Articles

Apples or pears? Pension offsetting on divorce

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This article addresses the divergence of approach to the question of pension offsetting in financial remedy proceedings. Case-law offers little guidance on the practice of pension offsetting. In *JS v RS* [2015] EWHC 2921 (Fam) Sir Peter Singer noted at para [74]:

> 'I am aware from my general reading that there is at present debate but as yet no conclusion on precisely this topic of arriving at an offsetting figure. I am not aware from my own knowledge nor have I researched what the competing methods might be. I am thus left in the unsatisfactory position where I must alight upon an amount which will necessarily be arbitrary …'

A recent study *Pensions on Divorce*[1] found that financial disclosure and explicit reasoning in relation to pensions was unclear or inadequate in the majority of cases with relevant pensions. Where pensions were considered at all, offsetting was by far the most common way of dealing with them but was somewhat of a Cinderella remedy, with more professional and academic interest being directed at pension sharing orders. Very few court files, however, contained any express reference to offsetting or its calculation and there was little agreement amongst family practitioners either as to how to apply or value the offset or whether expert assistance was needed. This narrow topic raises much wider questions:

- Why does the family justice system tolerate such divergence and uncertainty?
- Might it be appropriate for there to be some authoritative guidance from the courts in which the differences are adjudicated upon?
- Is there a need for more interdisciplinary

1 *Pensions on Divorce: An empirical study,* by H Woodward with M Sefton (Cardiff Law School, 2014, funded by the Nuffield Foundation) included a survey of 367 divorce court files with a financial remedy order, interviews with 32 family solicitors, meetings with seven district judges and assessment of the court data by a pension expert, available at http://orca.cf.ac.uk/56700 (last visited 21 October 2015).

engagement between lawyers and experts working in this field?

- How appropriate are the *Duxbury*[2] assumptions in the context of pension calculations and generally?
- How appropriate is the use of the utility discount when offsetting? The utility discount may be ordered by the court or agreed by the parties to reflect the perceived advantage of holding cash now rather than waiting for pension benefits in the future. This includes an element of discounting for accelerated receipt and a more amorphous judgment about the value of cash over other forms of wealth holding.

Background

If you are a family money practitioner, you will have probably had the following experience. You are busily preparing for a hearing and when reading that bit of the pension report which deals with the question of offsetting, you think, 'I'm sure the last pension report I read approached this differently.' However, life is busy, this is your single joint expert report and when is it ever proportionate to go into extended debate over the expert's proposed offsetting methodology? When it comes to offsetting, it is tempting for the family lawyer to hide behind the discretionary powers of s 25 to justify nearly any solution which can be cobbled together.

We are hugely indebted to 14 leading pension experts who took part in this project by answering three short mock pension offsetting problems (small, medium and bigger money cases) and to nine of them for attending a meeting on 1 September 2015 to discuss their differing approaches as if they were Part 25 experts. This paper would not have been possible without their invaluable and expert contributions. All experts who took part signed confidentiality declarations as a basis for sharing their reports with others in the group. As one expert did not wish to share his report he was not privy to any of the other reports or to the details of the meeting. It also follows that this expert's results are not recorded in the tables below. Nothing in this paper is intended as a criticism of any individual expert.

Whilst the individual approaches of each expert remain anonymous, the experts who took part are as follows (in alphabetical order): Stephen Bridges (Bridges UK Actuarial Services Ltd), Paul Cobley (Oak Barn Financial Planning), Ian Conlon (IWC Actuarial Limited), Peter Crowley (Windsor Actuarial Consultants), Dani Glover and Julian Whight (Smith & Williamson Financial Services), Miles Hendy (Fraser Heath Financial Management Ltd), Peter Moore and John Riley (BDM), Mark Penston (Bluesky Chartered Financial Planners), Kate Routlege and Jim Sylvester (Collins Actuaries), Geoffrey Wilson (Excalibur Associates), and Paul Windle (Actuaries for Lawyers).

The differing approaches to pension offsetting

In their excellent treatise, *Pensions on Divorce* (Sweet & Maxwell, 2nd edn, 2013) Hay, Hess and Lockett look at the different ways in which a pension may be offset. They state:

> 'There are many ways of calculating set-off . . . It is right to say, however, that none of them has been adopted by the courts as a universal or even a favoured approach. The authors would suggest that the reason for this is that the value of the set-off will change depending upon the nature of the case

2 *Duxbury* is described in *At A Glance 2015–2016* (Class Legal) at Table 14 (cited with approval by Ryder LJ in *H v H (Financial Remedies)* [2014] EWCA Civ 1523, [2015] 2 FLR 447). It states, '*Duxbury* calculators are based on an iterative computation, seeking the amount which if invested to achieve capital growth and income yield (both at assumed rates and after income tax on the yield and CGT on realised gains) could theoretically be drawn down in equal inflation-proofed instalments over a period (usually, but not always, the estimated actuarial life expectancy of the recipient) but would be completely exhausted at the end of the period. It is not, and never has been, an attempt to identify the sum necessary to guarantee a particular level of expenditure ... The assumptions include three key financial predications – an average income yield of 3% pa, an average capital growth of 3.75% pa and average inflation of 3% pa.' This results in a real rate of return (ie after inflation) of 3.75%.

and the reason for it. Consequentially, a rigid approach would prevent the court from utilising its full discretionary powers in accordance with the requirements of the Matrimonial Causes Act 1973 . . . The authors would suggest that there can be no 'one size fits all' solution to the offsetting problem. The fair and equitable offset will depend upon a number of factors that will vary from case to case.'

Hay et al describe seven approaches to offsetting, without consideration of the utility discount.[3] These include:

- An offset using only the Cash Equivalent (CE). This is the simplest technique.
- A more complicated approach assumes an outcome based on the present pension benefits (eg an equalisation of pension income at a set point in the future) and discounts that outcome back to a current lump sum, based upon realistic actuarial assumptions. (The lump sum can then be invested with income drawdown and amortisation of the lump sum to produce the required outcome.)
- A costlier outcome calculates the sum required to purchase an annuity at a rate equal to the pension member's pension income. This approach provides certainty of outcome but at a price.
- The *Duxbury* algorithm might also be used to calculate the sum required but is not based on actuarial assumptions. This produces the lowest figure for a party seeking a pension offset and will be commented upon in more detail below.

Upon reviewing the experts' reports for this exercise, we have found evidence of all the approaches outlined above but not necessarily the reasons for them. Rather, the differing approaches appear to reflect a particular expert's personal approach and subjective interpretation of the question asked and not necessarily the facts of a particular case. This is not to criticise any of the individual experts, all of whom have produced admirably reasoned reports when viewed in isolation. However, when placed side by side, a divergent picture emerges with experts defaulting to a variety of differing assumptions and interpretations of what they are being asked to do. This results in a wide range of outcome of offsetting calculation for no compelling reason, as detailed below.

Computation or distribution?

A difference of emphasis emerges between the present authors and Hay et al. The latter defend the status quo upon the basis that this allows for the maximum discretion pursuant to s 25 of the Matrimonial Causes Act 1973. However, as was made plain in *Charman v Charman (No 4)* [2007] EWCA Civ 503, [2007] 1 FLR 1246, an application for a financial remedy involves a two-stage process: first, computation and second, distribution. Whilst we accept that there is not an airtight seal between each stage, the computational stage has less to do with s 25 discretion and far more to do with simply identifying the correct figures. We suggest that placing a present capital figure on a right to receive a future income is more closely related to the computational stage than it is to distribution. Although within the computational stage, experts may also be applying professional judgment in the figures and assumptions which they adopt, this is not to be confused with the s 25 discretion.

Hay et al have eloquently systematised a divergent picture. Our respectful view is that such systematisation is something of a fig leaf for a situation which has arisen unchecked by the courts over many years of practice. The discretionary nature of outcome in financial remedy proceedings might act as something of a defence against accusations of woolly thinking, when any particular outcome becomes subject to challenge.

3 *Pensions on Divorce* (Sweet & Maxwell, 2dn edn, 2013), esp. 13–008, and 13–010–13–018.

The offsetting scenarios

The aim in each of the following scenarios was to achieve a broadly equal division of the assets between husband and wife. We invited the experts to assume they were Part 25 experts dealing with financial remedy proceedings in May 2015. In particular, the instructions stated: 'Make the assumption (which we accept does not pertain in real life) that the CE and/or "figure invested" represents the actuarial value of the pension and does not require further consideration to ascertain its "true" value.[4] This exercise is designed to focus only on approaches to any offsetting once the actuarial value of the pension has been calculated. If, however, you wish to comment upon the respective advantages/disadvantages of using the CE rather than an actuarially calculated figure, please do feel free to comment. Further, ignore the incidence of any basic state pensions, assume there are no Additional State Pensions and do not make any fractional adjustments for how long the parties have been married.'

Case A: Small money scenario

H is aged 42 and has a stakeholder pension with a CE of £100k, accumulated during the 15 year marriage. W is 40 and has no pension of her own. They have two young children. The net equity in the family home is £100k. Their net incomes are similar; both pay basic rate tax. They both want to offset in principle, so that W can retain as much of the current capital as possible and forego any pension sharing claim but they cannot agree on the amount.

Case B: Middle money scenario

H is aged 54 and a higher rate (40%) tax payer. He contributes to a final salary related pension scheme with a CE of £500k (which will allow H to transfer the fund into a personal pension and permits internal pension sharing orders). W is also aged 54 and is in part-time employment earning just below the minimum tax threshold, with no pension of her own. They have been married for 20 years and have one son at university. The net equity in the family home is £500k. Both wish to offset all of W's pension 'entitlement' against H's share in the home: but what is the value of the offset?

Case C: Bigger money scenario

H is aged 56 and has £1.5m invested in a SIPP, which owns commercial property from which he conducts his business. H has successfully applied under the Individual Protection 2014 provisions. W is aged 58. Both are higher rate tax (tipping into 45% rate) payers but W has no pension of her own (she is a barrister!). They have been married for 30 years with two children, now independent. Their current net assets are £3m, half representing the net equity in the FMH and half in an investment portfolio. They are considering all options and wish to know how they would value a pension offset (so that W receives as much current capital as possible in exchange for surrendering any pension entitlement she may have).

The results

The differing approaches in evidence made for a fascinating but confused picture. We readily accept that these are only mock scenarios based upon necessarily sparse facts and that some matters might have been tidied up by a 'real life' letter of instruction with more relevant information. We also acknowledge that complaint was made by a number of experts that we had not provided enough information generally and particularly for the middle money, defined benefit pension case. This resulted in some experts making their own individual assumptions about the benefits which would be received in retirement. We accept that, as authors of the questions, we are at least partly responsible for the divergence of opinion. The range of assumptions, even with the imperfections of this exercise, are arresting nevertheless. We have confined ourselves to the headline issues which emerge from the reports.

4 The invitation to assume the CE to be a reflection of true value elicited a number of critical comments from experts and many did not apply this assumption.

- The starting points employed by the experts in their offsetting reports varied. For example, in the small money scenario some experts started by using the CE whereas others wished to discount the receipt of future pension income back to a present capital sum.
- In those reports (whether small, medium, or bigger money) where an actuarial calculation was made to discount a future income stream back to a present capital sum, different experts applied differing investment and mortality assumptions.
- All experts made an adjustment for tax but the manner in which they did so differed, for example, in whether they included the personal allowance in their calculations or allowed for the tax free pension lump sum.
- Some expressly opposed the principle of a utility discount; some applied an automatic discount of between 1%–2% per annum to retirement; some applied a greater discount the greater the need for cash; others acknowledged that a utility discount might be appropriate but did not include it in their reports and left it to the parties or court to decide.
- Different retirement ages were assumed.
- Some made adjustments for the modest age differentials in the scenarios whereas others thought this to be inconsequential.
- Some made adjustments to the CE to provide for the costs of administration and transfer whereas others did not.
- Some gave a single, definitive answer; others a range of possible answers commenting that there is no one actuarially correct way to undertake this exercise; others gave a range and averaged the range to arrive at a single result.[5]
- Some allowed for ancillary benefits, such as a spouse's pension, as part of the overall valuation exercise; others ignored them.
- In the bigger money case there was a difference in treatment of Lifetime Allowance Limits.
- Different experts used different terminology.

The results are shown in tabular form below.[6] One independent financial advisor (IFA) declined to answer the medium and bigger money scenarios, expressing the view that it was outside its competence to do so. The tables show the range of answers provided to offset the whole value of a pension (a figure which is not accessible presently and will be taxed upon receipt) against the non-pension assets. In each case, the wife's cash offset amount is 50% of the amount shown.

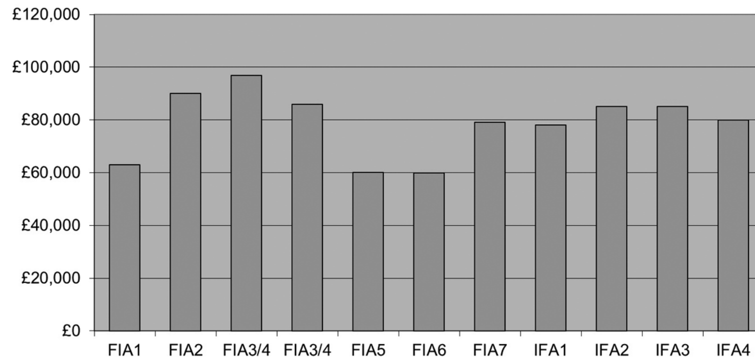
- The small money case had a pension CE of £100,000, with offset suggestions ranging between £60,000 and £96,900.
- The medium money case had a pension CE of £500,000, with offset suggestions ranging between £290,000 and £798,000.[7]
- The bigger money case had a pension CE of £1,500,000, with offset suggestions ranging between £886,000 and £1,425,000.

5 Readers are referred to PD 25D 9.1(g) which requires a summary of the range of opinion to be expressed.

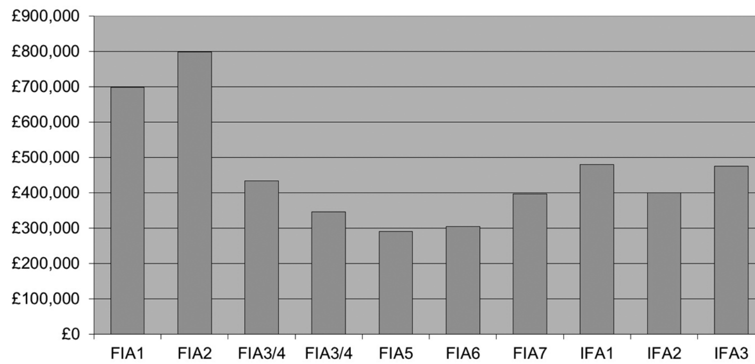
6 We are grateful to Stephen Bridges for allowing us to use the tables which he prepared for the experts' meeting. 'FIA' is Fellow of the Institute of Actuaries. Two experts (FIA3/4) collaborated to provide answers on two alternative bases.

7 The fact that some offset calculations came in higher than the CE underlines just how misleading the CE may be in the context of a defined benefit pension.

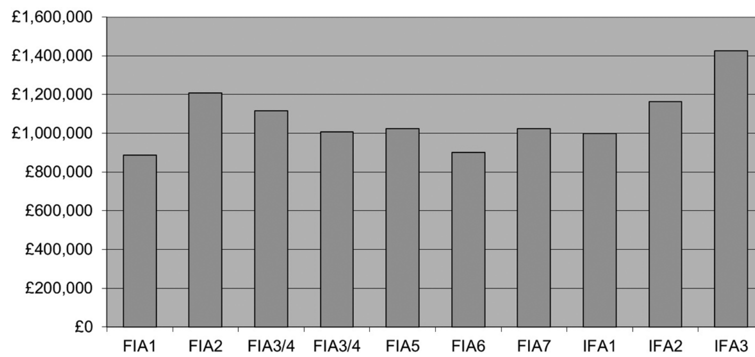
Expert pension offset valuations: Small money case



Expert pension offset valuations: Mid-money case



Expert pension offset valuations: Bigger money case



The Cash Equivalent valuation

It is submitted that the Cash Equivalent (CE) value occupies an unwarranted totemic position. This is hardly a novel point to make but one which is frequently overlooked in practice. The CE is the sum one pension arrangement will transfer to an alternative pension agreement to extinguish their liability under the scheme.[8] The CE is grafted into matrimonial law by virtue of the Pensions on Divorce etc (Provision of Information) Regulations 2000, which require pension arrangements to provide this information on divorce. It is merely a starting point in terms of information. While the CE may provide a rough working estimation for standard money purchase/defined contribution schemes, it is often wholly misleading as to the true value of a defined benefit scheme.[9] Different scheme actuaries apply different investment assumptions and therefore the 'true' value of defined benefit pensions with similar CEs can be wildly different; further, the 'true' value may be significantly higher than the CE.

A neutered adversarial system?

We are not aware of any reported financial remedy case in which each side has been permitted to appoint a pension expert to allow for rival actuarial approaches to be tested.[10] Whilst it would rarely be proportionate in an individual case to appoint competing pension experts (and in the truly big money cases pensions are often a small component part of a much bigger picture), the result is that the family courts have never been asked to adjudicate on rival approaches to be found in differing reports, so far as we are aware.

In an analogous (*Duxbury*) context we note *H v H (Financial Remedies)* [2014] EWCA Civ 1523, [2015] 2 FLR 447, at para [27] with Ryder LJ's commendation of the 'wise warning' given by Holman J in *F v F (Duxbury Calculation)* [1996] 1 FLR 833 at 849 cautioning against '… any standard practice arising of experts being instructed on the point given that the assumed rate of return was only a starting point for consideration of the s 25 factors in the Act'. However, the result of this type of warning is that no cases ever seem to feature an adjudication of competing actuarial assumptions. Further, and with the greatest of respect, the warning in *F v F* against expert evidence appears to have contributed something to the fudge as between computation and distribution issues.

This is in contrast to (an admittedly imperfect comparison) leasehold enfranchisement valuations (which give a current value of the freeholder's future reversionary interest). First-tier tribunals routinely allow for two experts and the assumptions behind competing expert evidence have been adjudicated upon in the Upper Tribunal in high profile test cases.[11] Such cases provide a judicially-adjudicated going rate which is then only departed from for good reason supported by expert evidence on particular facts.

Reflections on experts' meeting

As with the detail of the reports, it is simply not possible here to deal verbatim with all of the detail which was discussed at the meeting with the nine experts. The following must necessarily reflect only a summary of those parts which appear most noteworthy.

8 The Occupational Pension Schemes (Transfer Values) Regulations 1996 and The Occupational Pension Schemes (Transfer Values)(Amendment) Regulations 2008.

9 One expert made his point graphically by giving two different answers to our middle money scenario. The first answer assumed an NHS pension, whose value was dependent upon Government Actuary Department factors, and the second assumed a private sector final salary scheme where the CE was strongly market related. The difference in likely pension income ranged from £14,492 pa for the NHS pension scheme and £7,628 pa for the private scheme, notwithstanding that both have the same CE of £500,000. When deferring these future benefits back to a present capital sum the resultant difference in value between two pensions, each with the same CE, was about £290,000.

10 In *Martin-Dye v Martin-Dye* [2006] EWCA Civ 858, [2006] 2 FLR 901 the parties were before the Court of Appeal without a pension report. At para [70] Thorpe LJ recommended the use of a Single Joint Expert 'where proportionate'.

11 For example, *Earl of Cadogan v Sportelli EWLands* [2006] LRA_50_2005, [2007] 1 EGLR 153 http://www.bailii.org/ew/cases/EWLands/2006/LRA_50_2005.html

Respective skills of the experts

There was a good understanding, as between the actuaries and the IFAs, as to the range of their respective expertise. The IFAs present accepted that there were some calculations which necessarily involved actuarial assumptions and were outside the scope of their particular skill set. Likewise, the actuaries present accepted that there were certain pieces of work, such as considering the implications of Lifetime Allowance issues, which were far better dealt with by IFAs.

However, there remained a tension. Some IFAs asserted their competence to undertake complex pension reports whereas other IFAs drew the line elsewhere and deferred to actuaries when actuarial assumptions were required. The present writers are clearly not in any position to adjudicate upon where to draw the line. We merely note that there does appear to be a difference of opinion as to where the line should be drawn and that family lawyers are ill-equipped to determine that issue.

The letter of instruction

The importance of the letter of instruction was strongly emphasised. The experts were at one in highlighting the frequent deficiencies, unnecessary detail and over-complication presented in letters of instruction. The balance of preference in the group was for shorter letters which stated basic information to include contact details, ages, realistically considered retirement dates (for which the parties may first wish to see an IFA) and letters of authority for the expert to then approach the relevant pension providers to ask for the further detail required.

A helpful model of working, utilised by two of the experts, involved an IFA seeing the parties, understanding their pension and financial situation, highlighting the issues at stake and then drafting a letter of instruction to an actuary, jointly with the parties. This ensured that the right level of detail was relayed to the actuary and that the questions were properly framed, with the parties knowing the implications of what they were asking and the experts' complementary skills being deployed to maximum effect for the benefit of the parties. In practice, such an approach may not be possible where the parties are unable to work together.

The starting point

The group discussed the starting point for an offsetting calculation and whether a notional 'equalisation of income' pension sharing order should be used as the benchmark for the value to be offset. In practice, it is often the case that the offsetting option is considered alongside pension sharing in a composite report and so this approach may have a practical magnetism.

Many points discussed throughout the meeting hinged on whether this was the best starting point or whether the starting point was a straight offset against 50% of non-pension capital. They could produce very different results. When only considering offsetting, the group, on balance, did not consider that the notional 'equalisation of income' pension sharing assumption was necessarily the most straightforward starting point. However, all were agreed that it would depend upon how the instructions were framed.

The use of the CE as basis for valuation

The group accepted that in a standard defined contribution pension case, it would be acceptable to use the CE as the starting point for calculations. Whilst this would not be as actuarially accurate as deferring future benefits back to a present capital sum, the difference between the two figures was not considered to be so material that it necessarily justified a more complicated (and expensive) starting point.

The group was broadly in agreement that a 20% discount would usually be appropriate for tax and would often represent the main offsetting calculation required in defined contribution cases. Some were anxious to emphasise that the marginal rate of income tax for the party retaining the pension

benefits was the necessary calculation to make and that the standard rate of income tax when the pension is accessed could not always be assumed.

However, it was noted that this only applied to 'standard' situations and there may be a number of situations where a defined contribution pension scheme had non-standard features which would make the CE an inappropriate starting point. It was agreed that lawyers were often ill equipped to 'look under the bonnet' to see if non-standard features were present. It was agreed that a quick review by an IFA, short of a 'full' instruction, might be the way for a lawyer reasonably to determine whether the CE was acceptable to use.

Non-standard features which were highlighted included: the presence of guaranteed annuity rates or investment returns (a 'hybrid' pension which was essentially a defined contribution scheme but with some defined benefit characteristics), wildly differing ages, health issues, large surrender penalties, non-standard investments and high value pensions which may have tax implications and/or Lifetime Allowance issues.

The group was also in agreement that the CE was not an appropriate starting point in defined benefit pension cases, for the reasons given above.

Duxbury

Using the *Duxbury* assumptions is included by Hay et al as one possible way of offsetting a pension. It is of note that it provides, by some considerable distance, the lowest cash offset figure when compared to the other approaches.[12]

The group had strong views about *Duxbury*. In terms of its ability to produce a whole life income stream, it was referred to as 'not fit for purpose' with the experts being 'horrified' by the courts' continuing adherence to it. Experts were confused by its provenance and how it was reviewed or might be challenged. The present authors acknowledge that the proponents of *Duxbury* do not seek to defend its assumptions on the basis that it can be used to provide a guaranteed income stream in place of a joint lives' maintenance order.[13] The group appeared broadly in agreement with the following:

- For pension assets prior to retirement, a 2%–2.5% real rate of return (ie after inflation) was realistic (cf. *Duxbury* at 2.25% in year one and 3.75% thereafter[14]). It was noted that *Duxbury* does not take into account charges made to defined contribution schemes, which were assumed at up to 1%, widening still further the gap with the *Duxbury* outcome.
- For assets not held within a pension, a real rate of return of 1.5% to 2% (ie after inflation) was realistic.
- Post retirement it was considered that investor risk profile changes and that many would wish to become risk free at this stage and therefore experts assume an annuity purchase or other low risk strategy when assessing likely investment returns.

Over the medium to long term, such assumptions will produce an outcome significantly different from the *Duxbury* algorithm. Of course, *Duxbury* is a 'tool and not a rule' and there are eloquent defences to be made in its favour.[15] However, the 'only a tool' mantra may ring hollow when most practitioners appear unwilling to seek the instruction of a Part 25 expert to challenge the assumptions. Interestingly, Mostyn J in *JL v SL (No 3)* [2015] EWHC 555 (Fam), [2015] 2 FLR 1220 defended the *Duxbury* assumptions, in part, upon the basis, 'No evidence was

12 See Hay et al at 13–018.
13 *JL v SL (No 3)* [2015] EWHC 555 (Fam) per Mostyn J; and Lewis Marks QC, 'An Alternative view of Duxbury: A Reply' [2010] Fam Law 614.
14 The reduction in year 1 is due to 'credit crunch' factors and is now in its seventh year, *Capitalise, Version 20*, and *At A Glance 2015–2016* Class Publishing.
15 See fn 13.

adduced as to why the views of the *Duxbury* committee should not be followed …'[16] He further defended the assumptions based upon the history of how the market has performed.[17]

One of the defences of *Duxbury* is that earned income has risks attached to it and that the dampened assumptions fairly reflect the risks associated with life's vicissitudes. In contrast, as noted by Wilson LJ (as he then was) in *Vaughan v Vaughan* [2007] EWCA Civ 1085, [2008] 1 FLR 1108, at para [25], pension capital '… unlike any attempted capitalisation of earning capacity . . . does not depend on the application of future effort but, subject only to market and other vagaries, is in the bag …'. The difference in the quality of income receipt as between earned income and pension income/drawdown may provide a justification for not applying *Duxbury* assumptions in the pension offsetting context, in the authors' respectful view.

The present authors do not presume to be qualified to adjudicate upon the rival views of a congregation of nine experts and the *Duxbury* proponents. However, they are at odds with one another and it would be a worthwhile exercise to see such positions adjudicated upon by reference to evidence.

Utility discount

The discussion concerning the utility discount was illuminating. There was a real tension as to whether this should be regarded as an expert computational issue or a court discretionary issue. As already noted, it can reflect both an element for accelerated receipt and a value judgment about cash over other forms of wealth holding. In many cases the time value of money is not discounted back to the present date using any particular mathematical assumptions, rather an instinctive 'gut reaction' as to a fair discount is made.[18]

The experts said that they were able to crunch numbers if instructions invited them to do so, but none expressed any great enthusiasm for the process. One stated that the utility discount starts with the expert but finishes with the court; this is in contrast to calculations relating to pension sharing, which the experts respectfully expected the court to accept.

The experts variously referred to it as being a 'finger in the wind', 'fudge factor' and 'stick to beat the wife with'. Some questioned both the principle and the mechanism of discounting for utility. Confusion was expressed as to its provenance; guidance from the court as to whether and, if so, how it should be applied, was considered needed in this area.

The notional benefit of holding current assets rather than pension assets was also questioned when it is often the case that the offset is being required to assist a care-giver to retain the family home. The capital contained therein is not usually available for discretionary spending and there has been a constriction in the market for re-mortgages post 2008. It was also noted that equities can often outperform real property and also that the person with cash could be more at risk than the person with the pension fund.

It was noted that some experts had provided greater discounts for those claimants who were perceived to be in greater need of current assets. Whilst it was accepted that there was a certain harsh logic to this from a computational perspective, it was agreed that it sat very uncomfortably with the court's overall duty to be fair. This particular point highlighted the computation/distribution questions very starkly.

16 Paragraph [17], and see also *DR v GR (Financial Remedy: Variation of Overseas Trust)* [2013] EWHC 1196 (Fam), [2013] 2 FLR 1534, at para [57] '… Of course the *Duxbury* figure is only ever a guideline but departure from it must be rationally and numerically justified by reference to clear evidence …'

17 Paragraph [14].

18 Hay et al note at 13–010, 'The [offsetting] exercise will almost always reflect a reduction in CE to reflect taxation and 'utility' of realisable assets. The reduction is usually not more than 40 per cent and not less than 30 per cent (there is no authority for this proposition; it merely reflects the authors' experience and anecdotal reports).'

Despite the reservations and criticism of this approach a minority view was expressed that the parties' financial situation and the purpose of the offset remained relevant.

No going rate or approach was agreed. The view of the group, however, was that the utility discount has an unhelpful prominence in the offsetting process.

April 2015 pension freedoms

It was considered that pension freedoms may result in less need for offsetting calculations. The reform allows for the conversion of future income into present capital, albeit with tax and financial planning implications. Given the advantages that this may bring, the group was of the opinion that parties should be rationally more enthusiastic about holding or receiving pension assets as part of a settlement. The increased flexibility and utility of pensions further fed the question concerning the relevance of the utility discount.

The group took issue with some of the observations of Nicholas Francis QC (sitting as a Deputy High Court Judge) in the case of *SJ v RA* [2014] EWHC 4054 (Fam), at para [83] where he opined that pension freedoms meant that pensions '… are virtually to be treated as bank accounts for people over 55'. The deputy judge also suggested that courts are likely to be 'most reluctant in future' to allow for actuarial reports on the issue of how to effect equality of income outcomes. Further, 'I suspect that annuities will, in the overwhelming majority of cases, become a thing of the past.'

The fundamental problem with treating pensions as 'bank accounts' is knowing what, precisely, is the value contained within the bank account. While the group (as noted above) were content in standard defined contribution scenarios to use the CE as the starting point, defined benefit schemes required a proper assessment of value. Second, unlike a bank account, there may be significant tax issues depending on the manner in which value is drawn from a pension.

It is clearly a matter for the courts as to whether the approach of 'equalisation of income' or 'equal division of pension capital' is deployed at the distribution stage of analysis.[19] This does not, in our respectful opinion, remove the need for pension experts to be instructed, particularly in the context of defined benefit schemes or 'off piste' defined contribution schemes. The judgment in *SJ v RA* fails to make any distinction between defined contribution and defined benefit schemes. We respectfully suggest that such comments, emanating from the persuasive judgment of an eminent matrimonial finance practitioner sitting as a deputy high court judge, may encourage courts to make wrong decisions when considering Part 25 applications in particular circumstances.[20]

The IFAs present did not agree that annuities were necessarily a thing of the past and examples were cited of recent clients choosing to eschew 'pension freedoms' (and the lure of the Lamborghini) in favour of the security of an annuity.[21]

Following the experts' meeting on 1 September 2015, a sub-group of the

19 The practice of excluding pension capital acquired prior to cohabitation in 'middle money' cases is, respectfully, specious. Middle money cases are still, overwhelmingly, 'needs' cases and the exclusion of pre-acquired assets should only be considered in cases where assets exceed needs: *N v F (Financial Orders: Pre-Acquired Wealth)* [2011] EWHC 586 (Fam), [2011] 2 FLR 533, at para [15]. See also *Harris v Harris* [2001] 1 FCR 68, at para [26] where Thorpe LJ stated that the fractional approach, '… is an ingenious submission but one that, if followed with any sort of confidence might well lead to unrealistic results'. It is a curious accident of law reporting that such an important statement of principle never received wider publicity with a FLR citation.

20 There is a particularly egregious example posted by Magnus Mill (Alexiou Fisher Phillips) in the LinkedIn discussion group 'BDM Pension on Divorce Forum'. Registration on LinkedIn is required before viewing this page https://www.linkedin.com/grp/post/4992123–6035020415552802816?trk=groups-post-b-title (last visited 4 September 2015) where it is reported that a High Court Judge refused permission for an actuary where there was a defined benefit scheme with a CE of £2.6m and a DC pension with a CE of £1.5m. Pension sharing was not available and the court, in refusing the application, opined that counsel's submissions would be sufficient to deal with the issue.

21 Anticipating the April 2015 reforms the then pension minister, Steve Webb, made the memorable and ill-advised remark that people might choose to buy a Lamborghini with their pension pot and then live off their state pension. There are anecdotal reports that one individual cashed in his pension to purchase an old Routemaster bus!

experts kindly drew up a glossary of agreed commonly used terms. This is to be found in the Appendix to this paper.

Key factors

We suggest that there are six key factors which should be borne in mind when considering different approaches to offsetting:[22]

- Is the pension a defined contribution or defined benefit scheme? The former has a well-defined value, the latter does not.
- In the case of a defined contribution scheme, is it more appropriate to look at what it would cost to replace the current fund or the future benefits out of non-pension wealth? The answer will depend mainly on the parties' current ages and size of funds involved.
- In the case of a defined benefit scheme or the replacement of benefits under a defined contribution scheme, should the offset value be the value to the member of that pension, or the value to the non-member of having an equivalent pension or share of pension?
- What is the fair rate to use for discounting to present values (recognising that there may be differences in the discount rates appropriate to the pre-retirement and post-retirement periods)?
- What account should be taken for tax, before and after retirement?
- What account, if any, should be taken for the utility of holding cash?

Conclusion

Whilst the broad s 25 brush is entirely appropriate when considering asset distribution on divorce, it is another matter altogether to arrive at an arbitrary figure, for want of evidence or lack of appreciation of the issues in play.[23] The lack of explicit reasoning for pension offsetting outcomes, identified in the Nuffield report, *Pensions on Divorce*, is not a cause of these issues but may be a symptom. How much more thought would be taken if lawyers were required to record the rationale for their offsetting decision?

To date, it has not been possible to arrive at a working formula which might be applied in the valuation of pension offsets.[24] Further interdisciplinary discussion between lawyers, actuaries and IFAs of the above key factors is needed, to achieve better mutual understanding and consistency, and grasp of the interrelationship between pension offsetting assumptions and *Duxbury* calculations. Interdisciplinary forums, so successful in the child law context, are a model which financial remedy lawyers could consider.

In addition to further interdisciplinary discussion, both lawyers and judges might consider whether some adjudication of pension issues would be appropriate. This is not a call to open the floodgates but for a few test cases to be judiciously selected to provide some clarity in this confused and neglected corner of the law.

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22 We are grateful to Stephen Bridges for his helpful contributions here.

23 Note *NG v KR (Pre-Nuptial Contract)* [2008] EWHC 1532 (Fam), [2009] 1 FLR 1478, at para [135] per Baron J, declining to accept the argument that decisions in the financial remedy context are arbitrary and may therefore breach Art 1 of Protocol 1 of the European Convention of Human Rights etc. 1950. See also S Choudhry and J Herring, *European Human Rights and Family Law* (Hart Publishing, 2010), Ch 10.

24 David Burrows attempted to do so at [1999] Fam Law 556 'Pensions – How Much to Offset?' This pre-*White*, pre-pension sharing order era analysis makes for a fascinating retrospective as to how far the law in this area has changed in a relatively short period of time. In light of information gleaned in this exercise, we consider that David Burrows' proposed discount 'to compensate for … the accelerated benefit to the wife of offsetting the pension fund against the couple's liquid capital' may be too high at 2%–3% pa. Burrows himself describes it as 'entirely arbitrary'.

Appendix

Glossary of Terms/Abbreviations used in pension offsetting reports

Abbreviation	Stands for	Meaning/Comments
CE/CETV/CEV/CEB	Cash Equivalent (Transfer) Value (of Benefits)	
DB	Defined Benefit pension, aka Final-Salary or salary-related	
DC	Defined Contribution pension, aka Money-Purchase	
PLA	Purchased Life annuity	A 'non-pension' annuity purchased from personal funds.
SPA	State Pension Age	
UV	Utility Value	Value allowing for the lower attractiveness of pension benefits due to deferment of lump sums and pensions.
PCA	Pension Commencement Age	Age derived from instructions, or pension analysis.
LA, IP	Lifetime Allowance, Individual Protection	HMRC definitions indicating restrictions on maximum pensions, with tax implications.
FV, FAV	Fair (Actuarial) Value	Value of future pension benefits discounted to present value using specified actuarial assumptions, (sometimes) the value of a DC fund reasonably equivalent to a specified DB pension.
MCCV	Market Consistent Capital Values	Value of future pensions using actuarial assumptions consistent with present financial market conditions.
OEV	Offset Equivalent Value	Value of future pensions using actuarial assumptions consistent with values of other immediately-realisable capital assets.
LV	Liquidation Value	Value if pension realised using new pension freedoms – for DB pensions, assumes immediate transfer to a DC, then realisation.
NRA, NPA	Normal Retirement (Pension) Age	As defined in pension scheme rules, normally earliest age at which DB pension can be started without early retirement discount.
FOS	Financial Ombudsman's Service	Who publish actuarial assumptions for use in pension mis-selling calculations.
NISA	New Individual Savings Account	New form of ISA saving account