

## PENSION SHARING

**What arguments can be made in relation to the valuation of CETV at the relevant date, including special circumstances and the proportion to be treated as matrimonial property?**

**What counts and what would move the court?**

As so often happens when a question is set some time in advance of the answer being presented, my first thought in preparing for today had to be “These are the wrong questions!”

I will come back to what I think the right question would have been but in looking at the present one there are 4 elements namely valuation, apportionment, special circumstances and what would move the court.

The valuation of pensions is an important one. It is perhaps growing increasingly important as pensions have generally become relatively more valuable in comparison with other assets in the pool of matrimonial property in many cases. In addition, they do not hold the same liquidity as other assets which when it comes to division can prove problematic

The first part of the question is directed at the valuation of the CETV.

The valuation of the CETV has not been subject to challenge since **Stewart v Stewart 2001 SLT (ShCt) 114. Regulation 3(1) of the Divorce Etc Pensions (Scotland) Regulations (Pensions in Scotland) 1996** states that the value of any benefits under Pension Schemes be calculated and verified, for the purposes of the **Family Law (Scotland) Act 1985** in accordance with **Regulation 3 Paragraph 2** which provides that the value of the rights or interest which a party has in an occupational pension scheme shall be the cash equivalent to which, if an active member, you would have acquired right if your pensionable service had terminated at the relevant date. In the case of **Stewart**, in the context of divorce proceedings, the wife pursuer sought a capital sum of £50,000 based on an actuarial valuation of her husband's interest in an occupational pension scheme with Strathclyde Fire Brigade. The husband sought exclusion from probation of his wife's averments pertaining to the scheme. The wife averred that the statutory assumption of leaving service at the relevant date would produce a cash equivalent transfer value of £57,422; that a fair actuarial valuation of her husband's interest would be £96,355; that an amended basis of valuation was therefore appropriate and that this was permitted by **Regulation 3(5)**, by which in making any calculation regard might be had to certain information. *Esto* the cash equivalent transfer value was considered to be the correct valuation, the difference between the valuations constituted special circumstances, justifying a departure from equal sharing in terms of Section 10(1) of the 1985 Act. It was held (1) that the method of calculation set out in **Regulation 3** was mandatory and had to conform to **Regulation 3(2)** as well as **Regulation 3(5)**, the value of the benefits being the CETV where the party

concerned was an active or deferred member of the scheme in question and whether or not that scheme was salary related; (2) that Parliament having left it to the Secretary of State to provide for the calculation of the value of benefits under a pension scheme could not be taken to have provided that any unfairness resulting from a calculation properly carried out in terms of the Regulation made could be considered as special circumstance and averments excluded from probation.

That decision, although not authoritative has remained unchallenged and accordingly on one view this talk could be a short one!

The issue of pensions has of course become more topical following upon the decision of an Extra Division of the Inner House in the case of **McDonald v McDonald [2015] CSIH 61**. That decision related to the question of apportionment rather than valuation and accordingly is directed at the second element of the question.

The result of the majority decision in that case is that “period of membership” for the purposes of **Regulation 4 of Divorce Etc Pensions (Scotland) Regulations 2000 (SSI 112/2000)** requires to be interpreted as “active membership”, that is the period during which contributions were being made into a pension arrangement. The minority view (per Lady Smith) was that the word “membership” was not subject to any such qualification and that it could apply to active, deferred or pensioner membership of a pension arrangement. The case is presently the subject of appeal to the Supreme Court which I understand is due to

be heard in May 2017. Pending the Supreme Court considering matters, the decision is binding. Accordingly at the moment there are no arguments for departing from the formula in the Regulations and that membership means the period during which contributions are made. Returning to the original question “valuation for CETV” was not discussed in **McDonald** except obiter where it was confirmed that valuation had to be done in accordance with Regulation 3 of the Divorce, Etc (Pensions) (Scotland) Regulations 2000 (SSI 112/2000), namely in accordance with the CETV.

**Regulation 3 of the 2000 Regulation** stipulates the method by which some seven different types of pension arrangements should be valued. Insofar as occupational pension schemes are concerned, there are different methods provided for depending on whether the “membership” is active, deferred or in payment. Separate methods are also prescribed for private pensions.

**Regulation 4**, as dealt with in McDonald applies to all types of pension arrangements and in particular to both occupational and private pensions. It provides that “the value of the proportion of any rights or interests which a party has or may have in any benefits under a pension arrangement [or in relevant state scheme rights] (1) as at the relevant date and which forms part of the matrimonial property is by virtue of Section 10(5) shall be calculated in accordance with the following formula:

A x B

C

Where **A** is the value of the rights or interest in any benefit under the pension arrangement which is calculated at the relevant date in accordance with paragraph 2 of Regulation 3; and

**B** is the period of **C** which falls within the period of the marriage of the parties before the relevant date and if there is no such period, the amount shall be zero; and

**C** is the period of the membership of that party in the pension arrangement before the relevant date

**Section 10(4)** of the **Family Law (Scotland) Act 1985** is of course well known to us as the section providing a definition of matrimonial property, being all property acquired during the marriage with the exception of the family home and furnishings and third party gifts and inheritances. It is however qualified by **Section 10(5)** which states:

“5 The proportion of any rights or interests of either party (a) under a life policy or similar arrangements; and (b) in any benefits under a pension arrangement which either party has or may have (including such benefits payable in respect of the death of either party) which is referable to the period to which sub-section (4)(b) above refers shall be taken to form part of the matrimonial property.

In **McDonald** the position was as follows:

- Mr McDonald was formerly employed as a miner and joined the British Coal Pension Scheme in 1978, aged 25
- The parties married in 1985

- Prior to the marriage Mr McDonald had received an injury out of the workplace and whilst he returned to work, was working at the time of the marriage, he was unable to return to his pre-accident duties.
- In August 1985 Mr McDonald opted to receive an ill health pension under the pension scheme. At that point he was 32 years old and had only completed 6 years and 243 days of pensionable service. From that point his contributions to the scheme stopped and he became in receipt of a pension
- Mr McDonald had been a member of the scheme from 1978, initially as an active member and after 1985 as a pensioner member.
- The parties separated in 2010
- On that date the CETV was £172,748.38
- If membership for the purposes of Regulation 4 meant all forms of membership the apportioned value for the matrimonial property purposes was £138,734. If however **B** was given the restrictive interpretation of active membership then the value would only be £10,002.

Before the Sheriff, Mr McDonald had contended that **Regulation 4** was ambiguous and “period of membership” in relation to **C** required to be read as “active membership” as defined in Regulation 2. If there were no such restriction, the whole of the value attributable to the 25 years of the marriage that had elapsed before the relevant date would have been included in the matrimonial property pool which would be unfair given that after the parties’ marriage Mr McDonald had contributed for only five months.

Mrs McDonald contended that membership in Regulation 4 covered all forms thereof, including pensioner membership and that that meant the whole period of the marriage before the relevant date had to be taken into account.

The Sheriff found in favour of Mr McDonald, having considered the possibility of **B** being zero could not arise unless one or more of the categories of membership were to be excluded and secondly restricting membership to the period during which Mr McDonald was an active member would be consistent with the general principles enshrined in the 1985 Act because it would confine the relevant value to that which related to the period of the marriage during which the activity generating value took place from which Mrs McDonald would already have benefitted.

Mrs McDonald appealed. The appeal was refused.

As noted above Lady Smith dissented.

The majority decision was the express context of **Regulation 4** was calculating the proportion of the value of a pension which was referable to the period of the marriage which took place in the light of **Section 10(4) of the 1985 Act** which for present purposes defined matrimonial property as that which was acquired during the marriage but before the relevant date, namely the date of separation. Once payments into a pension have ceased, and that member became a deferred or pensioner member, it was difficult to describe the pension as still being acquired and purposive construction avoided results which would go against the grain of the Act and the underlying legislative purpose. For the process to function, there had to be

a pension in existence at the relevant date. **C** had to be a positive number but **B** could be zero and it follows that there had to be a possibility of a period of a type of pension arrangement membership which fell outside the scope of the calculation otherwise **B** could never be zero, which excluded Mrs McDonald's approach driven by statutory context of the acquisition of the pension value and the assessment of the proportion it acquired before and after the date of marriage. The Sheriff applied the concept of active membership but excluding periods of deferred or pensioner membership, which was the correct approach.

Opinion was that any injustice or unfairness in the interpretation or application of the Regulations, regardless of which interpretation was preferred, could be corrected by invoking the provisions of **Section 10(6) of the 1985 Act**. In dissenting Lady Smith noted that the Regulations disclosed no express intention to restrict the application to only one form of pension membership. Had it been so, there would have been no purpose in setting out the directions for the methods of valuation to be employed when valuing seven other types of membership as Regulation 3 did and Regulation 3 and 4 were plainly intended to be read together.

On the alleged conundrum arising from the reference to the possibility of the period of membership being zero leading to a conclusion that the applicability of the Regulation was intended to be restricted. Even if it did raise a question mark, it did not do so in such a way as to destroy the clear evidence of the contrary intention to be found within the Regulation as read in the context of the relevant primary legislation and there was no necessary conundrum if account was taken of the fact that the Regulations required the pension interest to be valued as at the date of

separation but the possibility of zero membership allowed for 5(b) was during a period prior to that date, it could not confidently be concluded that (b) could never be zero. The Sheriff was wrong to think that without restriction, the outcome of the foregone conclusion which would necessarily be unfair where the court had at its disposal the means to achieve a fair outcome. Had the appeal been allowed, the case would have been remitted to Sheriff to consider of new on the basis that the parties' matrimonial property included pension interests owned by H, what orders ought to be made in relation to wife's craves for financial provision.

### **Special Circumstances – addressing unfairness**

The decision in **McDonald** is simply one of establishing the starting point. In other words, the figure to be used in relation to the valuation of matrimonial property.

There is of course scope in both **Section 9(1)(b) and Section 10(6) of the 1985 Act** to address inequity brought out by the valuation in **Regulation 3 and apportionment in Regulation 4**. In particular Section 10 (6)(b) which defines special circumstances as including “the source of the funds or assets used to acquire any of the matrimonial property [or partnership property] where those funds or assets were not derived from the income or efforts of the persons during the marriage or partnership.

One relatively recent example of that was the case of **B v B 2012 SAM LR 65**.

In that case the husband held pre-matrimonial pension plans. He reinvested those plans into a new pension arrangement during the course of the marriage. In terms of the Regulations the entire pension was matrimonial property. The husband presented actuarial calculations to show that only 11.8% of the value of the pension had been built up from contributions during the marriage. The wife conceded that special circumstances applied to the value of the pension but argued that a time apportionment should be applied to each component part of the pension which would have been consistent with the approach which would have been taken by the Pensions Regulations. It was held that while it was not appropriate to attempt to restore the whole value of a pre matrimonial asset to the husband, it was appropriate to allocate a sum to the husband which broadly represented those assets that remained outside the pool of the common wealth of the family and the contributions to his pension arrangements referable to the period before the marriage. The fairest method of taking account of the value of contributions to the husband's pension arrangement made before the marriage was held to be by reference to the actuarial calculation.

It seems to me that in the event that the wife in **McDonald** had been successful in her submissions that the husband could have countered with a strong special circumstances argument in relation to the nature of the contributions and indeed reference is made to that by both Lord Malcolm and Lady Smith. As in **B v B** however, I think that inevitably in any such argument being made, it is essential that actuarial input is sought.

Another scenario which may lend itself to special circumstances arguments in relation to pensions is where, for whatever reason, greater contributions have been made at a specific time during the course of a pension membership which would render the apportionment in terms of the Regulations inequitable. For example, very significant contributions could have been made prior to marriage in a money purchase pension with minimal contributions being made during marriage, perhaps because of a decision to take time out to have a family or to invest money in a different way. Where a party has been contributing to a money purchase policy it is common for the amounts being contributed to vary from time to time dependent on the individual's financial position. That type of issue was discussed by Lord Malcolm in **McDonald**. In that case he said "Nonetheless while no doubt there will be cases where fact sensitive judgements have to be made, and perhaps Section 10(6) adjustments apply to the eventual division of matrimonial property, if it is held in mind that the calculation should focus on the period during which value is being added to a pension arrangement, it ought to be possible to make an appropriate calculation. By way of example if a self employed person makes annual contributions, perhaps of varying amounts to a personal pension, and even if these payments are subject to occasional lapses because of cash flow or other financial problems, it can still be said that over this period the member is acquiring a value of a pension scheme. However, once there is a positive decision to stop payments or even more so once benefits have been taken, the relevant period for the purpose of the Regulation for calculation has ended. If a Regulation 4 calculation operated in this way gives rise to obvious unfairness, there remains the Section 10(6) safeguard.

Another situation which may arise is, in relation to occupational schemes, there may be greater contributions at the end of a career rather than the beginning once again leading to an unfair outcome if the Regulations alone are used.

A further scenario where it is perhaps the case that we require to be more careful is in looking at the terms of pension provision. For some with occupational pensions, although they have been with the same employer, the scheme had changed during the period of that employment. The most obvious situation is for those who have been on final salary schemes and have then changed to defined benefit schemes. In such situations it may have some impact to look at the apportionment on the basis of active membership in the specific schemes.

These are just a few examples, and picking up on Lord Malcolm's comments much will depend on the facts of the case and there will of course be many other situations where special circumstances can be argued.

There is however a limitation in relation to **section 10** arguments in that section 10 deals with the unequal sharing of **matrimonial property**. Accordingly, if as a result of the application of regulation 4 in relation to active membership then the ability to balance any inequity may be limited. There will however be circumstances in which a **section 9 (1) (b)** argument may be possible. One example may be where there has been a longstanding pension prior to the marriage where nominal monthly payments have been made prior to the marriage over perhaps a 20 year period. Shortly after the marriage the parties benefited from a lottery win which was invested in the pension. The apportionment in **regulation 4** would leave a small proportion of the

pension as matrimonial property and available for sharing between the parties and in that case I think that there would be an argument for economic disadvantage coming into play.

There will however be cases where I suspect that neither **section 9 (1) (b)** or **section 10** can address the inequity.

**So where does that leave us in relation to the original question as to what arguments you can make in respect of the valuation of the CETV?**

The answer is that you cannot challenge the valuation of the CETV as it would appear established that we require to deal with it in accordance with **Regulation 3**.

**... Apportionment?**

In addition, at present, pending the Supreme Court decision, you require to deal with the apportionment of the pension as the valuation attributable to the period of active membership (albeit that it may well be that depending on which side you represent, that you wish to delay negotiations a little longer to see what the outcome of the appeal is.)

**...Special Circumstances**

Special circumstances arguments seem to me to have a part to play albeit that there may be issues in relation to sharing relating to matrimonial property.

## **And what would persuade a court?**

We need to ensure

- We ask the right questions about the history of the client's pension provision when we first see them. Questions need to be asked in relation to both the contribution history and any changes in occupational schemes. If the only question asked is when a pension started without any regard being had for example to whether there was any initial contribution which originated out with the marriage, then the opportunity to make this type of argument could potentially be lost.
- Investigate the pension history fully. It is not uncommon for clients to have a hazy memory about pensions. The importance of the history needs to be emphasised to them.
- Where there is something to be said, to obtain appropriate actuarial evidence, without it there will I suspect not be sufficient evidence to persuade a court.

As to what the original question should have been

**Pensions, valuation, apportionment and special circumstances. What counts and what would move a court?**