# Pension Rights and Interests on Divorce
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**INTRODUCTION**

Nowadays, the actuary is asked to give professional advice on a variety of diverse topics. For example, in some aspects of divorce the advice of the Actuary is sought by the legal profession.

This paper examines the current legal position of divorce in Scotland and the interaction with occupational pension arrangements. First, however, it will be worthwhile to review the circumstances which have brought about the current legislation.

To avoid any suggestion of sex discrimination the person, either male or female who participates in the pension scheme is referred to as the member and the spouse is referred to as the partner. In this day of equality it is not unlikely that the member in the pension scheme will be a female and the partner will be a male.

**BACKGROUND**

In England, financial provision on divorce is governed by the Matrimonial Causes Act 1973 which states, in section 25, that the court must:

> "... have regard to all the circumstances of the case ..."

There is, however, little that the court can do to compensate a partner for the loss of contingent pension rights. Thus, in 1985, the Lord Chancellor's Department issued a consultation

paper "Occupational Pension Rights on Divorce". It should be noted that this paper refers only to the law of England and Wales. Consultation will take place in Northern Ireland.

In Scotland, section 5(2) of the Divorce (Scotland) Act 1976 stated that on an application for financial provision the court:

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

Thus, the Act provided little guidance, if any, regarding the financial provision which should be made on divorce. Indeed, it was all left to the judge. In an analysis carried out in 1980, it was found that a capital sum was awarded to one party in only 6% of divorces granted and that this sum amounted to £4500; a periodical allowance was awarded to an ex-wife in 22% of divorces and that this allowance averaged £18 per week. Hence, it was generally felt, in Scotland, that the law on financial provision on divorce was unsatisfactory.

**FAMILY LAW (SCOTLAND) ACT 1985**

In 1981, the Scottish Law Commission published their report entitled "Report on Aliment and Financial Provision". A part of the report was devoted to a draft Bill which passed, largely unaltered, into law as the "Family Law (Scotland) Act 1985". It came into effect on 1 September 1986.

The Act is based upon the concept that a divorce causes a "clean break" with the result that the marriage therefore ceases to exist. Consequently, both parties should be

financially independent of each other after a redistribution of the matrimonial property has taken place.

**ORDERS FOR FINANCIAL PROVISION**

In a divorce action, either party to the marriage may apply to the court for financial provision by means of one or more of the following orders under section 8(1) of the 1985 Act:

(a) an order for the payment of a capital sum or the transfer of property;

(b) an order for the making of a periodical allowance;

(c) an incidental order.

In the case of the payment of a capital sum, it is worth noting that the court has the power (section 12(2)) to stipulate that the order shall come into effect at a specific future date. Further, the court can stipulate (section 12(3)) that the capital sum shall be paid by instalments.

The thrust of the Act is that financial provision should take the form of a capital sum or the transfer of property as distinct from a periodical allowance. However, section 8(1)(b) does allow the court to make a periodical allowance if there is a child of the marriage under age 16 or if one of the parties has been substantially dependant on financial support of the other party. It should be noted that the allowance should be paid for no more than three years.

If an order under one or more of the aforementioned sections is made by the court, it requires to be justified by the principles set out in section 9. Further, the order has to have regard to the resources of the parties.

**THE PRINCIPLES**

Section 9(1) of the Act sets out the principles that the court should apply in deciding what order for financial provision, if any, to make:

> (a) the net value of the matrimonial property should be shared fairly between the parties to the marriage;
>
> (b) fair account should be taken of any economic advantage derived by either party from contributions by the other ...

In applying the principle set out in section 9(1)(a), section 10(1) states that:

> "... the net value of the matrimonial property shall be taken to be shared fairly between the parties when it is shared equally or in such other proportions as are justified by special circumstances."

It is necessary to determine the net value at a specific date which is described in the Act as the relevant date. This date is the earlier of:

> (a) the date at which the parties cease to live together; and
>
> (b) the date of service of the summons in the action for divorce.

All matrimonial property which has been acquired during the marriage but before the relevant date has to be taken into account in the settlement. Matrimonial property is considered to be the house, the furniture and other contents - all goods and chattels acquired by the couple during the marriage.

Section 10(5) of the Act makes specific reference to pensions and it states:

> "The proportion of any rights or interests of either party under a life policy or occupational pension scheme or similar arrangement shall be taken to form part of the matrimonial property ..."

Thus, it is clear that if one of the parties to the divorce is in an occupational pension scheme, then the rights or interests which have arisen during the period of the marriage must be considered to be part of the matrimonial property. The Act makes reference to a pension scheme; however, if the scheme provides only a cash lump sum then it is this lump sum which must be taken into account and the words pension scheme are used as a generic term to describe the retirement benefits.

Fair sharing is prima facie equal sharing; however, the court can depart from this principle if other proportions are justified by special circumstances. Section 10(6)(d) makes reference to the nature of the matrimonial property, the use made of it and the extent to which it is reasonable to expect it to be realised or divided. Bearing in mind that pension rights or interests cannot be transferred at the date of divorce (unless it coincides with retirement) it appears that it would be possible for one of the parties to make a plea that matrimonial property, which is construed as the pension rights or interests, should be considered as "special circumstances" and therefore that there is no requirement for it to be shared equally.

In the United Kingdom, retirement benefits cannot be assigned and cannot be transferred to another party. In most occupational pension schemes, the benefits are held under irrevocable trust with the result that they cannot be

surrendered for cash. Finally, they cannot be converted for a cash lump sum except in limited circumstances.

The value of the retirement benefits arising out of an occupation pension scheme can be substantial and may be greater than the value of the family home. Hence, both partners have an interest in such benefits.

**THE VALUATION OF THE BENEFITS**

The problem for the actuary is to determine the value that he should place on "the rights or interests" arising from membership of an occupational pension scheme. The Act makes reference to the pension rights or interests which have accrued during the period of marriage. It appears that, at the relevant date, the valuation of the benefits can be made in one of two fundamental ways:

(i) the incoming transfer value which is equivalent to the retirement benefits in respect of the relevant period; or

(ii) the outgoing transfer value which is the cash equivalent of the deferred pension and is the member's entitlement for the relevant period.

Invariably, in private occupational pension schemes, as distinct from public sector schemes, the transfer value under (i) is higher than (ii). The principal reason is that the former method assumes that the member will continue to participate in the scheme and will be subject to the demographic assumptions of withdrawal, death in service and retirement with salary increases up to the date of termination. On the other hand, the latter method assumes that the member has left the pension scheme and is entitled only to pension increases during the period of deferment.

It can be argued, with some substance, that the value should not be based upon the outgoing transfer value as the member did

not (or at least is unlikely to) leave the scheme at that date. However, the Social Security Act 1986 stipulates that, with effect from April 1988, membership of an occupational pension scheme cannot be compulsory. From April 1988 a member has the right, if he so wishes, to leave the scheme whilst continuing in employment with the same employer. In some schemes such a member is allowed to uplift the value of his retirement benefits and invest them with an insurance company.

In this scenario it would seem incongruous for the actuary to place a higher value on the retirement benefits than the value which is actually paid to either an insurance company or the pension scheme of a new employer. This line of reasoning suggests that the value placed on the retirement benefits, for the purposes of divorce, should be based on the outgoing transfer value as at the relevant date. The member may or may not leave the pension scheme; however, this cannot be known at that date and his future action should not be prejudiced by the divorce or resulting financial settlement.

It appears that there are three principal ways of calculating the outgoing transfer value:

(i) calculate the value at the relevant date in respect of the retirement benefits which have accrued during the marriage;

(ii) calculate the value at the relevant date in respect of the total retirement benefits and thereafter obtain the proportion for the period of marriage compared with the total pensionable service of the member from the time that he joined the Scheme;

(iii) calculate the value for the retirement benefit rights at the relevant date and from them deduct the value of the rights at the date of marriage;

No problem arises if the benefits attributable to the member remain unchanged during the period of marriage. On the other

hand if, during the marriage, the retirement benefits have been improved, it appears that anomalies can arise in the calculations. For example, if the value is ascertained by proportion, this will tend to understate the value if there has been an improvement in benefits. Conversely, if the benefits have decreased such a method will give an enhanced value.

Similarly, under (iii) if the value of the benefits at the start of the marriage are taken into account without adding interest this tends to place an undue emphasis on the benefits that have accrued during marriage. It appears that there is justification in carrying out the calculations accurately as set out in method (i) above.

The Social Security Act 1985 stipulates that, in respect of deferred pensioners, pension increases must be provided on the element of pension accruing from 1 January 1985. The foregoing arguments concerning the changing level of benefits is ignored in this legislation and the pension which has accrued since January 1985 is ascertained by proportion. In these circumstances, it would appear to be an extension of this logic if, for the purposes of the calculations on divorce, the retirement benefits accruing during the marriage are calculated as the proportion that the period of marriage bears to the total period of membership up to the relevant date.

The same Social Security Act stipulates that a transfer value must be made available when a member of an occupational pension scheme leaves service. A member who is involved in a divorce action may or may not leave service; however, it seems not unreasonable that the value of the relevant benefits, for the purposes of divorce settlements, should be based upon the transfer value as if the member leaves the scheme at the relevant date. It can be argued that the divorce reduces the partner's interest in the retirement benefit - especially the contingent partner's benefits. On the other hand, this Act is

attempting to quantify the financial contribution of the partner made during the marriage; hence, contingent partner's benefits should be taken into consideration in the calculation. In the circumstances, the transfer value for the purposes of divorce should be made in the same way and using the same economic assumptions as if the member is uplifting the cash equivalent and investing the value with an insurance company. Such a transfer value is based upon the Guidance Note issued by both the Institute and Faculty of Actuaries.

Although the calculations will not be made at the relevant date, it is important that they are based upon the facts and other pertinent information as at that date. If this is not done, either party may claim an unfair advantage over the other party by postponing the calculations to a date which is best suited for his own interests. For example, the member may have made significant financial progress in his career since the relevant date and it would be unreasonable to take this financial progress into consideration in the calculations.

**POINTS FOR CONSIDERATION**

The foregoing paragraphs set out a basis, subject to mutual agreement, for the division of the matrimonial property which includes retirement benefits. Inevitably, cases will arise when the two parties cannot agree and the financial provision will be settled in court (no court has as yet heard a case).

For example, if the member is unhappy with the prospects of losing one half of the value of his retirement benefits, he could argue that the value of such benefits should not be shared equally and that it is "justified by special circumstances" (section 10(1)). He may put forward the argument that there is no value at this point of time as the benefits cannot be commuted or surrendered. In these circumstances he may argue that the split should be 25/75% or 40/60%.

Another example would be if the member has no other assets so that nothing can be paid to the partner at the time of settlement. He could argue that on retirement he will require the pension to live on and hence, in these circumstances, no sum should be paid.

If the member has reached the age at which an early retirement pension can be taken, is it the value of this pension or is it the transfer value which provides the more equivalent value? Again, both partners will inevitably opt for the benefit which provides the better financial transaction.

In the court cases which will inevitably arise, the actuary must remember that the decision will be given by the judge and that the actuary is in court to help the judge arrive at his considered opinion. It is not for the actuary to tell the judge what to do; such a stance may lead to further statements which liken actuaries to astrologers but without the entertainment value of the latter.