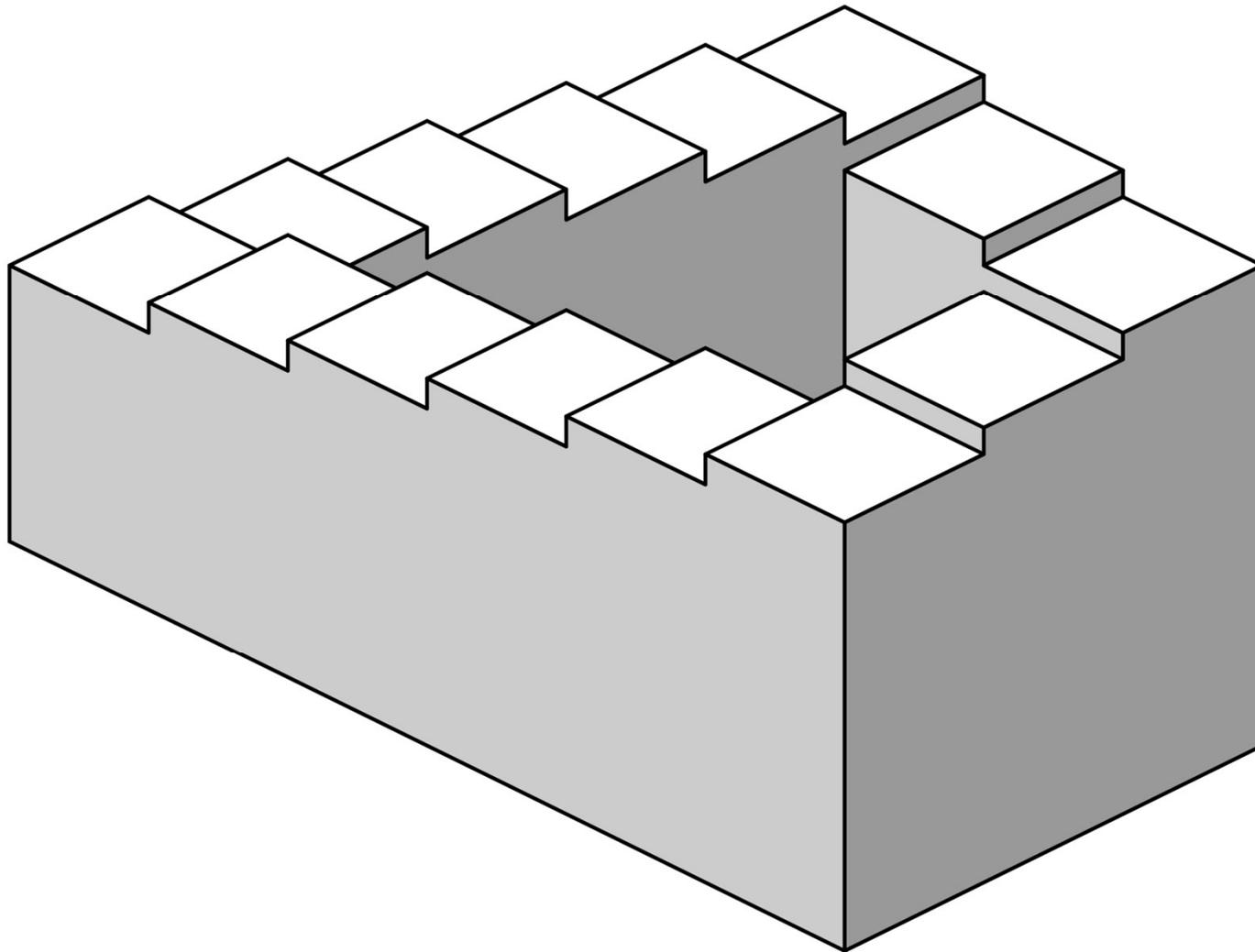
- Many PODEs have up to now recommended equalisation of future pension benefits in any public sector Defined Benefits scheme so that any advantage from remedy would be shared
- If the CEV is post 1st October 2023, the scheme *MAY* have effected the remedies, so the PSO should be accurately calculated
- If the CEV is post 1st October 2023, the scheme may *STILL* not have effected the remedies (ask the PODE), and you have the choice of continuing to guess (50% PSO) or put on hold

UNDERSTAND THE BENEFITS

DISCLAIMER

- What information do you have
- What information is missing
- What advice have you been able to give
- On which issues are you unable to advise
- Lewis v Cunningtons Solicitors [2023] EWHC 822 (KB)

Disclaimer ***in the light of all the above***







Grant Lazarus

Barrister and MCI Arb (and Grumpy Old Man still banging on about pensions.....)



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