

## PENSIONS IN ANCILLARY RELIEF

### 1. Introduction

- 1.1. Pensions are a difficult topic. They can be (potentially) one of the largest, if not the single-largest asset, particularly in a long-marriage moderate overall asset case, especially if one of the spouses is or has been a serving police officer or member of the Armed Forces.
- 1.2. There are so many different types of pension, in terms not only of who contributes to them and in what proportion, but also how and when they are funded, let alone what sort of benefits they offer. So it is perhaps not surprising that the courts have had difficulty even defining them within the context of an ancillary relief case. Are they to be treated as capital, albeit the payment of which is to be deferred? Or a fixed-rate income stream? Or should they be put into a category entirely of their own?
- 1.3. How should they be valued? Although the FPR prescribes the CETV as the basis of valuation, this is little more than an educated “snapshot” guess as to value at a single moment in time. It is not intended to be the last word. Depending on the nature of the scheme the only certainty is that is likely to be (more or less) inaccurate. What are the circumstances in which it would be prudent (and proportionate) to seek an alternative valuation?
- 1.4. Which of the remedies available to the court, i.e. offsetting, attachment, sharing, should be utilized, if at all? What guidelines are there as to how a court should approach pension assets when exercising its s25 MCA criteria? In a long-marriage case should the value of both parties’ accrued pension capital during that marriage (and any prior period of cohabitation) be added together and divided 50-50? How, if at all, should short-marriage cases such as **MILLER v MILLER (2006) UKHL 24** be applied across the board to justify providing pension assets to a spouse as *compensation* for what has been lost as a result of entering a marriage and/or leaving it? There remains a dearth of authority on the subject.
- 1.5. The above are the topics it is intended to address within the compass of this short talk. In the time available, it will not be possible to address State pensions in any detail so the focus will be on occupational pensions. State pensions, however, should not be overlooked altogether. There are two state pension arrangements: the basic State pension, and the second State pension (S2P) replacing “SERPS” –the State Related Pension Scheme which provided around 20% of earnings up to around £30,000.00 p.a.). ASP benefits can be provided *either* by the state (in which case the scheme is “contracted-in”) *or* privately by an employer’s pension scheme (“contracted-out”) or through an

individual's personal pension (an "appropriate personal pension"). The level of benefits can be ascertained by asking the DWP for Form BR20. It is important to make this enquiry as the maximum amount can exceed £100,000.00. If benefits are provided through a company or personal pension scheme, they are conventionally included in the ordinary valuation and not separately identified. Whereas a divorced former wife (but not divorced former husband) can use a former husband's former earnings to claim a basic state pension in her own right, there is no such entitlement to a parallel second state pension, but this can, of course, be made subject to a pension sharing order.

## 2. An overview of Occupational Pensions

### 2.1. Occupational pensions vary in terms of:

- (a) how contributions are made;
- (b) how they are funded;
- (c) what benefits they provide.

I propose to address each in turn.

### Who makes the contributions

2.2. Pensions can be provided individually, either: (i) by the individual contributing (perhaps with additional contributions by his employer, if any) to a personal pension scheme (perhaps with an insurance company or bank or building society), or (ii) by an employer making contributions to a company scheme (perhaps with contributions from the employee); or, collectively, by the employer providing benefits as set out in a "defined-benefits" scheme, with contributions made primarily or solely by the employer, sometimes with contributions, or added contributions, from the employee<sup>1</sup>.

### How they are funded

2.3. In a "defined contribution" or "money-purchase scheme" a sum of money accumulates over time which is used at retirement to purchase an annuity which then provides a pension. Its value must necessarily depend on rises or falls in the stock market by the time it is cashed in.

2.4. A "defined benefit" or "final salary" scheme is based simply upon a promise by an employer to provide a benefit, for example, a proportion of salary for each year of employment, which may, or may not, be index-linked. Only since April 1997 has the law required such promises to be supported by funds.

2.5. Some schemes, particularly "defined benefit" schemes often do not have enough funds to pay all the benefits if they were closed tomorrow, whether

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<sup>1</sup> Since October 2001 all employers with 5 or more employees if they do not provide a suitable pension arrangement must have provided access to a "stakeholder" pension for their employees. They do not, however, have to contribute to a "stakeholder" pension.

because the assets have fallen in value at the time the scheme was closed, or because of an unanticipated fall in interest rates.

- 2.6. Some of the most valuable pension schemes, for example, Civil Service, police and fire service pensions, are unfunded because it is not tax effective to provide assets to support promises for pensions in respect of income in excess of £99,000.00 per annum. These are called UURBS (Un-funded Unapproved Retirement Benefit Schemes).

### Types of benefits payable

- 2.7. In final-salary or salary related schemes, it is usual for some benefits to be available of right (subject to sufficient assets being available), whilst the payment of others such as benefits on ill-health, early-retirement or inflation protection) are payable at the discretion of the pension trustees. Sometimes these are included in the overall valuation of a pension, sometimes not. It is important to note that dependent's and survivor's pensions, ill-health and early retirement pensions are often discretionary.
- 2.8. In most schemes some of the pension annuity can be taken at retirement in a "commuted" form, i.e. as a cash-free lump sum. Under the Civil Service scheme commutation is mandatory.

### 3. How the courts define pensions and their benefits

- 3.1. In **COWAN v COWAN (2001) 3 WLR 684, CA** Thorpe LJ stressed that a husband's pension fund, notwithstanding the fact it had vested, was not to be treated as the direct equivalent of a cash fund of equal value.

"... the special characteristics of the pension funds held by the husband and wife respectively require recognition. The husband's fund is all vested and is no more and no less than a whole life fixed rate income stream. The fact that it would cost £1.19m to purchase an identical income stream allows a capitalisation for comparative purposes. But it is not truly comparable with a cash fund of £1.19m for the obvious reason that the latter is replete with options as to deployment, investment, and spending, as well as having the capacity to survive intact the owner's demise."

- 3.2. In **MASKELL v MASKELL (2001) 3 FCR 296, CA** Thorpe LJ developed the same theme, albeit in a case where the assets were much more modest, and castigated the appeal judge for adopting the reasoning of DJ Pearl who had found a "rough equivalence" between W retaining the fmh and a £6,000.00 endowment making £32,000.00 in all and H retaining the £40,000.00 pension fund (which had not vested), plus a £4,000.00 endowment, less debts of £8,000.00, leaving him with assets of £36,000.00.

"... the judge is making the seemingly somewhat elementary mistake of confusing present capital with as right to financial benefits on retirement, only 25 per cent of which maximum could be taken in capital terms, the other 75% being taken as an annuity stream. He simply failed to compare like with like."<sup>2</sup>

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<sup>2</sup> **MASKELL v MASKELL**, however, was distinguished in **NORRIS v NORRIS (2002) EWHC 2996** in which Bennett J rejected a submission on behalf of H that the value of his pension fund (which

- 3.3. In **MARTIN-DYE v MARTIN-DYE (2006) 2 FCR 325**, there were assets of £6.3m, excluding both parties' pensions which were in payment and together worth £1.04m but W's pension was only 10% of H's. H appealed an order giving a 57: 43 split of the assets in W's favour but allowing each to retain his/her pension. The CA, substituted a pension sharing order whereby W would receive 57% of the combined value of the pensions and the remaining property divided 57:43 such that W would need to make a substantial balancing payment to H. The CA held that where pensions that are in payment are small or where the parties have pensions of roughly equal value it might be possible to aggregate their value with the other assets and distribute the resultant total value. Generally, however, pensions do not sit comfortably in the category of "property" for they are not realisable and not transferable. Not so they sit comfortably as "income" because they are usually a product of the marriage rather than future endeavour. It is more appropriate to regard them as "other resources".

#### 4. How should pensions be valued?

- 4.1. Since the onset of attachment orders in 1996 the Cash Equivalent Transfer Value (CETV) has been prescribed by regulations as the method of valuation to be provided to the court in financial disclosure. It followed the decision in **H v H (1993) 2 FLR 335** in which Thorpe J (as he then was) said:

“ ... in deciding what weight to give to pension rights it is more important ... to look at the value of what has been earned during cohabitation rather than look at the prospective value of what may be earned over the course of 25 or 30 years after separation”.

The CETV, however, dates from the Social Security Act 1986 which required pension service members who wished to leave schemes to permit them to do so and to offer a transfer value which would be paid over to the scheme into which they were transferring their pension.

- 4.2. The advantages of the CETV are that it is cheap, often free, readily available and provides an easy snapshot of the position of the pension in the overall scheme of things. In many cases it may mean that the pension can be eliminated from further consideration, particularly where both H & W have pensions but their values are relatively small compared with the other available assets.
- 4.3. The main disadvantage of a CETV is that it may not give an accurate<sup>3</sup> assessment of value for one or more of the following reasons:

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had not vested) should be the CETV less the 25% which can be withdrawn as a lump sum, together with a Duxbury capitalisation of the annuity stream purchased now by the remaining 75%. He accepted a submission this was the wrong approach because the fund might not vest for another 25 years during which time the assets of the fund could appreciate and no CGT would be payable. H had the opportunity to draw down income, before having to vest, 75% of the fund by 75 at the latest.

<sup>3</sup> In **T v T (1998) 1 FLR 1072** Singer J said “I am satisfied (and fortified by the evidence of the actuaries) that the CETV would have been of no assistance in this case... I should perhaps emphasise that these values are at best a guide, and their apparent precision (down to the nearest pound) is

- (a) the CETV quoted by a scheme which is under-funded as a result of falls in the stock market is likely to be less than the value available on a transfer out of the scheme;
- (b) the CETV takes into account penalties payable in the event a pension holder exercises his statutory right to leave the plan before the end of the contract, or if an external transfer is taken. In such cases the CETV is likely to be less than the value of the fund;
- (c) the CETV does not take into account accrued benefits and reserves within final salary or deferred benefit schemes designed to encourage particularly younger members to stay in the scheme until retirement;
- (d) the CETV of a Small Self Administered Scheme or SSAS in which each members has a different entitlement may well give a different (and in all likelihood much lower) valuation from a valuation based on each member's share of the fund if the scheme were broken up;
- (d) the CETV may not allow for early retirement lump sum and benefits in some public sector schemes.

4.4. Where the CETV is likely to be inaccurate for any of the above reasons in the case of a pension of high value or significant value in the overall context of the matrimonial assets, consideration should be given to applying for expert evidence as to the pension's more realistic value. This is permissible under the FPR, following the case of **T v T (1998) 1 FLR 1072** in which Singer J allowed a projection of future benefits.

## 5. A short history of the development of the family court's powers in relation to pensions.

5.1. Until July 1996 the court had no direct power to make orders in relation to pension rights, nor against the trustees to obtain information about pensions, but was obliged to take their existence into account when considering financial arrangements on divorce. Its only remedy was offsetting, i.e. adjusting other assets by means of a lump sum or property adjustment orders to take account of pension assets. The extent of the set off might itself need to be discounted to take account of the fact a capital benefit is being obtained (a) without any tax obligation and/or (b) in cash and/or (c) much earlier than under the spouse's pension arrangement and/or (d) is certain, i.e. not contingent upon the vagaries of the stock market or future alterations in the tax regime and/or (e) the beneficiaries' own (more modest) pension arrangements.

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illusory, and the product of mathematical rather than predictive accuracy. For they necessarily incorporate various assumptions (as to the rate of future inflation before and after the pension commences in payment; an appropriate discount rate reflecting the tax-exempt environment (currently enjoyed by the pension fund; and of course that ultimately unpredictable factor, mortality)... Thus (as has been said of a *Duxbury* fund) the only fact which can be predicted with absolute accuracy is that the prediction will turn out to be inaccurate. These figures are, therefore, at best and when it is appropriate to have regard to them at all, a guide rather than a rule."

- 5.2. Pension attachment (earmarking) was introduced in 1996 and gave the court power to order the trustees or managers of a pension scheme to pay on a member's retirement (a) all or part of a member's pension to his spouse as a periodical payments order, (b) a lump sum by way of commutation of a member's benefits, (c) all or part of death in service benefits to the other party. The disadvantages of earmarking is that (a) it is contingent upon the availability within the scheme of benefits available to meet them, (b) any benefits available are not payable until retirement of the other spouse, (c) periodical payments do not survive death of either party or remarriage of the spouse; (d) lump sum payments are variable even as to the amount payable; (e) tax is payable before payment. Above all it hardly sits comfortably with the desirability for a clean break wherever possible.
- 5.3. Pension sharing was introduced by the Welfare Reforms and Pensions Act 1999 enabling the court to divide a pension at the time of divorce so that the spouse either becomes a member of the pension scheme in his/her own right ("internal transfer") or takes a transfer of a designated amount into his/her own pension ("external transfer") although external transfers are not possible from unfunded public schemes, in which case the transferee must leave the pension share within the scheme although will have his/her own pension.
- 5.4. The following points are to be borne in mind in relation to pension sharing:
- (a) it does not apply to judicial separation;
  - (b) it cannot be implemented retrospectively;
  - (c) it is discretionary not compulsory;
  - (d) it continues as a range of options including attachment orders;
  - (e) it applies to the additional State pension;
  - (f) in relation to overseas pensions it can only apply to those subject to U.K. jurisdiction;
  - (g) it applies only to those rights which have accrued at the time the order has been made;
  - (h) it gives a share of the other spouse's pension based upon the CETV (or other valuation) before the court at the time the order is made;
  - (i) once a pension sharing order is made it cannot be varied after DA;
  - (j) a pension sharing order can be made to capitalize periodical payment orders in relation to proceedings brought after 1<sup>st</sup> December 2000<sup>4</sup>.

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<sup>4</sup> See MCA 1973 s31(7B)

6. How the courts approach pensions within the context of the exercise of their s25 MCA discretion

6.1. In **T v T (1998) cit sup.** (an earmarking case) H was 46 and W 47 when they divorce after 14 years of childless marriage. He had significant earning power; hers was modest. Singer J declined to make an attachment order in favour of W save that on H's death the pension trustees of his pension scheme pay her 10 times any subsisting annual maintenance payment. He ordered maintenance of £22,000.00 per annum reducing to £17,000.00. He held that attachment orders for pps should only be made at or near retirement; also an attachment order continues subject to variation for the payer's lifetime until death or remarriage of the recipient. He pointed out that the court has no power to order the party with pension benefits to retire and take those benefits at any particular time. He rejected an argument that sections 25B, 25C and 25D of the MCA require the court to compensate a spouse for loss of pension benefits. It was simply a matter for the court's discretion in carrying out the section 25 exercise.

6.2. In **S v S (FINANCIAL PROVISION: DEPARTING FROM EQUALITY) (2001) 2 FLR 246**<sup>5</sup> the court (Peter Collier QC sitting as a Deputy High Court Judge) rejected a submission that because H's pension fund was his single-largest asset it took the case outside the ambit of **WHITE v WHITE** and justified a departure from an equal capital division of assets. He said:

“I do not consider that I can differentiate between assets in relation to their value. The courts have always approached these matters on a net asset basis, i.e. taking account of sale costs and tax liabilities. *White* affirmed that approach”.

However, where an equal division of the capital assets (bringing the value of H's pension into the equation) would force H to liquidate his assets, including his pension (which had only recently been set up such that he could not draw capital from it) and in order to prevent discrimination against his new family, the court awarded W just over £1.2m in realisable assets and H over £760,600.00 in realisable assets and allowed him to keep his pension fund of £689,000.00 intact.

6.3. In **F v F (CLEAN BREAK: BALANCE OF FAIRNESS) (2003) 1 FLR 847** a 50% pension sharing order was made in relation to a self-administered scheme of which H was a beneficiary, the assets of which were held entirely in cash and stood at £468,000.00 and where illiquidity meant a clean break was not possible. Singer J said:

“I very much bear in mind that these pension valuations, whether expressed as CETVs or as the value of a fund held in cash, are for practically all purposes a quite distinct form of currency compared with assets which can be realised for cash which is then freely available. As and when these pensions can be drawn, there will clearly be the potential to withdraw up to the maximum permissible commuted lump sum.

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<sup>5</sup> Although an interesting case illustrating how a court takes into account the illiquidity of pension funds in the overall context of matrimonial assets, it should be borne in mind it was decided before pension sharing. Insofar as the court added the pension CETV to the realisable assets, i.e. did not treat the pension as falling into a separate category *ab initio*, it is somewhat anomalous.

But the balance must be used to produce an income stream. Happily, the power to make pension sharing orders under s25(1A) of the 1973 Act is available in this case, and each party proposes an order is made in W's favour. It is possible then to arrive at an approximation for the gross income which such a pension annuity could in current circumstances provide, if W chose (as I assume she could) to draw her pension immediately. .. In this manner, the section 25 discretion as to the pension assets can be looked at in isolation, s it were, although always taking into account their nature, value and proposed distribution when standing back to consider how fair and appropriate any proposed order is overall. What is then highlighted in the case of this family is the serious lack of practical liquidity imposed by the distribution and nature of the other main elements in their economic equation ...”

He went on to explain that he had “left the pension funds in their own compartment”. He declined to make pension sharing orders in relation to four similar pension policies with commercial providers (H's worth £80,000.00; W's £18,229.00) “because it does not seem to me to be cost-efficient to mnake pension sharing orders in relation ... to three out of these four relatively modest policies.”

6.4. In **GW v RW (FINANCIAL PROVISION: DEPARTURE FROM EQUALITY) (2003) 2 FLR 108**, Nicolas Mostyn QC sitting as a Deputy HCJ declined to reduce the value of H's US pensions of £130,000.00 by £50,000.00 being the tax payable if H were to withdraw the money because the court would not discount the CETV of a UK pension to reflect tax payable once it came into payment.

6.5. In **S v S (2006) EWHC 2793**, a bizarre case which ended up being tried by Burton J a judge of the QBD because one of the witnesses was a Deputy HCJ in the Family Division, the court ruled that H's pension fund which was already worth some £435,524.00 at the outset of a 7-year marriage, but which was worth in excess of £3 million at its end, should be brought into account because their increase in value was caused by his liquidating them during the marriage and converting them into “a property portfolio within the pension wrapper”. If excluded from the pot as non-matrimonial assets, they would, however have been brought back into play because there would otherwise have been insufficient assets to meet W's needs. The court awarded the W (exclusive of the payment of a £500,000.00 debt) some 40% of the matrimonial property or 35% of all property. Having found W had not been handicapped on the labour market by a 7 year gap in her employment and bearing in mind she had agreed she would not work, the court declined to make a compensatory award following Lord Nicholls at para. 13 of **MILLER v MILLER (cit. sup.)**

## 7. Conclusion

7.1. Pension Sharing Orders have proved to be relatively straightforward, flexible and efficient, in other words, all that Attachment Orders were not.

7.2. Pensions are not to be equated with cash save when they are in payment in which case they are an income stream.

- 7.3. In a long-marriage case it seems tolerably clear that, provided they are substantial assets, the court's approach is likely, at first instance, to add the value of pensions to the extent their value has accrued *during* cohabitation and marriage and divide by two.
- 7.4. Even pension capital acquired *outside* cohabitation and marriage might be brought back into the pot (cf inheritance monies) if required to meet a party's reasonable needs.
- 7.5. It is interesting to speculate to what extent courts might increasingly seek to compensate a spouse pension capital she has lost as a direct result of entering a marriage, as well as divorce. If this is, following **MILLER v MILLER (cit. sup.)** a requirement in short marriage cases, how more relevant this may be in long marriages, where a wife might have abandoned a lucrative career to look after her husband and bring up their children?

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