

PENSIONS AND DIVORCE - THE CURRENT PITFALLS

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The number of divorces in the United Kingdom continues to increase as shown by the undernoted figures which have been extracted from *Social Trends 21, 22, 23 and 24*.

Year	Marriages	Divorces
1987	398,000	165,000
1988	394,000	166,000
1989	392,000	164,000
1990	375,000	168,000
1991	350,000	171,000

It will be noted that the marriage rate is tending to decline, whilst, at the same time, the divorce rate is increasing with the consequence that in 1991 the divorce rate was 1 for every 2 marriages that had occurred in earlier years.

It is acknowledged in the UK Divorce Court that the occupational pension is part of the joint assets of the divorcing couple and, in the circumstances, has to be taken into account in the financial settlement.

The existing practice of pension settlement is inequitable as the partner (with the pension) has to provide assets equivalent to the share of the pension out of free assets which are entirely separate from the pension scheme; this situation arises as the pension, under present pension law, is unalienable. Frequently there are insufficient free assets with the consequence that the spouse is deprived of pension as a source of income during retirement. This means that the spouse is more dependent upon State subsidies.

First, let's examine the legislation in England & Wales and Scotland; thereafter in this brief paper, we'll look at the proposals of the Independent Working Group that was appointed by the Pensions Management Institute.

Divorce in England and Wales

Divorce in England and Wales is governed by the Matrimonial Causes Act 1973 as amended by the Matrimonial and Family Proceedings Act 1984; the law in Northern Ireland is similar to that in England and Wales. As regards the financial settlement on divorce, Section 25(2) of the Act makes it clear that

"... the court shall in particular have regard to the following matters:

- (a) the income, earning capacity, property and other financial resources which each of the parties to the marriage has or is likely to have in the foreseeable future, including in the case of earning capacity any increase in that capacity which it would in the opinion of the court be reasonable to expect a party to the marriage to take steps to acquire.

.....

- (h) in the case of proceedings for divorce or nullity of marriage, the value to each of the parties to the marriage of any benefit (for example a pension) which by reason of the dissolution or annulment of the marriage that party will lose the chance of acquiring."

The Courts consider that pensions may be covered by sub-Section 25(2)(a) "income, earning capacity, property and other financial resources ... in the foreseeable future ...". One of the problems is that "the foreseeable future" is not defined by the Act; however, Courts tend to interpret this as a period of some 10 years. Thus, it is often the case that if the pension comes into payment more than 10 years in the future, the Courts will either give little consideration to or ignore it.

On the other hand Section 25(2)(h) of the Act requires the Courts to take into account the value of any benefit, including a pension, that one of the parties may lose the chance of acquiring - the focus is clearly on the spouse's pension. There is no reference to the date that the pension comes into payment.

Assuming the Court agrees that the pension should be taken into account there are several areas which require clarification. Is it all pensionable service or only pensionable service for the duration of the marriage? There is no guidance on the method of calculating the value to be placed on the pension - should it be the past service reserve, the cash equivalent of the deferred benefit or some other intermediate value? What about the spouse's pension - is it included or excluded?

Under present pension legislation, the pension is inalienable and consequently the Courts have no control over the pension scheme assets; hence the pension cannot be split. Thus, if on divorce, the Court awards the spouse a proportion of the value of the pension, it is necessary for assets of equivalent value to be allocated to that spouse. However, this in itself creates an anomaly as the transfer of non pension

scheme assets gives the spouse immediate access and use of cash whereas the pension only becomes payable under certain conditions. Further, assets in a pension scheme are granted favourable tax relief and if non pension scheme assets are invested to compensate for the lack of an actual pension they do not enjoy such generous tax relief.

A substantial number of pension scheme members are contracted out of SERPS and, even if it were possible to transfer the pension under an occupational pension scheme the non transferability of SERPS creates its own problems.

Divorce in Scotland

Divorce in Scotland is governed by the Family Law (Scotland) Act 1985 which sets out the principles to guide the Court in the financial settlement.

Sections 10(4) and 10(5) of the Act make reference to "matrimonial property" and define matrimonial property to be all property which has been acquired by either party during the marriage up to the relevant date (if acquired before the marriage, the family home may also be included). The relevant date is also defined and is the earlier of the date of separation or of the summons for divorce. It is worthwhile noting that Section 10(5) states specifically that matrimonial property shall include

"The proportion of any rights or interests of either party under a life policy or occupational pension scheme...".

Although there is more clarity and guidance to the Courts under the Scottish Act it is still less than satisfactory; for example, the relevant date may precede the date of divorce by a number of years and the Act makes no reference to the addition of interest between the calculation as at the relevant date and the date of divorce. In the circumstances, it is in the interest of the pension scheme member to delay settlement for as long as possible.

In line with England and Wales, the Scottish Act gives no guidance on the valuation method to be used for valuing a pension. Similarly, the other difficulties outlined in connection with England and Wales also apply in Scotland.

Independent Working Group

The Pensions Management Institute in agreement with the Law Society established an Independent Working Group to investigate the social and legal problems surrounding the treatment, at the time of divorce, of the rights to pension and related benefits from occupational and personal schemes.

The Working Group considered all aspects of the problem and published its Report in May 1993. As divorce law differs in Scotland from England and Wales, the Group felt that its recommendations would have more chance of being accepted if they were made to fit in with the existing divorce law of the countries rather than make fundamental changes to it. The general recommendations were:

- * Pension rights should be valued and taken into account in the divorce settlement.
- As far as possible, no additional costs should be imposed upon pension schemes and additional administration should be kept to a minimum.

Unless there are extenuating circumstances, the Report recommended that the value of a defined benefit pension should be based upon the cash equivalent. The Group acknowledged that this calculation is easily understood; further it is easily obtained from the administrator and does not involve conflicting views from actuaries on the actuarial assumptions that would need to be taken into account if past service reserve were to be used. In the case of money purchase occupational pension schemes or personal pensions, the Report recommended that it is the value of assets that are taken into account and split.

Transfer Payment

In the case of a pension that is either continuing to accrue or is deferred, the Report recommended that the member's pension scheme should be able to make a transfer to the spouse of the value of a proportion of the pension benefit. This transfer value should be able to be paid to either a personal pension, Section 32 policy or to the spouse's own pension scheme (if there is one). In this scenario the member's pension would be reduced by either a fixed amount or some years deducted equivalent to the transfer value.

As an alternative it should be possible for the spouse to be offered membership (in the spouse's own right) of the member's pension scheme; effectively the spouse would become a deferred pension member. However, the pension should not be linked in any way to the member's pension and it should be payable from the spouse's own retirement age rather than the member's. On account of the difference of mortality and possible age disparities, the spouse's pension would be different from the amount of pension given up by the member at the time of divorce.

In the case of public sector unfunded schemes, it was acknowledged that such schemes would be unhappy at paying out substantial transfers and would probably prefer that the spouse is granted membership in the pension scheme in the spouse's own right, as if a member.

Pension in Payment

A member who has retired and is in receipt of a pension needs special consideration. In this scenario it was recommended by the Report that the member's pension should be earmarked and the Courts given power to order the trustees to pay a pension to the spouse. In the case of a spouse who dies whilst the member is alive it is recommended that the earmarked pension payable to the spouse should revert to the member and continue to be payable for the rest of his lifetime.

Unfunded Schemes

Since 1989 there has been some growth in unfunded unapproved schemes. Obviously a transfer value cannot be paid and it is recommended that the divorced spouse should be treated similarly to the member with the result that the pension, calculated as at the date of divorce and based on pensionable service up to and salary at that date, would become payable at the time of retirement.

Pension Law Review Committee

Question 20 in the Pension Law Review Committee's (PLRC) Consultative Document asked if pension rights should be divisible on divorce. Section 4.16.14 in the PLRC Report mentions that various points need closer examination. For example, what arrangements should be made for GMPs and protected rights and what should happen to SERPS? In the case of the unfunded public sector schemes the Treasury estimates that there could be an outflow of some £500 million each year on account of divorced spouses transferring their share of the pension rights to an arrangement of their own choice.

These statements signal a delay by the Government to introduce legislation which would enable the pension to be split at the time of divorce. The recent White Paper *Security, Equality, Choice : The Future for Pensions* states that further research is being undertaken to establish the extent of the problem! This is regrettable as the forthcoming Pensions Act would have been the ideal channel and opportunity for changing the law so that the pension on divorce is distributed more equitably between the parties to the divorce.