

## **PENSION SCHEMES AND THE FAMILY – A TIME FOR CHANGE?**

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### 1. INTRODUCTION

1.1 The principal motivation for this paper is our involvement in the valuation of pension benefits under the Family Law (Scotland) Act 1985 and the review being undertaken by the Pensions Management Institute Working Group on pensions and divorce. As a consequence of the introduction of the Family Law (Scotland) Act 1985, there is an explicit provision that pension benefits should be included as part of the matrimonial property in a divorce settlement. It will be clear from this paper that we have considerable doubts as to whether the present law is satisfactory; nevertheless it is difficult to argue that such an important item as pension rights should be disregarded in divorce. This however, is often the position in England, Wales and Northern Ireland.

1.2 One of the major purposes of this paper is to consider how pension benefits might be dealt with in a divorce settlement, both in the context of the Scottish law as it currently stands and more generally if it were possible to change the current divorce or pensions law. Our prime emphasis is on final salary pension schemes; similar principles can be applied to money purchase schemes. It became clear in writing this paper that it is necessary to consider also State benefits, both pension and means tested benefits.

1.3 Some relevant marriage and divorce statistics are included in Appendix A. The increase in recent years in rates of divorce is well known. It is particularly well illustrated by the graph A1 showing the rates of divorce in Scotland at successive durations of marriage for marriages taking place in 1965, 1970, 1975, 1980 and 1985. For the 1965 marriages, the rate of divorce has never exceeded 10 divorces per 1,000 marriages in any year. By contrast, for 1980 marriages, the divorce rate peaked at over 25 per mille, for marriages of five years duration. The graph suggests some slight evidence that the rates of divorce may no longer be increasing, as the rates for 1985 marriages are, for most years, slightly lower than 1980 marriages. There is certainly no sign of any substantial down turn however. Table A2 illustrates the increase in a different way, showing a rise in the rate of divorce over the entire married population from 2 per mille in 1961 to 13 per mille in 1990 (for England and Wales), and from 1 per mille in 1961 to 11 per mille in 1990 (for Scotland). Table A3 shows a comparison of divorce rates by age in 1981 and 1990, showing an increase at all ages below 60. The Northern Ireland registrar has only been keeping comprehensive divorce statistics since 1983, so a full comparison cannot be made in the Province. The information available suggests a gradual increase in divorce rates there, although the level is lower than in Great Britain.

1.4 Less attention has been paid to the decreasing rates of marriage. Table A5 shows rates of marriage in 1981 and 1990. The rate of first marriages for men below age 25 has

almost halved between the two dates. In England and Wales there was also a substantial fall in the rate of marriage for men between 25 and 29 whilst in Scotland there was a slight fall in the rate in this age band. There is, as yet, no sign of a compensating increase in rates of marriage for men over 30 although this may yet come about. This table also shows a considerable fall in the rates of re-marriage, particularly for divorcees.

1.5 Table A6 summarises the population by age and marital status since 1961. This table shows clearly the effect which increased rates of divorce have already had upon the distribution. In England and Wales, for men between 35 and 45, the proportion who are married has fallen by almost 10 percentage points since 1961, almost exactly corresponding to the increase in the proportion of men who are divorced. The divorce rates have not yet worked through to have a major impact upon the proportion of men of retirement age who are married. However, if rates of first marriage and of re-marriage remain at their current low levels, then in due course the proportion of men at retirement age who are married will fall substantially. If current rates do continue, we estimate the proportion of men aged 60 to 64 who are married could fall from about 80 per cent in 1990 to 63 per cent in 2030.

1.6 Pension schemes in the U.K. have developed in an environment where normal family life was considered as a couple legally married who remained married until one of them died. In addition the automatic granting of widows' benefits, but until recently not always widowers' benefits, has been based upon the assumption that, in the majority of cases, a wife is economically dependent upon her husband. Whatever the precise figures may be for future rates of marriage and divorce and women working, it is likely that this pattern of family life will continue to apply in the majority of cases. However it is a pattern that will be increasingly less common.

1.7 The operation of the Family Law (Scotland) Act 1985 in relation to pensions was discussed in an Actuarial Note by Allan Martin<sup>1</sup> presented to the Faculty in November 1991. Other papers and articles of interest include those by Athole Smith<sup>2</sup> and Andrew Scott<sup>3</sup>. However the wider implications of divorce and changing family structure for pension schemes have not been considered. In Section 2 we review the valuation of pensions for the purposes of divorce in Scotland, whilst in Section 3 we consider more generally the financial effect of divorce. Sections 4 - 6 set out certain principles which any form of pension settlement on divorce should follow and examine ways in which these might be met. In Section 7 we consider more generally whether current benefit design is well suited to the changing circumstances outlined in paragraph 1.6.

1.8 For simplicity of expression, in general throughout the paper we have assumed that the pension scheme member is male and that the partner is female. Similar principles do of course apply in the converse situation where a scheme member is female.

1.9 We are grateful to all our colleagues and acquaintances for their views and comments which have contributed directly or indirectly to this paper. However, the views expressed are solely the responsibility of the writers. We are particularly grateful

to Anne Kennedy for many of the background calculations and Heather Laing for dealing with our many drafts.

## 2. VALUATION OF PENSIONS FOR THE FAMILY LAW (SCOTLAND) ACT 1985

### 2.1 *Theory and Practice to date*

The provisions of the Family Law (Scotland) Act 1985 as relating to pensions are set out in Appendix C. The Act refers to “rights or interests of either party under a .... Occupational Pension Scheme . . .” but it provides no guidance as to how the value of these rights or interests should be determined. Clearly, the level of benefits that will emerge from a pension arrangement, the length of time for which they will be paid and the current cost of providing them depend upon future economic conditions and the future demographic experience of the parties concerned. It appears to have been accepted by the Courts that the value of the pension benefits must be an average or expected value which in some way will depend upon the assumptions made. This is a welcome contrast to personal injury cases where Courts generally seem reluctant to pay attention to any calculations which rest upon actuarial assumptions.

### 2.2 *Final Salary Schemes*

The Act makes it clear that only benefits accruing in respect of the period of marriage up to the relevant date (in most cases the date of separation) should be taken into account and valued. The lack of guidance on the valuation method has led, in the case of final salary schemes, to a contentious debate: should the value be taken as a leaving service value, based upon earnings at the relevant date and subsequent pension increases during deferment, or a continuing service value which makes some allowance for increases in future earnings. The term “continuing service value” may be confusing as it is sometimes interpreted as meaning a value based on the assumption that the member continues in service until normal retirement age. In practice most actuaries quoting a continuing service value include an allowance for future withdrawal from service.

2.3 In an article in the Journal of the Law Society of Scotland, Andrew Scott<sup>3</sup> put forward a number of arguments in favour of the leaving service value, the principal ones being:

- It can be based upon the transfer value available from the member’s pension scheme and is therefore simple, practical and cheap.
- It is objective as a scheme has only one basis of calculation and this avoids a need to take decisions about the assumptions to be made. This argument falls if the calculations are being made by an independent actuary, rather than being based upon the transfer value.
- It is objective as it allows only for inflationary increases in the member’s benefits between the relevant date and normal retirement age and is thus independent of a member’s future achievements.

- It is appropriate as pension schemes should be funded at least at the level adequate to provide transfer values.

2.4 We consider that the principal arguments in favour of a continuing service value are:

- Unless the member does leave service at or shortly after the relevant date, it is likely that the benefits ultimately emerging (even ignoring service after the relevant date) will be greater than the leaving service value calculated. The continuing service value provides a better measure of the average level of benefits that are expected to emerge.
- An actuary will generally calculate the continuing service value in different cases on the same assumptions (subject to any adjustment for market conditions at different dates) and these assumptions will be stated and can be analysed in court. By contrast the leaving service value would depend upon the actuarial basis used for transfer values by the scheme and two schemes, otherwise identical in all respects, may use different actuarial bases for this purpose.
- In some schemes, particularly certain public sector ones, retirement with no reduction to take account of early payment or at least on favourable terms, may be available at an earlier age than the deferred pension is payable.

2.5 Two points that have received less attention are the treatment of widows' benefits and lump sum death in service benefits. There is a wide range of possible treatments for widows' benefits. At one extreme no allowance might be made, on the basis that, following the divorce, no widow's benefit would be payable from the scheme. In principle if this approach is followed an allowance should be included for the possibility of re-marriage; this raises the practical difficulty of whether such an allowance should be a general one based upon population statistics or reflect any known intention in the particular case. At the other extreme, widows' benefits may be valued in full by applying a factor which assumes 100 per cent proportion married, on the grounds that the aim is to value the benefits as they existed at the relevant date. An argument can be put forward for applying a lower proportion married factor to reflect the possibility of future divorce based upon population statistics. Lump sum death in service benefits may present a problem since in most cases they are not expressed as a function of service. Nevertheless, there is a case for valuing a proportionate part of the lump sum death in service benefits for a continuing service valuation, although probably not in a leaving service valuation.

2.6 Unless the value is taken as the transfer value available from the member's scheme, an actuary, in valuing the pension benefits, will need to make the usual type of assumptions such as rate of return, rate of growth in earnings, rates of mortality, etc. The general approach adopted by practitioners in this area seems to be the pragmatic one of adopting standard assumptions based upon population or pension scheme membership statistics, without attempting to make adjustments for individual circumstances. On the

grounds of practicality this must be right, although it does leave actuaries open to the criticism that they have assumed the pension scheme member is an average man.

2.7 The most significant factor in determining the value will generally be the real rate of return. The choice of this is likely to be influenced by whether the actuary is calculating the value as the cost to a pension scheme of providing a certain level of benefits or the cost to an individual of replacing them. Some actuaries have argued that this distinction is irrelevant since the individual would always be able to invest the proceeds of the divorce settlement in a personal pension or other tax sheltered investments such as PEPs. However in the case of a spouse with no relevant earnings, the former will not be available whilst the level of charges on the latter may be significantly more than the investment expenses incurred by a pension scheme. Aside from the allowance to be made for tax on investment income, the choice of method may have a significant impact upon the rate of return chosen, if it is assumed that an individual would invest in relatively low risk assets (e.g. index-linked stocks) rather than equity type investments more often held by pension schemes.

2.8 In many cases there is an interval of some years between the relevant date and the actuary being asked to carry out a valuation. There appears to be no clear guidance as to whether, in these circumstances, the actuary should take account of events that have happened since the relevant date. In some cases this question may be of little importance. In two particular circumstances, however, it may make a very significant difference to the valuation: if a member has subsequently left his pension scheme or if there have been benefit improvements which have retrospective effect for all service. A similar, and perhaps even more difficult, choice arises where there are foreseeable future changes. For example, where a scheme has a substantial surplus but currently provides no pension increases, should the impact of limited price indexation be allowed for? As the Act stipulates that the pension benefits should be valued as at the relevant date, the consistent approach would be to ignore subsequent events, placing a value on the benefits as if the calculation had been done at the relevant date itself. However if a continuing service value is calculated in this way, and the member has subsequently left service this may be widely regarded as unfair however actuarially and legally correct.

### *2.9 Money Purchase Schemes*

At first glance the valuation of benefits arising from money purchase schemes may seem easier than those from final salary schemes for two reasons: first, the value of the pension does not depend upon a member's future salary progression and secondly, there is an identifiable sum of money attributable to the member. Apart from occasional difficulties with insurance companies which are unable to quote a transfer value as at a retrospective date, there are two issues that arise. The first, relating mainly to individual arrangements, is that if the policy has only been in existence for a short time the transfer value available may represent a low proportion of premiums paid because of initial expenses. If the member continues to contribute to the policy, these initial expenses will effectively be spread over the whole lifetime of the policy. In our view, for consistency

with a continuing service approach, some allowance should be made for this. We do, however, recognise the practical problems involved and that such adjustments may only be worth making for policies of relatively large value. The second point concerns tax and is discussed below.

#### 2.10 *Tax*

We believe it will be generally accepted that an allowance should be made for tax on the pension emerging from a pension scheme. For example, it would not be fair that for a person just on the point of retirement at the relevant date, the value of a personal pension should be taken as the gross open market option. In our view an allowance for tax should equally be made for a person some years away from retirement, although determining the precise amount becomes more difficult the younger the member. Related to this is the question of whether any allowance should be made for tax on investment income. This is essentially the same question raised in paragraph 2.7 as to whether the value should be the cost to the pension scheme of providing a pension or the cost to an individual of replicating that pension. If the latter approach is chosen, some adjustment must be made to allow for the effect of tax on the investment income of an individual. This adjustment is particularly noticeable in the case of money purchase pension schemes. Allan Martin<sup>1</sup> has suggested that, as making such an adjustment would lead to valuing money purchase pension benefits at an amount different from, and higher than, the transfer value, this could lead to ridicule. We believe the force of this argument is diminished by the fact that an adjustment for tax on pensions in payment will in any event cause the pension to be valued at an amount different from the transfer value. In the absence of clear guidance, we think it is difficult for the profession to avoid the fact that in order to answer the question “what is the value of the pension” one needs to ask the question “to whom?”

#### 2.11 *Unfunded Schemes*

In general these schemes can be treated in the same way as final salary pension schemes. However, additional problems may arise for unapproved unfunded arrangements for executives whose earnings are in excess of the earning cap. First, the documentation specifying the benefits to be awarded may be incomplete or unclear, in which case it will be necessary to take advice from the instructing solicitor as to the benefits to be valued. Secondly, there is the question of whether a reduction should be applied to reflect the possibility that the employer will not in the event meet the benefits promised. At present such schemes are rare but increasingly there will be occasions when such benefits need to be valued.

#### 2.12 *Case Law*

The extent of guidance to date by the Courts has been quite small. The fundamental issue of whether a continuing service or leaving service value should be used has only rarely been addressed. In one case, *Slane -v- Slane* in Dundee Sheriff Court, the Sheriff's decision to use a leaving service value was overturned by the Sheriff Principal. His reasoning included the remark that both methods rested upon assumptions but the

leaving service value rested primarily on one assumption that was patently false viz that the member had left service at the relevant date. We understand that this judgement is not binding on other Courts, except possibly within the Dundee Sheriffdom, but it has been quoted in subsequent judgements. Its general application may be limited by the fact that the scheme member was close to retirement age and stated in cross-examination that *he intended to continue working until normal retirement age*. It is worthy of note that the Sheriff Principal confirmed it was acceptable for a valuation to be put forward on both bases with the Court making the decision as to which was the appropriate one to use.

2.13 One issue which has been considered on a number of occasions is the date at which the valuation should be made and whether any allowance should be made for subsequent interest. It appears to be firmly accepted that the valuation must be made as at the relevant date with no allowance for interest between the relevant date and the date of the divorce. There have been cases where the period between the relevant date and date of divorce has been in excess of ten years. If a basic purpose of the Act is to give the non pension scheme member a sufficient sum of money to replicate the share of pension benefits which she might otherwise have benefited from, this insistence upon valuing the benefits at the relevant date with no allowance for interest appears to frustrate this aim.

2.14 As practitioners are only too well aware, theoretical arguments about the correct valuation of pension benefits can often be rendered superfluous by the lack of free resources to finance a settlement. If one of the basic aims of the Act is to provide a reasonable level of income for the non-pension scheme member in retirement, this will not be met in many cases because of the inability to obtain any resources from the member's pension scheme. We consider this point further in Section 6.

2.15 There have been a number of decisions about the appropriate split of the pension benefits. Several cases have either awarded a greater proportion to the scheme member (typically 60 per cent) or deferred part of the settlement for a number of years without the addition of interest which may produce approximately the same result. We have some sympathy with the view that, in effect, a further discount should be applied to the value of a pension to reflect the lack of any immediate access to it. However, one judgement (*Latter -v- Latter*) stated that, provided the scheme member has sufficient free resources to finance the settlement, an equal split should be awarded.

### 3. FINANCIAL EFFECT OF DIVORCE

#### 3.1 *Financial Effect on Pension Schemes*

Most pension schemes provide pensions and lump sum benefits upon the death of a member either in service or after retirement. In a typical scheme the lump sum benefits are paid irrespective of marital status, although a few schemes give different levels of benefit for married and unmarried members. Pensions, however, are generally only payable to the spouse of a deceased member; a divorced spouse does not qualify. Indeed

Inland Revenue conditions for approval will not permit a pension to be paid automatically to a divorced spouse; a degree of dependency would have to be proved which will only apply if the member is paying an allowance to his ex-spouse. Some schemes do provide a higher level of children's benefit if no spouse's pension is payable, or permit the payment of a dependant's pension to, for example, the member's parents. Notwithstanding this, the divorce of a scheme member will tend to reduce the liabilities of the scheme. To the extent that the funding basis incorporates a proportion married for assessing the cost of the spouse's benefits which implicitly allows for divorce rates, the reduction in liabilities will have been anticipated. The reduction in liabilities will be reversed if the member remarries.

3.2 The statistics in Appendix A demonstrate clearly the reduction in rates of marriage and the increase in rates of divorce over recent years. These changes have not yet had a great impact upon the proportion of the population which is married at ages 60 and above – the ages at which most widows' pensions will start. However our projections suggest that in 40 years time, the proportion married amongst males at retirement age may have dropped from some 80 per cent to about 63 per cent. These proportions are derived from population statistics and may therefore understate the proportions for members of pension schemes. However the approximate size of the reduction should not be affected. Clearly the results of this projection are sensitive to the continuation of recent trends in marriage and divorce rates. Our results are similar to previous population projections<sup>4</sup>.

3.3 Using the model pension scheme and actuarial basis set out in Appendix B, we calculate that the contribution rate required for the scheme would fall by 0.3 per cent of pensionable payroll if the assumed proportion married at retirement of male employees is reduced by some 17 percentage points. We consider this reduction in cost further in Section 7 in the context of whether the traditional system of paying dependants' pensions only in respect of those members who are married remains appropriate.

3.4 We have calculated the release of liabilities occasioned by divorce (allowing for the probability of subsequent remarriage), assuming continuation of current rates. We find that this is equivalent to a contribution rate of approximately 0.17 per cent of pensionable payroll. In the context of U.K. pension schemes as a whole, this might be equivalent to about £250 million each year. In practice part of this saving will not occur for schemes which pay transfer values which include spouse's benefits even for single people. Many of the proposals for "pension splitting" mean that a scheme would no longer benefit from the release of liability for spouses' benefits upon divorce. These figures therefore give an estimate of the maximum additional costs that may be imposed upon pension schemes. However to the extent that schemes are currently funded using conservative (high) proportions married which do not reflect the actual rates of divorce this cost will take the form of a reduction in future surplus rather than an unexpected strain.



### 3.5 *Financial Effect on Individuals*

In a paper on the pension consequence of divorce, Joshi and Davies<sup>5</sup> consider the total income in retirement of women with a number of “life histories”: different cases covering different ages at divorce, number of children and level of earnings. In particular they compare the level of income with an “adequacy level” which is £25 per week in excess of the full single person’s basic State pension. Their study incorporates general observations about the adequacy of women’s pensions. However, for the purposes of this paper, the main points of interest are the effect of divorce, particularly in a case where a husband has been a member of a final salary pension scheme. The main findings of relevance are:

- Where both husband and wife are members of final salary pension schemes, the divorced wife’s pension is likely to be adequate. A divorced wife will typically receive between 50 per cent and 90 per cent of the (half share of the) pension she might have expected to receive but for the divorce.
- For the “career housewife” i.e. a woman who does not work after marriage, or after divorce, the pension will not be adequate, and will be only about 10 per cent of the expected pension. Some form of pension splitting will normally tend to make the pension adequate.
- Where the husband is a member of a final salary pension scheme and the wife only has SERPS benefits, the pension will often be inadequate for the divorced wife, typically being between 15 per cent and 25 per cent of the expected pension, but only 2 per cent for the career housewife. In the majority of cases, some form of pension splitting will restore the wife’s pension to an adequacy level.
- Some form of pension splitting does not in general result in a second wife’s pension falling below the adequacy level, and never does so if the husband has a final salary pension.

3.6 Interested readers are referred to Joshi and Davies for more details. To illustrate this aspect we have included in Appendix E three sample illustrations. These show:

- the joint income of the couple if there is no divorce;
- the income of each party separately after divorce under the current system, and
- the income of both parties after divorce if some form of pension splitting is introduced.

3.7 All three illustrations assume that the wife is not a member of an occupational pension scheme and to this extent they may overstate the problem for a wife following divorce. The illustrations do, however, show the considerable reduction in income suffered by a divorced wife; indeed in one of the three illustrations if there is no form of pension splitting, the wife’s income will be so low that she qualifies for income support.

### 3.8 *Financial Effect on the State*

There are three principal areas in which the State income and expenditure may be affected by divorce: basic State pension, payment of income support and other means tested benefits, and tax receipts. The payment of a basic State pension is dependent upon the pensioner having an adequate contribution record. After divorce, a woman may substitute her former husband's contribution record for her own for the period of marriage if this is more favourable to her for the purposes of calculation of the basic pension (there is no such facility in the case of SERPS). It should be noted that where this applies, this is not a transfer of benefits, it increases the total pension paid to the couple. There are no statistics available regarding the cost of this concession. Two of the examples in Appendix E show an increase in State pensions. Any cost to the State from this effect will be offset to some extent by the removal of the married couple's additional tax allowance.

3.9 Although one of the examples in Appendix E shows the divorced wife receiving income support, in the long term this may become relatively rare. Ultimately the majority of divorced women should receive a relatively full basic State pension, using a combination of their contribution record whilst at work, home responsibility allowance for any period when they were looking after children, the substitution of their husband's contribution record for the period of marriage (if appropriate), and automatic allocation of a full contribution record for ages 55 to 60. At present levels, income support for a single pensioner is only some £3 per week higher than the full basic State pension. It will therefore require only a small SERPS or occupational pension in addition to the basic State pension to bring the divorced wife's income above the maximum level for income support.

3.10 In the long term it is likely that any measure of pension splitting will increase the expenditure of the State. First, if pension splitting is restricted to non-State pensions, there is likely to be a loss of income tax receipts by the State. This is because pension splitting will, to some extent, result in pensions which would have been taxed at 25 per cent (or a higher rate) in the hands of the husband, being taxed at 20 per cent or not at all in the hands of his former wife. Secondly, if pension splitting extends to SERPS benefits then one half of the husband's SERPS benefit will continue to be paid for the lifetime of the former wife. In general this is likely to be a longer period of time than the lifetime of the husband.

3.11 It is extremely difficult to produce any reliable estimates of what might be the cost to the State. At present, total income support payments to divorced women over age 60 are some £111 million a year. There are no precise figures available for tax payments by divorced men, but the best estimate is £77 million a year. However, the relative levels of the income support and tax thresholds is such that these amounts cannot simply be offset against each other. It is probable that the introduction of pension splitting would reduce the tax take for the State by more than the reduction in income support payments, particularly in the long term.

#### 4. GENERAL PRINCIPLES FOR PENSION AND DIVORCE

4.1 Upon divorce a wife may lose four elements of pension and ancillary benefits:

- The indirect benefit arising from her husband's pension in respect of service prior to the divorce.
- The prospect of obtaining a widow's pension based upon service prior to divorce upon her husband's death.
- The prospect of obtaining a lump sum upon her husband's death before retirement.
- Benefits corresponding to the first two elements but based upon service after the date of the divorce.

4.2 Sections 4 – 6 of this paper are concerned almost entirely with the first two elements above. Although it can be argued that due to divorce a wife has lost the prospective lump sum death in service benefit, it can equally be argued that in most cases she has no need for it, as she is no longer financially dependent upon her former husband. This argument may not be true if some periodical allowance has been allocated, perhaps for the care of children. The loss of pension benefits in respect of future service may be a very real factor, particularly where a divorced wife has to care for young children. However this cannot be considered in isolation from compensation made for lost future earnings.

4.3 In evaluating any options for dealing with pension benefits on divorce, it is useful to consider what characteristics an ideal method would have. We put forward the following as the most important considerations.

##### 4.4 *Fairness to Scheme Member*

This is interpreted as covering two aspects:

- The scheme member should receive benefits, in respect of the period of marriage, at a level of at least one-half the level he would have received but for the divorce.
- The member should not have to allocate a sum out of the matrimonial property to cover a non-realizable asset.

##### 4.5 *Fairness to Spouse*

This is interpreted as meaning that the spouse should receive income, in respect of the period of marriage, at a level at least half that her husband would have received but for the divorce whilst he is alive and at least equal to the level she would have received after his death. (Given the most common spouse's pension proportion of 50 per cent, this will often mean the same level of pension throughout her life).

##### 4.6 *Practicality of Settlements*

This covers the following areas:

- In order to facilitate out of court settlements, there should be no measures which are available to the Court but not to the parties in an agreed settlement.

- The process of valuing and splitting the pension benefits should be as simple and cheap to the parties as possible.
- The effect of pension benefits on any judgment by the Court should be predictable; again this will facilitate out of court settlements.

#### 4.7 *Ease of Administration for Schemes*

This covers the following areas:

- Whether the scheme merely has to supply information or is involved in the re-allocation of benefits.
- Whether the scheme's involvement is only at the time of the divorce or there is an on-going involvement.
- Whether the scheme is involved in any uncertainty, either as to the amount of any benefit or the beneficiary.
- Whether any special record keeping is required.
- Whether complicated calculations are required, particularly those involving actuarial values.

#### 4.8 *Cost to Schemes*

This covers the cost of benefits, rather than the cost of administration, whilst cost should also be interpreted as including a saving. Some of the options discussed below involve costs which are estimated using the model whose details are set out in Appendix B.

#### 4.9 *State Benefits*

Any method should be consistent regardless of the level of State benefits. In particular there should not be any inconsistency between the treatment of a member of a contracted-out scheme and a member of one which is not contracted-out. Secondly, no additional liability should be placed upon the State.

#### 4.10 *Comprehensiveness*

Any method should be capable of dealing not only with members of final salary pension schemes but also members of defined contribution schemes, and with deferred pensioners and pensioners. The answers produced, for example, for a member shortly before retirement and shortly after retirement should be consistent.

4.11 It is not possible simultaneously to satisfy the requirements of fairness to the member and spouse as set out above, at no cost to the scheme. This is because at present, divorce leads to a release of liabilities for the spouse's pension. To this extent, there is arguably no perfect method of dealing with the problem.

## 5. SUGGESTED IMPROVEMENTS UNDER SCOTTISH LAW

5.1 We believe that the introduction of the Family Law (Scotland) Act 1985 represented a major step forward by explicitly stating that pension benefits should be taken into account in a divorce settlement. The significance of pension benefits needs no emphasizing to an actuarial audience, but is underlined by the number of cases in which pension benefits are valued at a greater amount than all the other matrimonial property combined. As pension benefits are included in matrimonial property and hence split upon divorce, it would be reasonable to hope that the Act would provide a reasonable measure of security for divorced spouses after retirement. In fact, we believe that in many cases this will not occur. Many of the failings of the Act cannot be rectified under current pension law, and these aspects are discussed in the next section. This section considers ways in which the operation of the Act could be improved in the relatively short term.

### 5.2 *Method of Valuation*

We believe it is crucial that some guidance is given regarding the circumstances in which it is appropriate to use either the leaving service or continuing service methods. From experience to date it appears that the Courts will not wish to rule out either of these methods totally. We think there is a role for the actuarial profession to explain the characteristics of these methods. However, we think any attempt by actuaries to influence unduly the choice of method would be unwise, and possibly damaging to the reputation of the profession with the Courts.

### 5.3 *Basis of Valuation and Tax*

At present there is a significant difference of opinion as to what allowance, if any, should be made for tax. A related issue is whether the pension should be valued from the viewpoint of the scheme providing it, or of an individual trying to replicate the benefits. As with the basic method of valuation, we believe this is such a fundamental point that the ultimate decision must rest with the Courts (or with Parliament through an amendment to the Act). Again, it may be helpful for the profession to explain the consequences of each choice.

5.4 Clearly there is scope for the profession to be criticised if different actuaries produce significantly different valuations for the same pension. Although we have not conducted a full survey of the assumptions used by different practitioners in this field, we do not think that the range is such that unacceptable variations are arising, especially if differences due to different tax treatments can be eliminated. Although the use of a standard basis for all Court work has some attractions, we think it would be difficult to justify when such matters as cash equivalent bases are not so tightly controlled. On balance our view is that no specific professional guidance is required.

### 5.5 *Loss of Interest*

The Act states that matrimonial property, including pension, should be valued as at the relevant date. In Court Judgments this has been interpreted as meaning a valuation

at the relevant date with no addition of interest for the period between the relevant date and date of settlement. Reference has been made to this being consistent treatment with other property. We think that, given the essential discounted nature of a pension valuation, it is difficult to justify not adding interest for the period to the date of settlement and we believe that discussions between the actuarial and legal professions on this point would be useful.

### *5.6 Widow's benefits*

The present uncertainty regarding the inclusion of widow's benefits can only lead to additional valuations and extra arguments. We see this as essentially a legal point relating to what benefits should be valued, and hope that it will be clarified soon.

## 6. POSSIBLE WAYS FORWARD

6.1 In this section we consider four possible ways of taking account of pension benefits on divorce. Each option is analysed against the criteria set out in Section 4.

### **Clean Break, Capital Settlement, No Transfer Value Available**

6.2 This is the method currently in use in Scotland. It involves placing a value upon the pension benefits and notionally allocating half to the spouse. Since no transfer value is available from the scheme, in practice the money must be raised from other matrimonial assets.

### *6.3 Fairness to Scheme Member*

The member's benefits are unaffected by the settlement. However, he does have to allocate out of the remaining matrimonial property a sum to cover the non-realizable pension asset that has been valued.

### *6.4 Fairness to Spouse*

The spouse does not directly receive any pension benefits. She can however, use the part of the settlement that represents half of the value of the pension benefits to provide a pension for herself by investing it. Because of the effective switch between a final salary and money purchase arrangement (in many cases), there can be no guarantee that the expected level of income will be met. However, if she is given a value calculated as a past service reserve at the date of settlement it can be said that she has a reasonable expectation of matching that level of income. Indeed, since she is receiving this value as an immediate settlement rather than an unrealizable value within a pension scheme, she is gaining a major although unquantifiable advantage. If the value is calculated as a cash equivalent, or is calculated as at the date of separation which is some time before the settlement date, it may be argued that she is not receiving a fair settlement.

6.5 There is one peculiarity which relates to the treatment of the contingent spouse's pension. If the value of the pension benefits includes the spouse's pension and the aggregate is split between the two parties, then in effect this does not allocate the whole

value of the spouse's benefit to her. To this extent this method does not meet the criterion for fairness to the spouse set out in Section 4. Typically, the widow's pension might form about 25 - 30 per cent of the total value. Thus, the "fair" split would be 62.5 - 65 per cent to the wife rather than 50 per cent. In cases where the scheme member is female a widower's pension might only be 10 per cent of the total value leading to a "fair" split being 55 per cent to the husband.

#### 6.6 *Practicality of Settlement*

If suitable guidance is given in the legislation, there is no reason why the process of valuing pension benefits should not be relatively simple. The guidance should include:

- Whether a cash equivalent or a past service reserve should be used.
- Whether the value should be calculated as the cost to the scheme of providing benefits, or the cost to an individual of replacing the benefits, assuming tax sheltered investment is not available.
- Whether interest should be added from the date of separation to the date of settlement.

6.7 Depending upon the answers to the first two points above, there may be a role for professional guidance as a supplement to the legislation. A combination of legislative and professional guidance would improve the position compared with the current situation in Scotland. The major problem that would remain is how to deal with cases where the value of the pension is close to or above half the total matrimonial property.

#### 6.8 *Ease of Administration by Scheme*

The scheme's involvement is minimal, simply being the supply of information. Most, if not all, can in any event be demanded under the Disclosure of Information Regulations.

#### 6.9 *Cost to Scheme*

There is no cost to the scheme compared with existing practice. The release of reserve for spouses' benefits upon divorce will continue to apply.

#### 6.10 *State Benefits*

The State makes a similar saving to occupational schemes in regard to the contingent spouse's pension under SERPS. This saving may be partly or totally offset by the additional basic State pension entitlement awarded as a result of the substitution of the husband's contribution record for the wife's. The other major effect on State benefits relates to income support and other means tested benefits. To the extent that allocation of a capital sum in lieu of pension benefits replaces continuing alimony, this method of pension splitting may increase the claims for income support. If the divorced wife invests the money arising from the transfer in a house, which does not count as a capital resource for determining eligibility for income support, or has used all the money by the time she retires, then income support would be payable. Any attempt to estimate the size of the additional cost would be pure speculation, but it seems clear that it could be substantial.

### 6.11 *Comprehensiveness*

There is no particular problem in extending this method to deal with deferred pensioners and pensioners and to members of money purchase schemes. There are however some points of detail to be considered. For example, if the chosen method of valuing the pension benefits is the cash equivalent, it will be necessary to decide how this would be calculated for a pensioner.

### **Clean Break, Capital Settlement, Transfer Value Available**

6.12 This option is the same as the previous one with the difference that a transfer value could be made available from the member's scheme to help finance the settlement. If legislation were introduced to permit this, it would presumably be a condition that the transfer value should be paid to a personal pension or an occupational scheme for the wife. We think it would be crucial that the member had the right to insist upon using a transfer value to finance the pension part of the settlement. If a spouse could refuse this option then it would almost always be the case that she would request a cash settlement instead.

6.13 Whichever method is used for valuing the pension, the scheme could only be asked to provide a transfer value equal to the normal cash equivalent. As a past service reserve will rarely be more than twice the cash equivalent, this should permit half the pension value to be transferred in most cases even if the past service reserve method of valuation is used.

6.14 It is unlikely that this method will be seen as acceptable if it results in the scheme making a profit from the divorce. This means that it will be necessary to devise a method of reducing the member's benefits which does not result in a profit or loss to the member. The easiest method is probably:

- Determine the transfer value being paid out.
- Using the scheme's cash equivalent calculation method in reverse, calculate the deferred pension which corresponds to this transfer value.
- When the member's benefits come into payment, deduct this deferred pension, revalued at whichever rate underlies the cash equivalent calculation (normally either statutory revaluation or full price indexation).

### 6.15 *Fairness to Scheme Member*

If the valuation method is the cash equivalent, the member's benefits will be at least half the level he would have received but for the divorce. If the method is a past service reserve, they may not be, although the reasonable expectation would be that they would. The extent to which the member may have to allocate out of remaining matrimonial property a sum to cover a non realisable asset will be much reduced and in most cases zero.

### 6.16 *Fairness to Spouse*

The value placed upon the pension would be the same in this option as in the previous



one subject to the point made below concerning spouse's benefits. The difference is that in many cases the spouse will be forced to accept the settlement as a transfer to a personal pension or occupational scheme. Whilst this will undoubtedly be less attractive to many spouses, it is difficult to see how it can be considered as unfair. Indeed in our view a major attraction of this method, compared with the previous one, is that it retains the essential purpose of pension benefits, rather than allowing one party to, in effect, raise immediate capital on the expectation of these benefits for the other party.

#### *6.17 Practicality of Settlements*

This method would greatly reduce or even eliminate the extent to which, under current Scots law, there are insufficient resources to pay half the value of the pension benefits to the spouse. Care may need to be taken in drafting legislation to ensure that out of court settlements are not discouraged. However, since even agreed divorces need a Court Order this should not be a major problem.

6.18 One side effect of this change compared with the current Scottish system is that, in many cases, this will leave the value of the matrimonial home to be split equally between the two parties. This would presumably lead to a considerable increase in the number of cases where the matrimonial home needs to be sold, and could lead to conflict with the Matrimonial Homes Act.

#### *6.19 Ease of Administration by Schemes*

This method involves a certain amount of additional administration compared with the previous one. In many cases the scheme will have both to calculate and pay a transfer value. In addition it will have to make certain adjustments to its records and make additional calculations when the member leaves or retires.

#### *6.20 Cost to Scheme*

Unless a special basis is used, for most schemes the transfer value paid out to the spouse will include the value of a spouse's contingent pension, probably with a proportion married factor applied. The scheme will therefore lose part of the savings currently generated by a divorce – but this cost is likely to be 0.1 per cent per annum of pensionable payroll at most. In principle these savings could be recouped by cutting back on the member's remaining benefits, but in practice this may be unacceptable.

#### *6.21 State Benefits*

For some members of pensions schemes, the GMP will form a relatively high proportion of their benefits, although this feature will diminish with time. If the GMP cannot be transferred it may restrict the availability of resources from the scheme in some circumstances. More generally, this point highlights the fact that there is no pension transfer in respect of SERPS benefits. A logical complement to this method would be for half a member's SERPS benefits to be re-allocated to his wife. Compared with the existing position this will tend to increase the SERPS outgo, on the assumption that the pension transferred from husband to wife will be greater than that transferred in the opposite direction. However compared with the position before divorce it still

represents a slight saving to the State because of the possibility that the wife might die before her husband. If pension splitting of SERPS were introduced, it might be possible to remove the provision whereby a wife can use her husband's contribution record to count towards her basic State pension entitlement.

6.22 The other effects on State income and expenditure relate, as discussed in Section 3, to tax relief and income support. In general a pension transfer from husband to wife may result in a reduction in the total tax received by the Inland Revenue, and a reduction or removal in the payment of income support. For example, if the ex-wife's income, before pension transfer, is below the tax-free personal allowance, then at least part of the transferred pension will escape tax. If her income was also below the income support threshold, this loss of tax will be offset by a reduction in income support payments. The net effect of these two changes is impossible to predict accurately. Based on the current number of divorced pensioners, the maximum loss to the State would be £120 million per annum, but the actual loss may be much less. The examples in Appendix E illustrate the effect.

#### 6.23 *Comprehensiveness*

The one area to which it might be difficult to extend this method is pensioners. Schemes may be wary of paying transfer values for pensioners on the grounds that they may be in ill-health. This may be particularly true if the pension has been secured by an annuity, as is usually the case in money purchase schemes. Whilst there is a potential danger here, it is perhaps unlikely that a significant number of pensioners would choose to divorce simply for this advantage. As the problem of resources to finance the settlement can be most severe for a pensioner, it would be unfortunate if a transfer value could not be made available for that class of member. If this method is unacceptable for pensioners, it may be necessary to introduce, as an alternative, the assignment of part of a member's pension if the divorce is after retirement.

### **Clean Break, Split of Pension Benefits**

6.24 In this option the pension benefits arising from service during the period of marriage would be split between husband and wife, but initially at least remain in the pension scheme. If the wife chooses immediately to take a transfer value this option is little different to the previous one, with the important qualification that the method of valuation is fixed as the cash equivalent.

6.25 In the absence of special provisions, it is unlikely that the wife would wish to leave her entitlement with her husband's scheme. If she did, it would come into payment at a date determined by her husband's normal, or early, retirement age, and would be payable throughout his lifetime. For this method to be feasible, it would therefore be necessary for the pension to be re-expressed as a pension payable during the wife's lifetime. Two adjustments may be necessary. The first is to adjust for a different commencement date of a pension. Provided the scheme normally permits early or late payment of a deferred pension, the scheme's normal factors may be used. Secondly, if

this option is not to impose an additional liability on the scheme compared with the current system, it will be necessary to reduce the pension to allow for different mortality rates (assuming the transfer is from husband to wife). Although theoretically correct, it may prove to be unacceptable to make such an adjustment. If so a split of pension benefits is similar to the transfer value option, i.e. the adoption of pension splitting would impose a cost upon the scheme compared with the current system, but the divorce would still result in a reduction in liability.

6.26 In this option the analogy to the choice between the continuing and leaving service value is whether the spouse's share of the pension should be increased in line with the member's future salary increases until he leaves service or retires, or only receive deferred pension increases. One attraction of this method is that salary increases can be taken into account only as and if they occur, which avoids the major criticism of a continuing service approach, viz that it anticipates salary increases that may not occur. If, however, the spouse's pension receives only deferred pension increases, then the member's pension should be adjusted in the same way as would apply in the previous option, i.e. the deduction would also increase in line with deferred pension increases.

#### 6.27 *Fairness to Scheme Member*

Any change in the linkage of his spouse's portion of the benefits does not affect the member's own benefits. If his spouse's pension receives only deferred pension increases, the member's pension will be more than half the total pension (provided his own salary increases exceed deferred pension increases). He will not need to allocate out of remaining matrimonial property a sum to cover a non-realisable asset.

#### 6.28 *Fairness to Spouse*

The position for the spouse is broadly the converse of that for the member. If the link to the member's salary increases is maintained then, apart from any changes in the commencement date of a pension, she will receive a pension exactly half the member's original pension. If the linkage is to deferred pension increases, she will probably receive less than half. If, however, a further reduction is made to allow for different mortality rates of men and women, and cost neutrality is preserved within the scheme, this will further reduce the wife's pension below one half.

#### 6.29 *Practicality of Settlement*

This is very similar to the transfer value option.

#### 6.30 *Ease of Administration by Schemes*

This option will involve a fairly considerable amount of administration by schemes. At the date of divorce an additional record will have to be set up for the spouse and then maintained. When the member's benefits come into payment, special calculations may be necessary.

#### 6.31 *Cost to Schemes*

Unfunded public service schemes may find this option preferable to the transfer value

one because of the cash flow implications. In other respects the costs are likely to be similar.

### 6.32 *State Benefits*

The implications for State benefits are very similar to those under the transfer value option.

### 6.33 *Comprehensiveness*

As with the previous option, the only significant problems might arise with pensioners. The easiest approach is to split the pension in payment equally (or in some other proportion if part of the service was before the date of marriage). This corresponds to the method suggested for members below pension age, if no mortality adjustment is made. If, however, the intention is to preserve cost neutrality to the scheme, an adjustment would need to be made to the allocated pension reflecting both the different mortality rates of men and women and the age difference between husband and wife. As with other such adjustments discussed, this may be difficult to justify in practice.

## **Deferred Maintenance and Allocation of Spouse's Benefit**

6.34 This method has been suggested by Robin Ellison<sup>6</sup>. He suggests that the pension should not be split but that an order should be made for deferred maintenance against the husband. There are a number of ways in which the amount of deferred maintenance could be determined, but for consistency with the nature of pension benefits it should probably be done in a similar way to that described in the previous option. The amount will be determined on the basis of service and salary at the relevant date and subsequently increased either with deferred pension increases or with salary increases. A further element of this suggestion is that any contingent spouse's pension should be allocated between the divorced spouse and any future spouse. It is not clear whether any spouse's pension would be payable if the member did not remarry. If not, the spouse is unprotected if the husband dies before pension age. For the purposes of the discussion we have therefore assumed that a spouse's pension, in respect of the period of marriage, would be paid by the scheme to the former spouse, even if the member had not remarried.

### 6.35 *Fairness to Scheme Member*

The member's benefits from the scheme will be unaffected. His net pension, after paying alimony to his former wife, will be at least half the total pension. He will not have to make a capital transfer at the date of settlement to cover a non-realisable asset.

### 6.36 *Fairness to Spouse*

The pension paid, indirectly, to the spouse will be precisely half the level she would have shared in, and after her husband's death she will receive the same level of spouse's pension she would have received (in respect of the period of marriage). The difference between this option and the previous one lies in the tax treatment. Alimony is not tax deductible for the payer, and is tax free for the recipient. In effect, therefore, the alimony is treated as the member's income for tax purposes, whereas if the pension is split it

would be more natural for it to be treated as the spouse's income. The net of tax income for the spouse may often be less under this option than under either of the previous two.

### 6.37 *Practicality of Settlements*

Our main concern with this option is that it may simply defer the problems until retirement age when a further court hearing may be necessary to determine the amount of alimony. For all the possible drawbacks of the previous options, they would at least settle the matter at the time of divorce.

### 6.38 *Ease of Administration for Schemes*

As with the current Scottish system, the amount of additional work for schemes would be small, since the payment of the member's pension would be unaffected. Following the member's death, additional work would be required with the possible splitting of the spouse's pension between two or more spouses and former spouses.

### 6.39 *Cost to Schemes*

The cost to schemes of this option is that of paying a spouse's pension to the former spouse i.e. up to about 0.17 per cent of pensionable payroll.

### 6.40 *State Benefits*

The principal difference between this and the previous option relates to the tax treatment of alimony. As indicated in paragraph 6.36, alimony remains the income of the payer for tax purposes. This method therefore avoids the loss of tax receipts by the State that is likely to occur under the transfer value or pension splitting methods.

### 6.41 *Comprehensiveness*

This option would appear to be suitable for all types of scheme and of member.

### 6.42 *Conclusion*

This section has examined the advantages and disadvantages of four possible ways of proceeding, assuming that changes in legislation are possible. In arriving at a conclusion we believe there are two main considerations: first that any method of dealing with pension benefits should not detract from the 'clean break' principle increasingly followed in divorce, and secondly that a member should not be expected to finance from free resources a sum to cover the value of the (non-realisable) pension benefits. These two considerations rule out the current Scottish system and deferred maintenance as being suitable ways forward. The deferred maintenance approach does however have the advantage that it could be implemented with relatively little legislation and cost to the State.

6.43 The other two methods: payment of a transfer value and pension splitting within a scheme are in many respects similar and we do not believe that one is demonstrably better than the other. Despite the problems of implementing either method, we think that these methods offer the most satisfactory solution to settling pension arrangements upon divorce.

## 7. FUTURE BENEFIT DESIGN

7.1 The previous sections have concentrated upon pension benefits on divorce. A more fundamental question is whether current benefit design is well suited to increasing divorce and falling marriage rates. Originally, a pension scheme would have been established by an employer to provide income for his employees on retirement. It was considered to be payment for long service and replaced the income (pay) that the employee received whilst working. In time, there was an acceptance that if an employee died either in service or during retirement, there was still, in many cases, a need for income. In years past, an employee often had to surrender some of his pension to provide for his widow after his death. More recently, most schemes have provided widows' pensions automatically without requiring surrender.

7.2 The tables in Appendix A tend to suggest that customs are changing within the U.K. and that the proportion of the population that is married is reducing. A further social change is that over the past years there has been a steady increase in the number of women working; they now account for some 43 per cent of the working population.

7.3 Existing pension arrangements may not meet the changing financial requirements in the 1990s. For example, if both partners are working is it necessary for the employer to provide a widow's pension? If the member dies, is it desirable that the widow may receive two incomes - one as an employee and another from her deceased husband's pension scheme? This type of arrangement may mean that a pension is being paid to someone who does not need it. If it is argued that such an arrangement is desirable, is it possible to defend pension arrangements where only a widow's pension is paid and not a dependant's pension? Current arrangements also involve a lack of symmetry between scheme member and wife. On the member's death, if he is survived by his wife, the pension probably drops to one half of its former amount. On the other hand, if the wife predeceases the member, the pension continues at the same rate.

7.4 Inland Revenue practice recognises that benefits may be paid to either a spouse or a dependant. They define dependant as any person who is financially dependent upon the employee at the time of his death or retirement. Although in principle one party cohabiting may not be dependent upon the other, we understand that in practice the Inland Revenue will permit payment of a dependant's pension provided the couple had shared living expenses.

7.5 In the light of changing social customs, we put forward the following three topics for consideration:

- If pension benefits are regarded as deferred pay, is it reasonable to provide additional benefits for a married employee compared with a single employee?
- Should pensions be paid to adult dependants even if the couple are not married?
- Should separate pensions be provided for the member and his spouse (dependant)?

### 7.6 *Deferred Pay*

Until recently, pensions have not usually been thought of as pay. Indeed, pensions were exempted from much legislation concerning pay and conditions, for example, sex discrimination legislation. This approach is increasingly being questioned. It may be argued that the Barber Judgement effectively implies that pensions are deferred pay. In recent years, several Court Judgements have substantiated the view that pension is deferred pay. Some of the questions raised by the Pensions Law Review Committee relate to the contractual nature of pensions. The accounting approach required by SSAP24, whereby the cost of pensions accruing in a year should be accounted for in that year, reinforces the view that pension benefits are a part of the normal employment cost (rather than a gift to a long-serving employee).

7.7 If a pension is deferred pay, is it equitable to provide benefits for a married man which may be worth some 25-30 per cent more than for a single employee? The employee is carrying out a certain task for which he is paid. The value added by the employee is independent of his domestic arrangements, and therefore so should be his pay. Any adjustments to the net income of the employee which may be required for social reasons should be made by the Government through the Department of Social Security or Inland Revenue.

7.8 Following this line of argument, employees who are receiving the same pay should be provided with the same pension benefits, irrespective of marital status. It is accepted that longevity differs from person to person with the result that the value of the benefits being provided will differ. It is, however, an entirely different concept to provide a spouse's benefit in respect of a married employee. A single employee could argue with some justification that the employer has a policy of marital discrimination. Employers may provide some other benefits at different levels for single and married employees, e.g. medical insurance. However, it is unlikely that any other benefit as valuable as a pension, or basic pay itself, would be at different levels according to marital status.

7.9 In a money purchase scheme the employer makes a specific contribution which, in most cases, is independent of the marital status of the employee. On retirement, the employee determines the amount of pension that he wishes for himself and the balance of the fund can be used to provide the pension for his dependant. The marital status of the employee is of no significance and the contingent pension is paid so long as that person is financially dependent upon the employee. Subject to Inland Revenue limits there is complete flexibility regarding the proportion of pension set aside for the employee and the dependant.

7.10 In most final salary schemes, a contingent spouse's benefit is provided at no extra cost to the married employee (in the past, many schemes only provided widows' pension by means of allocation). There is no reason in principle why at retirement the accrued member's pension cannot be converted by the employee to a reduced pension for himself and a contingent pension for his partner – this might be called "dependants allocation".

7.11 In the case of death in service, the dependant would be entitled to a pension equal to the value of the member's accrued pension. If death occurs shortly after the employee joins the scheme, such a benefit is not as beneficial as a final salary type benefit where the dependant's benefit may be based upon accrued service plus all future service up to normal retirement date. To overcome this problem, additional life cover can be provided on a reducing scale.

7.12 This type of arrangement would meet two potential objections to the typical current system: first, that of discrimination in favour of those who are married over those who are single and have no dependants, and secondly that of discrimination in favour of those who are married over those who are single but are co-habiting. It would also provide flexibility for couples where both partners have pensions and prefer a greater immediate income in place of a survivor's pension. There is clearly the danger of under provision for widows. Moreover, if such an arrangement were to be introduced at no cost, it would have to be at the expense of reduced benefits for married employees. Instead of a pension fraction of  $1/60$ th, the basic fraction might be  $1/53$ rd, but a married man providing a contingent pension for his wife at 50 per cent of his own pension would see his pension fraction fall to  $1/64$ th.

7.13 The following example illustrates where such flexibility may be welcome, but also the potential dangers. A man has a choice between a single life pension of £8,000 pa, and a pension of £6,600 pa with a widow's pension of £3,300 pa. His wife has a choice between a single life pension of £3,000 and a pension of £2,500 with a widower's pension of £1,250. If both choose the single life pension, and the husband dies first, the wife's gross pension income amounts to 27 per cent of the previous joint income. Although the fall will be less once tax and the State pension are allowed for, this may still be a much larger reduction than the fall in expenditure. It would therefore be unwise for the man to opt for a single life pension. However, the option of the wife electing a single life pension may be attractive, with her husband taking a joint life pension. In these circumstances, if she dies before her husband, his gross pension income is still almost 70 per cent of the previous joint income (rather than 85 per cent if a widower's pension was taken).

#### 7.14 *Adult Dependant's Pensions*

A number of schemes give the trustees discretion to pay a dependant's pension in certain circumstances, but few pay such a pension as of right. If the trustees are given this discretion, they may be faced with a difficult decision as to whether a relationship was sufficiently permanent to warrant the payment of such a pension.

7.15 One way of overcoming this problem has been outlined in the paragraph 7.10; making members allocate dependants' pensions even if married, rather than providing spouse's pensions as of right. The opposite approach would be to provide a dependant's pension in all circumstances where there is a survivor who would satisfy the (fairly wide) definition of dependant laid down by the Inland Revenue. To assist the trustees, it would



be possible to request members to nominate dependants, but reserving the right to overrule any nomination if they thought that circumstances justified doing so (as they currently have the right to do for lump sum benefits).

7.16 The introduction of adult dependant's pension would increase costs for pension schemes compared with the costs if spouse's pensions only are provided. The level of cost depends upon how tightly the definition of adult dependant is drawn. If such pensions are paid only to the surviving partner of a cohabiting couple, it may be argued that it does not represent an increase in costs over the current level, rather that the decrease in costs that would arise because of falling marriage rates would not now occur. If adult dependants pensions are paid in almost all cases, an additional cost will arise. This cost may be estimated by considering a scheme where all members are married; this indicates an additional cost compared with current levels of some 0.4 per cent of pensionable payroll.

#### *7.17 Separate Member's and Dependand's Pensions*

An alternative scenario is for the employer to provide a pension for the employee and a similar pension for the partner. For example, instead of a pension of 1/60th of final salary for the member and a widow's pension of 1/120th the benefits could be rearranged to provide at no additional cost, two throughout life pensions each of 1/110th. There is a suggestion from the European Commission that countries should be moving towards individual benefits and away from derived benefits (such as spouses' pensions), although this mainly applies to State schemes.

7.18 This is an opposite approach from the concept of setting aside the same resources for a single employee as a married one. A single employee would receive only half the pension of a married or co-habiting employee. Given that a married couple may have a pension from both parties' former employment, the total income of a single employee after retirement may be very much less than half of his married colleague's, although the difference in expenditure will probably be much less than this. For this reason we doubt that this option would be generally acceptable.

7.19 An alternative interpretation of this concept is that each employee should be credited with a certain pension (say 1/60th of final salary for each year of service) but that if he is married one half of it should be allocated to his wife. Our view is that if this is restricted to legal wives, it would provide little if any advantage that could not be gained by some form of pension splitting on divorce. It could however be extended to other dependants, as a means of giving them some security (if the member so elects) at little or no cost to the scheme.

#### *7.20 The Way Forward*

As previously mentioned, pensions were originally provided for the employee; however, employers have generally extended provision to include contingent benefits for widows and widowers. These extensions have added significantly to the cost of schemes. As set out in paragraph 7.16, the cost of paying pensions to adult dependants

for all members would be relatively modest, probably less than 0.5 per cent of pensionable payroll. The chief practical problem is that the trustees would have to decide in many cases whether or not a pension should be paid.

7.21 With the growing pressure for pensions to be treated as deferred pay, we believe a more promising approach may be the “dependants allocation” one set out in paragraphs 7.10 - 7.13. From an employer’s viewpoint, costs may be easier to control since the proportion of members who are married will no longer be a factor. The principal advantage of this option, however, is that the member can decide for himself on the optimum allocation of pension between himself and his partner; there is more flexibility and it automatically provides for unmarried couples. Clearly there are practical difficulties, not least the classic one of selection against the scheme. We are also aware that it would be reversing some general developments of the last few decades. However, we do believe that it is an option that merits serious consideration.

## 8. CONCLUSION

8.1 In recent years rates of divorce have increased and rates of marriage have decreased significantly. These changes have not yet had a major impact upon the retired population but in due course this will come about. Unless these changes are reversed, what has hitherto been regarded as the normal pattern of family organisation, a couple legally married and remaining married until death, will become increasingly less common.

8.2 The effect of ignoring pensions upon divorce, as is currently done in most cases in England and Wales, is to reduce very considerably the income after retirement of the divorced wife. In many cases this will lead to divorced wives having incomes little more than the income support threshold.

8.3 The present system in Scotland, as introduced by the Family Law (Scotland) Act 1985, has given rise to a number of practical problems: the most serious being the need to provide for the value of pension benefits without having any access to the assets of the pension scheme. It does, however, represent an advance by recognising that pensions are a valuable asset and should be taken into account.

8.4 Under current law and practice in England and Wales, many divorced wives will be dependent upon the State for their income in retirement. The current Scottish system represents an improvement upon this and fits in with the concept of no attributable blame. However, it does suffer from some inherent disadvantages and may still lead to a lack of income after retirement. Given the high rates of divorce, we think that both systems can and should be improved. In particular, we suggest that existing pension legislation should be amended so that the wife can have her share of the pension benefits transferred to her own pension arrangements, or retain a share of benefits in her husband’s scheme.

8.5 Family circumstances are changing and in order that modern pension schemes can provide benefits which are suitable for the family unit in the next century, some attention should be given to benefit design. In particular we believe that the existing structure which gives extra benefits to married members, as distinct to single members including those who are co-habiting, may warrant revision so that there is no matrimonial discrimination.

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The statistics in Appendix A are derived from annual Reports of the Registrar General Scotland and from Marriage and Divorce Statistics 1990 (HMSO, 1992) and are included with the permission of the Controller of HMSO.

## APPENDIX A

Divorces per 1,000 marriages

Scotland

Divorces per 1,000 marriages at risk, by duration of marriage

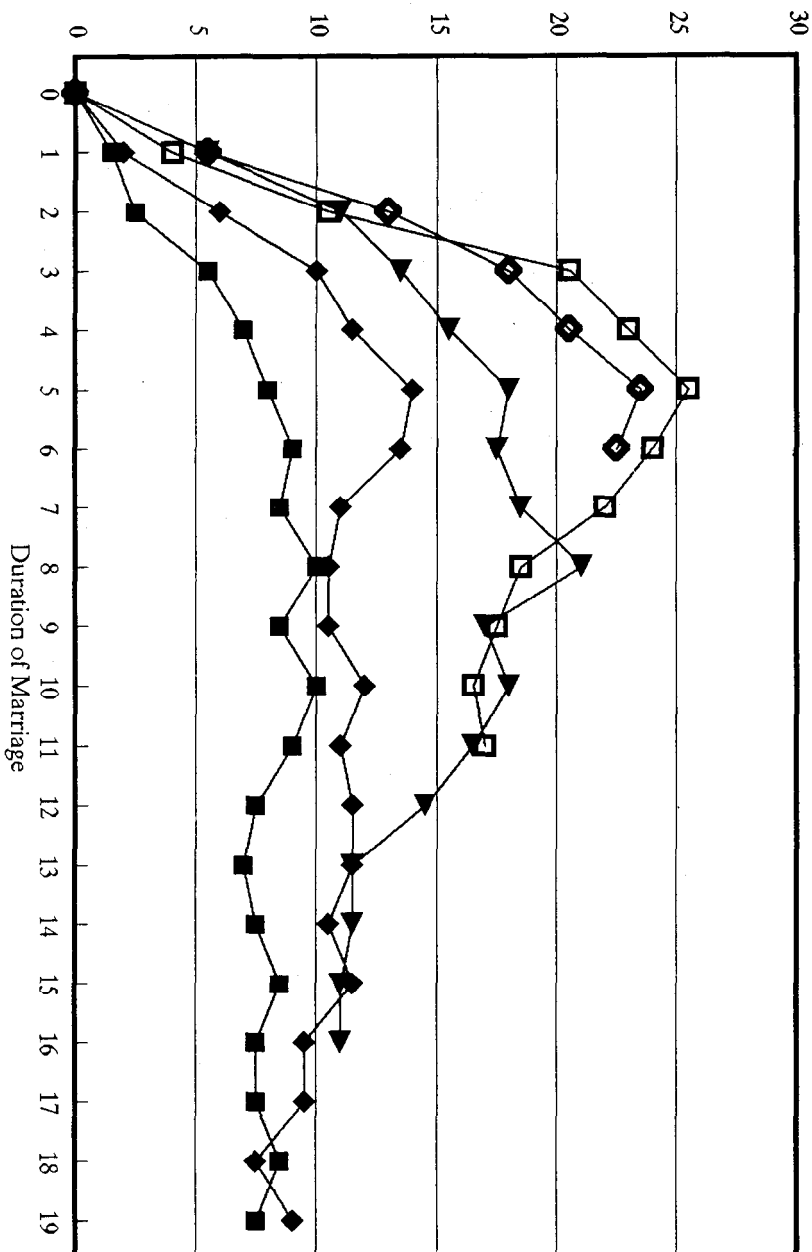


Table A1

**Table A2***Number of Divorces (thousands)**England & Wales*

	<i>1961</i>	<i>1971</i>	<i>1981</i>	<i>1990</i>
Number of divorces	25.4	74.4	145.7	153.4
Married Population	11848	12522	12238	11732
Divorce rate (per mille)	2	6	12	13

*Scotland*

	<i>1961</i>	<i>1971</i>	<i>1981</i>	<i>1990</i>
Number of divorces	1.6	4.5	9.9	12.3
Married Population	1208	1229	1230	1158
Divorce rate (per mille)	1	4	8	11

**Table A3***Number of divorces per thousand of married population, by age**England & Wales*

Age Group	<—Males—>		<—Females—>	
	1981	1990	1981	1990
Under 20	2.0	7.0	3.0	10.6
20-24	18.5	25.0	24.4	27.9
25-29	27.6	32.1	26.7	30.1
30-34	22.8	26.9	20.2	23.9
35-39	18.6	21.8	16.6	18.8
40-44	15.2	17.0	12.9	14.4
45-49	11.0	12.8	8.7	10.4
50-59	5.8	6.8	4.3	4.8
60 +	1.7	1.6	1.4	1.2
All ages	11.9	13.1	11.9	12.9

*Scotland*

Age Group	<—Males—>		<—Females—>	
	1981	1990	1981	1990
Under 20	NA	46.7	17.0	31.2
20-24	NA	17.4	14.5	17.6
25-29	NA	24.1	18.2	24.3
30-34	NA	22.2	13.0	20.8
35-39	NA	16.7	10.1	15.5
40-44	NA	12.8	7.8	11.5
45-49	NA	9.9	5.8	7.6
50-59	NA	4.9	2.7	3.6
60 +	NA	1.3	1.0	0.9
All ages	NA	10.6	8.0	10.5

**Table A4***Number of divorces (in thousands) by duration of marriage**Divorces in 1990*

<i>Duration</i>	<i>England &amp; Wales</i>		<i>Scotland</i>	
	<i>Number</i>	<i>Prop'n.</i>	<i>Number</i>	<i>Prop'n.</i>
0-4	36.3	24%	2.2	18%
5-9	42.1	27%	3.5	28%
10-14	27.3	18%	2.4	20%
15-19	19.8	13%	1.6	13%
20-24	14.2	9%	1.3	11%
25-29	7.5	5%	0.7	6%
30+	6.2	4%	0.6	5%
Total	153.4	100%	12.3	100%
Median Duration	10 years		10 years	

**Table A5***Number of marriages per thousand of male population at risk**England & Wales*

	<—————1981—————>			<—————1990—————>		
Age Group	First Marriage	Remarriage Widowers	Divorcees	First Marriage	Remarriage Widowers	Divorcees
16-19	11.1			4.2		
20-24	94.1	72.0	242.7	49.2	94.1	91.6
25-29	120.8	157.9	260.9	84.6	132.7	122.0
30-34	70.3	140.7	205.8	70.1	109.3	111.6
35-39	39.1 )	105.0	141.9	40.2 )	84.8	82.1
40-44	20.1 )			20.0 )		
45-49	11.5 )	68.3	89.2	11.5 )	55.8	56.9
50-54	7.4 )			7.2 )		
55 +	3.1	14.5	39.3	2.6	10.6	25.0

*Scotland*

	<—————1981—————>		<—————1990—————>	
Age Group	First Marriage	Re-marriage *	First Marriage	Re-marriage *
16-19	16.7		4.9	
20-24	109.6		56.8	
25-29	125.4	243.8	100.3	113.8
30-34	62.3	219.8	62.6	115.2
35-39	33.3 )	128.1	35.8 )	92.4
40-44	15.3 )		17.9 )	
45-49	10.2 )	69.0	10.6 )	61.8
50-54	6.7 )		7.3 )	
55 +	2.2	13.3	1.6	11.7

\* For Scotland, separate statistics on remarriage of widow(er)s and divorcees are not available.



**Table A6***Male Population by Marital Status (proportions)**England & Wales*

<i>Age Group</i>		<i>1961</i>	<i>1971</i>	<i>1981</i>	<i>1990</i>
16-19	Single	98.6%	97.5%	98.9%	99.5%
	Married	1.4%	2.5%	1.1%	0.5%
	Widowed	0.0%	0.0%	0.0%	0.0%
	Divorced	0.0%	0.0%	0.0%	0.0%
20-24	Single	69.1%	63.6%	74.9%	86.2%
	Married	30.8%	36.2%	24.6%	13.2%
	Widowed	0.0%	0.0%	0.1%	0.0%
	Divorced	0.1%	0.2%	0.5%	0.6%
25-29	Single	29.5%	26.1%	34.6%	54.7%
	Married	70.1%	72.9%	62.2%	41.3%
	Widowed	0.1%	0.1%	0.1%	0.0%
	Divorced	0.3%	1.0%	3.2%	4.0%
30-34	Single	14.0%	14.0%	17.0%	26.6%
	Married	85.1%	84.3%	77.6%	65.1%
	Widowed	0.1%	0.1%	0.2%	0.1%
	Divorced	0.7%	1.6%	5.2%	8.2%
35-39	Single	13.2%	11.2%	11.3%	15.2%
	Married	85.7%	86.9%	82.6%	74.2%
	Widowed	0.4%	0.3%	0.2%	0.2%
	Divorced	0.7%	1.7%	5.8%	10.4%
40-44	Single	10.7%	10.8%	9.4%	10.8%
	Married	87.4%	86.9%	84.1%	78.3%
	Widowed	0.7%	0.6%	0.5%	0.4%
	Divorced	1.1%	1.6%	6.0%	10.4%
45-49	Single	9.5%	9.9%	9.0%	8.9%
	Married	88.0%	87.3%	84.7%	80.1%
	Widowed	1.2%	1.2%	0.9%	0.8%
	Divorced	1.2%	1.6%	5.3%	10.2%

*continued*

**Table A6***Male Population by Marital Status (proportions)**England & Wales*

<i>Age Group</i>		<i>1961</i>	<i>1971</i>	<i>1981</i>	<i>1990</i>
50-54	Single	8.8%	8.8%	9.4%	8.0%
	Married	87.9%	87.7%	84.4%	81.4%
	Widowed	2.2%	2.0%	1.8%	1.4%
	Divorced	1.2%	1.5%	4.4%	9.1%
55-59	Single	8.5%	8.2%	9.1%	8.2%
	Married	86.9%	87.0%	84.3%	82.0%
	Widowed	3.7%	3.4%	3.2%	2.6%
	Divorced	0.9%	1.4%	3.5%	7.2%
60-64	Single	8.5%	7.9%	8.0%	8.4%
	Married	83.4%	86.0%	83.9%	81.3%
	Widowed	7.3%	5.0%	5.2%	4.9%
	Divorced	0.8%	1.1%	2.9%	5.4%
65-69	Single	7.2%	7.7%	7.6%	7.9%
	Married	81.2%	81.5%	81.1%	79.6%
	Widowed	11.1%	9.9%	9.0%	8.5%
	Divorced	0.5%	0.9%	2.4%	4.0%
70-74	Single	7.5%	7.0%	7.2%	7.1%
	Married	73.4%	75.5%	76.2%	76.8%
	Widowed	18.8%	17.0%	14.9%	13.0%
	Divorced	0.3%	0.6%	1.8%	3.1%
75 +	Single	7.7%	6.3%	7.0%	7.3%
	Married	54.3%	57.9%	60.3%	62.4%
	Widowed	37.8%	35.5%	31.5%	28.1%
	Divorced	0.1%	0.4%	1.2%	2.2%

*continued*

**Table A6**

*Male Population by Marital Status (proportions)*

*Scotland*

<i>Age Group</i>		<i>1961</i>	<i>1971</i>	<i>1981</i>	<i>1990</i>
16-19	Single	98.4%	97.5%	98.3%	99.7%
	Married	1.6%	2.5%	1.7%	0.3%
	Widowed	0.0%	0.0%	0.0%	0.0%
	Divorced	*	0.0%	0.0%	0.0%
20-24	Single	68.7%	61.3%	70.2%	85.4%
	Married	31.3%	38.7%	29.3%	14.2%
	Widowed	0.0%	0.0%	0.0%	0.0%
	Divorced	*	0.0%	0.5%	0.5%
25-29	Single	29.7%	25.3%	30.7%	48.8%
	Married	69.8%	74.1%	67.0%	47.4%
	Widowed	0.6%	0.0%	0.0%	0.0%
	Divorced	*	0.6%	2.3%	3.7%
30-34	Single	21.3%	14.4%	15.8%	28.8%
	Married	78.1%	84.9%	81.0%	63.9%
	Widowed	0.6%	0.0%	0.0%	0.0%
	Divorced	*	0.7%	3.3%	7.3%
35-39	Single	16.4%	11.3%	11.0%	16.6%
	Married	82.5%	87.2%	84.4%	74.0%
	Widowed	1.2%	0.7%	0.6%	0.6%
	Divorced	*	0.7%	3.9%	8.9%
40-44	Single	14.0%	11.6%	9.7%	11.3%
	Married	83.4%	86.4%	85.5%	80.2%
	Widowed	2.5%	0.7%	0.7%	0.6%
	Divorced	*	1.4%	4.1%	7.9%
45-49	Single	12.7%	11.7%	9.8%	9.6%
	Married	84.8%	85.7%	85.3%	81.5%
	Widowed	2.4%	1.3%	1.4%	1.4%
	Divorced	*	1.3%	3.5%	7.5%

*continued*

**Table A6***Male Population by Marital Status (proportions)**Scotland*

<i>Age Group</i>		<i>1961</i>	<i>1971</i>	<i>1981</i>	<i>1990</i>
50-54	Single	12.1%	10.8%	10.5%	8.8%
	Married	84.2%	85.6%	84.6%	82.5%
	Widowed	3.6%	2.9%	2.1%	2.2%
	Divorced	*	0.7%	2.8%	6.6%
55-59	Single	11.6%	10.6%	10.6%	8.4%
	Married	83.0%	84.5%	83.0%	82.4%
	Widowed	5.4%	4.2%	4.3%	3.8%
	Divorced	*	0.7%	2.1%	5.3%
60-64	Single	11.3%	11.1%	10.3%	8.9%
	Married	79.1%	80.7%	81.2%	79.7%
	Widowed	9.6%	7.4%	6.8%	7.3%
	Divorced	*	0.7%	1.7%	4.1%
65-69	Single	10.8%	11.2%	11.1%	9.9%
	Married	74.7%	75.7%	76.9%	75.7%
	Widowed	14.5%	12.1%	11.1%	11.7%
	Divorced	*	0.9%	0.9%	2.7%
70-74	Single	10.2%	10.3%	10.6%	9.2%
	Married	66.1%	69.1%	70.6%	72.4%
	Widowed	23.7%	20.6%	17.6%	17.1%
	Divorced	*	0.0%	1.2%	1.3%
75 +	Single	11.3%	10.1%	11.6%	12.3%
	Married	43.7%	50.7%	54.7%	56.6%
	Widowed	45.1%	39.1%	32.6%	30.2%
	Divorced	*	0.0%	1.2%	0.9%

\* For 1961, the Scottish figures for widowed and divorced are combined

## APPENDIX B

## SUMMARY OF MODEL PENSION SCHEME USED FOR COSTINGS

**Structure of the Pension Scheme**

The model scheme used for the calculations is a final salary scheme which is contracted-out of SERPS. The benefit structure is summarised as follows:

*Definitions:*

Normal Retirement Age (NRA):	65 for males and females.
Pensionable Pay:	Basic pay with no deduction.
Pensionable Service:	Period of service in years and completed months.

*Benefits:*

Pension at NRA:	Immediate pension of 1/60 of Pensionable Pay at exit for each year of Pensionable Service.
Benefits on Ill-health:	Immediate pension of 1/60 of Pensionable Pay at exit for each year of Pensionable Service and for each year of potential future service to NRA.
Benefits on Death in Service:	Spouse's pension based on 50 per cent of the pension the member would have received if he had retired on ill-health at the date of death. Lump sum of 3 times basic pay.
Benefits on Death after Retirement:	Spouse's pension based on 50 per cent of member's pension at date of death. If death occurs within five years of retirement, a lump sum equal in value to the balance of five years instalments of pension.

*Pension Increases*

Increases to pensions in payment are awarded on the excess of the pension over the GMP at the rate of 5 per cent or the increase in the Retail Prices Index if less.

The distribution of the membership by age, pay and pensionable service has been based on the membership profile of a large industry-wide scheme which includes both manual and administrative employees. Female members account for almost 50 per cent of the membership of the scheme.

**Actuarial Assumptions****(i) Demographic Assumptions**

The rates of in-service mortality, withdrawal, ill-health and age retirement have been derived from the experience of large pension schemes. The standard mortality table PA(90) rated down by 1 year has been used for mortality rates in deferment and in payment.

There is assumed to be a three year age difference between members and their spouses, with males being 3 years older than the females, 90 per cent of male members and 60 per cent of female members are assumed to be married.

**(ii) Economic Assumptions**

Assumed rate of	Nominal % pa	Real % pa
Price Inflation	5	–
Pay Escalation	7	+2
Return on Investments	9	+4
Pension Increases	$4\frac{1}{2}$	$-\frac{1}{2}$

**Contribution Rate**

The contribution rate assessed on the basis of the above (using the Projected Unit Method) is 16.8 per cent of total pensionable payroll.

## APPENDIX C

### SUMMARY OF LEGAL POSITION

This appendix gives a brief summary of divorce law as it affects pension rights in Great Britain.

#### *Scotland*

In Scotland, divorce is governed by the Family Law (Scotland) Act 1985. This Act tries to promote a “clean break” whereby matrimonial property is divided up at the time of divorce and continuing payments are only made from one party to the other for a limited period of time. In particular, if there are no dependent children a periodic allowance will usually be payable for at most 3 years.

The Act introduces a concept of “matrimonial property”. Broadly, this is all property of either party except that acquired before the marriage or by way of gift or inheritance during the marriage. The family home is specifically included as matrimonial property even if acquired by one party before the marriage. The proportion of pension benefits accrued during the period of marriage up to the separation date is specifically included as matrimonial property. Once the value of matrimonial property has been determined, it is shared fairly between the two parties where shared fairly means equally, unless special circumstances warrant a different split. Any order for distribution of property does not over-ride basic pension and tax law and therefore it is not possible to allocate part of a member’s pension to his former wife nor to arrange a transfer value to a pension arrangement for her.

#### *England and Wales*

In England and Wales, the principal Act governing divorce is the Matrimonial Causes Act 1973. Unlike the Scottish Act, this has no definition of matrimonial property. Instead the Act gives the Courts powers to distribute almost all the assets of either party and to provide for periodic maintenance payments. Provisions introduced in 1984 favour a clean break approach wherever possible, and periodic payments may often now be awarded for a limited time. As with the Scottish Act, the Matrimonial Causes Act does not over-ride basic pension or tax law and therefore the Courts have no specific power to adjust the parties’ pension rights.

In deciding how the parties’ property should be adjusted, the Courts must consider in particular, the value to each of the parties of any benefit which, by reason of the dissolution of the marriage, that party will lose the chance of acquiring. The loss of a pension is specifically referred to in the Act as an example of this type of benefit. It appears that in practice the Courts have interpreted this as applying only to the loss of the expected spouse’s contingent pension, and have not taken into account the indirect

benefit derived from the member's own pension. It also appears that the Courts tend only to take account of this loss where the couple are close to retirement age.

One of the grounds for a divorce is five years separation; in this case the consent of the other party to the divorce is not required. The Courts may dismiss a claim for a divorce based solely on this ground if it finds that the divorce will result in "great financial or other hardship to the respondent" and "that it would in all other circumstances be wrong to dissolve the marriage". One fact that has been taken into account in such cases is the loss of a contingent spouse's pension. However, this objection has only been found to be sufficient in itself where the couple are very close to retirement age.



## APPENDIX D

### STATE BENEFITS

#### *Basic State Pension*

Every person in employment in the U.K. who pays Class 1 (employed) national insurance contributions is entitled to a State flat rate pension if such contributions have been paid or have been credited for 9/10ths of their working life. Working life is the period from 6 April prior to a person's 16th birthday to 5 April preceding attainment of State Pension Age. In the case of a woman this means that national insurance contributions must be paid or credited for 39 years, for a man the corresponding period is 44 years.

If these conditions are not fully met, a reduced pension will be payable and will be calculated on a pro rata basis; however, a pension will only be paid if it is at least 25 per cent of the State pension (that is currently £13.54 per week).

In the case of a woman who has not worked or is not entitled to the minimum pension, her husband will receive a dependant's pension (60 per cent of flat rate pension – currently £32.55 per week) from the time that he attains his 65th birthday (or retirement if later) until she attains age 60. When the woman attains age 60 the dependant's pension is paid to her in her own right. On the other hand, if a woman attains age 60 before her husband reaches age 65 (or retirement, if later) she is not entitled to any pension, until her husband attains age 65 or retires (whichever occurs later).

If a married woman becomes divorced before age 60, and assuming she remains single until her 60th birthday, the contribution record (during the period of marriage) of her ex-husband can be substituted for her own contribution record if this is more favourable. If a woman is divorced and remarries before age 60, her pension is based upon the contribution record of her second husband – the contribution record of her first husband is ignored. If a woman remarries after attaining age 60, the pension, either based on her own contribution record or that of her ex-husband, which came into payment at age 60 will remain payable irrespective of her ensuing marital status.

The provisions for substitution of the former spouse's contribution record now apply equally to men as to women.

If a woman (or man) is not able to work regularly because she stays at home to care for someone or is in receipt of child benefit, she may be able to protect her basic retirement pension if:

- she is receiving child benefit as the only or main payee for a child under 16,  
or
- she is looking after someone for at least 35 hours a week who is receiving constant attendance allowance,  
or

- she is receiving income support because she is staying at home to look after someone who is old or ill.

This protection, Home Responsibilities Protection, is available for tax years from 6 April 1978 and is deducted from the number of qualifying years which would otherwise be needed to receive a full pension.

From the foregoing paragraphs it will be noted that the State takes a benevolent attitude towards retirement pensions that are paid to a divorcee on attainment of State Pension Age. For example, a person (man or woman) with little or no pension entitlement is able to claim a pension based in part on the ex-spouse's contribution record. If a second marriage is contemplated it is financially beneficial to defer this until attainment of State Pension Age in order that the ex-spouse's contribution record can be used to calculate the pension – assuming that this will provide a greater pension.

### **State Earnings Related Pension Scheme**

The general details of the State Earnings Relation Pension Scheme are well known. At present, if a man dies his widow receives his full SERPS pension. However this provision was changed in 1988 and for any deaths after 5 April 2000, the widow will only receive one half of the member's pension.

Following divorce, the ex-wife loses any entitlement to a widow's benefit from SERPS. Unlike the basic State pension, there is no provision for substituting her husband's earnings record for her own; her SERPS pension will depend purely upon her own earnings record. If the man remarries and dies before his second wife, she will receive a survivor's pension of one half (or the whole for death before 2000) of his SERPS pension, including any that has accrued in respect of the period of the first marriage.

Home Responsibilities Protection also applies for SERPS pension by reducing the denominator in the calculation of the pension.

### **Income Support and other Means Tested Benefits**

The principal means tested benefit that may apply to pensioners is income support. Subject to certain rules concerning the maximum amount of capital a claimant may have, income support acts to bring up a claimant's income to a specified minimum level. For a single pensioner, aged under 75, this level is £57.15 per week. A pensioner receiving the full basic State pension but with no other income, would qualify for income support. Higher levels apply for pensioners aged 75 and over.

There are other means tested benefits such as housing benefit and relief from the Community Charge/Council Tax. In general these are linked to eligibility for income support. Thus even if an individual's income is such that the level of income support payable would be only a few pence per week, it may still be a very valuable benefit as it carries with it the right to these other payments.

## APPENDIX E

### INCOME AND STATE BENEFITS

This appendix provides sample calculations of income after retirement for divorced couples. In particular it illustrates the extent to which State income and expenditure is affected by divorce, and how the effect would differ if some form of pension splitting were introduced. The calculations incorporate a number of simplifying assumptions:

- SERPS is assumed to be fully mature, with all accrual post April 1988.
- The wife is assumed to have no pension other than from the State.
- The divorce is assumed to have no impact upon the subsequent working pattern of the wife.
- The member is assumed to have no pensionable service before marriage.

The results which are illustrated by these examples are:

- In all three examples the divorced wife's income after retirement is considerably less than 50 per cent of the couple's joint income if there is no divorce.
- In the main, pension splitting increases the divorced wife's income substantially to close to 50 per cent of the couple's joint income if there is no divorce.
- Divorce may either increase or decrease the net expenditure of the State after retirement; pension splitting always increases it compared with the current system.

## APPENDIX E

### INCOME AND STATE BENEFITS

#### Example 1

##### Husband:

Age at divorce	55
Pensionable Service to divorce	25 years
Retirement Age	60
Salary	£18,000
Contribution Record to divorce	35 years

##### Wife:

Salary	£4,000
Contribution record before divorce	5 years
Home responsibility credit before divorce	15 years
Contribution record after divorce (*)	5 years
Home responsibility credit after divorce	0 years

(\*) including credit for ages 55-60 if appropriate

#### Summary of income under current system

	Income p.a.	State Outgo p.a.
<b>Before Divorce</b>		
Couple's income		
- Occupational pension	£9,000	
- State pension	£4,591	£4,591
- Tax	(£1,188)	(£1,188)
	£12,403	£3,403
<b>After Divorce</b>		
Husband's income		
- Occupational pension	£9,000	
- State pension	£2,816	£2,816
- Tax	(£1,804)	(£1,804)
	£10,012	£1,012
Wife's income		
- State pension	£2,898	£2,898
- Tax	£0	£0
- Income Support	£74	£74
	£2,972	£2,972
<b>Total</b>	£12,984	£3,984

After divorce the State expenditure increases by £581 p.a.

The wife's net income after divorce is 24% of the joint income she would have shared in but for the divorce.

*continued*

Example 1 (*continued*)

## Summary of income with pension splitting on divorce

	Income p.a.	State Outgo p.a.
After Divorce		
Husband's income		
- Occupational pension	£5,250	
- State pension	£2,816	£2,816
- Tax	(£867)	(£867)
	<hr/> £7,199	<hr/> £1,949
Wife's income		
- Occupational Pension	£3,750	
- State pension	£2,898	£2,898
- Tax	(£512)	(£512)
	<hr/> £6,136	<hr/> £2,386
Total	£13,335	£4,335

After divorce the State expenditure increases by £932 p.a.

The wife's net income after divorce is 49% of the joint income she would have shared in but for the divorce.

## Analysis of State Expenditure

	Before Divorce  p.a.	Current  p.a.	After Divorce  With Splitting p.a.
State Pension	£4,591	£5,714	£5,714
Tax	(£1,188)	(£1,804)	(£1,379)
Income Support	£0	£74	£0
Total	<hr/> £3,403	<hr/> £3,984	<hr/> £4,335

## Example 2

## Husband:

Age at divorce	45
Pensionable Service to divorce	15 years
Retirement Age	60
Salary	£13,000
Contribution Record to divorce	25 years

## Wife:

Salary	£10,000
Contribution record before divorce	5 years
Home responsibility credit before divorce	15 years
Contribution record after divorce (*)	15 years
Home responsibility credit after divorce	0 years

(\*) including credit for ages 55-60 if appropriate

## Summary of income under current system

	Income p.a.	State Outgo p.a.
Before Divorce		
Couple's income		
- Occupational pension	£6,500	
- State pension	£6,153	£6,153
- Tax	(£563)	(£563)
	<hr/> £12,090	<hr/> £5,590
After Divorce		
Husband's income		
- Occupational pension	£6,500	
- State pension	£2,816	£2,816
- Tax	(£1,179)	(£1,179)
	<hr/> £8,137	<hr/> £1,637
Wife's income		
- State pension	£3,807	£3,807
- Tax	£0	£0
- Income Support	£0	£0
	<hr/> £3,807	<hr/> £3,807
Total	£11,944	£5,444

After divorce the State expenditure decreases by £146 p.a.

The wife's net income after divorce is 31% of the joint income she would have shared in but for the divorce.

Example 2 (*continued*)

Summary of income with pension splitting on divorce

	Income p.a.	State Outgo p.a.
After Divorce		
Husband's income		
- Occupational pension	£4,875	
- State pension	£2,816	£2,816
- Tax	(£773)	(£773)
	<hr/> £6,918	<hr/> £2,043
Wife's income		
- Occupational Pension	£1,625	
- State pension	£3,807	£3,807
- Tax	(£246)	(£246)
	<hr/> £5,186	<hr/> £3,561
Total	£12,104	£5,604

After divorce the State expenditure increases by £14 p.a.

The wife's net income after divorce is 43% of the joint income she would have shared in but for the divorce.

Analysis of State Expenditure

	Before Divorce  p.a.	Current  p.a.	After Divorce  With Splitting p.a.
State Pension	£6,153	£6,623	£6,623
Tax	(£563)	(£1,179)	(£1,019)
Income Support	£0	£0	£0
Total	<hr/> £5,590	<hr/> £5,444	<hr/> £5,604

## Example 3

## Husband:

Age at divorce	35
Pensionable Service to divorce	5 years
Retirement Age	65
Salary	£10,000
Contribution Record to divorce	10 years

## Wife:

Salary	£15,000
Contribution record before divorce	10 years
Home responsibility credit before divorce	0 years
Contribution record after divorce (*)	25 years
Home responsibility credit after divorce	0 years

(\*) including credit for ages 55-60 if appropriate

## Summary of income under current system

	Income p.a.	State Outgo p.a.
Before Divorce		
Couple's income		
- Occupational pension	£5,833	
- State pension	£7,024	£7,024
- Tax	(£398)	(£398)
	£12,459	£6,626
After Divorce		
Husband's income		
- Occupational pension	£5,833	
- State pension	£2,560	£2,560
- Tax	(£948)	(£948)
	£7,445	£1,612
Wife's income		
- State pension	£4,464	£4,464
- Tax	(£53)	(£53)
- Income Support	£0	£0
	£4,411	£4,411
Total	£11,856	£6,023

After divorce the State expenditure decreases by £603 p.a.

The wife's net income after divorce is 35% of the joint income she would have shared in but for the divorce.

*continued*



Example 3 (*continued*)

## Summary of income with pension splitting on divorce

	Income p.a.	State Outgo p.a.
Before Divorce		
Husband's income		
- Occupational pension	£5,417	
- State pension	£2,560	£2,560
- Tax	(£844)	(£844)
	<hr/> £7,133	<hr/> £1,716
Wife's income		
- Occupational Pension	£417	
- State pension	£4,464	£4,464
- Tax	(£136)	(£136)
	<hr/> £4,745	<hr/> £4,328
Total	£11,877	£6,044

After divorce the State expenditure decreases by £582 p.a.

The wife's net income after divorce is 38% of the joint income she would have shared in but for the divorce.

## Analysis of State Expenditure

	Before Divorce  p.a.	Current  p.a.	After Divorce  With Splitting p.a.
State Pension	£7,024	£7,024	£7,024
Tax	(£398)	(£1,001)	(£980)
Income Support	£0	£0	£0
Total	<hr/> £6,626	<hr/> £6,023	<hr/> £6,044

## 3rd SESSIONAL MEETING 1992-93

{15th February 1993}

The President welcomed the following guests:

Mr J. Martin, President of the Institute of Actuaries; Mr C. Daykin, the Government Actuary; Dr E. Clive, a commissioner of the Scottish Law Commission; Mr F. Coulthard, Treasurer of the Family Law Association; Ms J. Leibling, Senior Principal of the Department of Social Security; and Mr K. Robb, Chairman of the Family Law Committee of the Law Society of Scotland.

**I. M. Aitken** introducing the paper said: The Family Law (Scotland) Act 1985 makes explicit provision for pension benefits to be included as part of the matrimonial property in a divorce settlement. The purpose of our paper is to consider how pension benefits are dealt with in a divorce, how the Scottish system can be improved, the advantages and disadvantages of different types of pension splitting and, finally, to look at the present design of pension schemes bearing in mind increasing rates of divorce and decreasing rates of marriage.

The tables in Appendix A illustrate the increase in the rates of divorce. The Graph illustrates the increase in divorce rates at successive generations. Other tables indicate an increase in divorce whether examination is by duration of marriage or age at the date of divorce. However, less attention has been paid to the decrease in the rates of marriage. Table A5 shows that the rate of first marriage for men below age 25 has virtually halved between 1981 and 1990. The last table (table A6) sets out the population by age and marital status. It indicates that, in England and Wales for men between 35 and 45, the proportion married has fallen by almost 10 percentage points in the last 30 years and this, incidentally, almost exactly corresponds to the increase in the proportion of men who are divorced. If current rates continue we estimate that the proportion of men aged 60 to 64 who are married could fall, from some 80% in 1990 to about 63% in the year 2030.

The Act refers to rights or interests of either party under an occupational pension scheme. The Act is quite clear that only benefits accruing in respect of the period of marriage up to the Relevant Date should be taken into account. However, we believe there is a lack of guidance on how the value of these rights or interests should be determined. This has led to a contentious debate. Should the value be taken on the basis of leaving service or should it be a continuing service value which makes allowance for future salary increases?

Arguments can be made in favour of either method. It is, however, interesting to note that in a recent case, *Bannon v Bannon*, Lord Cameron of Lochbroom held that the value of the pension should be calculated on a continuing service basis, although it is not entirely clear what provision is made for future salary increases.

Frequently there is an interval of some years between the Relevant Date and the date when the actuary is asked to make his valuation. There is little guidance as to whether, in these circumstances, the actuary should take into account events which have happened since the Relevant Date. It is generally accepted that the valuation must be made at the Relevant Date with no allowance for interest between that date and the date of the divorce. Occasionally, this period may be in excess of 10 years. If the purpose of the Act is to allow the non-pension scheme member a sufficient sum of money to replicate the appropriate share of pension benefits it does not appear equitable that no allowance should be made for interest over this period. We believe it would be useful for the actuarial and legal professions to have discussions on this topic.

If you are involved in pension matters you will ask yourself the question – “What are the financial affects of divorce in the occupational scheme?” There is evidence that few pension schemes provide different levels of benefit between married and unmarried members. Consequently, the divorce of a scheme member would tend to reduce the liabilities of the scheme because of the ending of provision for a spouses pension. However, if the funding basis incorporates a proportion married then the reduction in liabilities will have been anticipated to a certain extent. We estimate the contribution rate could fall by 0.3% of pensionable payroll if it is assumed that the proportion married at retirement dropped from 80% to about 63% over the next 40 years.

Any measure of pension splitting will increase expenditure by the state. For example, there will be loss of income tax receipts as some of the pension will be paid to the former wife and will fall within her tax free allowance. If that eligible pension is paid to the husband it will be more likely to fall within his taxable income. If, in future, pension splitting extends to SERPS and one half of the husband's SERPS pension is

paid to the former wife, in general the benefit will be paid for a longer period on account of her usual longevity of life.

In valuing the options for dealing with pension benefits from divorce it is useful to consider the characteristics that an ideal method should have. We would like to suggest that the following are the most important:

- fairness to the scheme member;
- fairness to the spouse;
- the practicality of settlement;
- ease of administration;
- cost to the scheme;
- state benefits;
- comprehensiveness.

There is no doubt that the introduction of the Family Law (Scotland) Act represents a major step forward by explicitly stating that pension benefits should be taken into account in a divorce settlement. However, as already stated, the existing Scottish system has some disadvantages and in the circumstances we have examined possible ways forward.

Briefly we believe there are four ways:

First, the clean break/capital settlement/no transfer value method. In fact this is the method currently used in Scotland. From a pension scheme's point of view the advantage is that the member's pension benefits are unaffected by the settlement.

Secondly, the clean break/capital settlement/transfer value available method. The main difference between this method and the previous method is that the member's pension scheme finances the settlement. The advantage of this method is that it would greatly reduce or even eliminate the extent to which, under existing Scots Law, there are insufficient resources to pay half the value of the pension to the spouse.

Thirdly, the clean break/split of pension method. In this proposal the pension entitlement arising from the divorce would be split between the husband and the former wife. The wife, could, if she wishes, choose to leave the pension in her husband's scheme. Alternatively she could take a transfer value to a personal pension arrangement of her own. It appears to us that unfunded public sector schemes would find this option preferable as it does not have any cash flow implications.

Lastly, there is the deferred maintenance/allocation of the spouses' benefit method. It has been suggested that an order be made of deferred maintenance against the husband. In this scenario the maintenance would be paid at the time the husband's pension came into payment.

In arriving at a conclusion on the way forward, there are two main considerations:

First, any method should not detract from the clean break and second, the member should not be expected to finance benefits from his own free resources. This rules out the existing Scottish system and also deferred maintenance as being simple ways forward.

The other two methods, payment of transfer value and pension splitting, are similar in many respects and either, in our opinion, is preferable to the existing Scottish system.

So far I have talked about the benefits to be provided from divorce. Perhaps a more fundamental question is whether current benefit design is best suited in circumstances of increasing divorce and falling marriage rates. There has been a steady increase in the number of women working and now they account for 43% of the working population. If both parties are working, is it necessary for the employer to provide a widow's benefit? For example, if the member dies is it desirable that the widow may receive two incomes, one as an employee and the other from her deceased husband's pension scheme? Such an arrangement may mean that a pension is being paid to someone who does not need it.

If it is argued that such an arrangement is desirable, then is it possible to defend pension arrangements where only a legal widow's pension is paid and not a dependant's pension? In most final salary schemes a continued spouse's benefit is provided at no cost to the married member. It can be argued that this is marital discrimination. We see no reason in principle why there should be any benefits other than a member's pension accruing at certain a percentage for each year's service. Then, at retirement, the accrued pension

would be converted by the member to a reduced pension for the member and a contingent pension for the partner. This might be called a dependant's allocation and this would be similar to action taken by a member in a money purchase scheme.

The alternative scenario is to provide a dependant's pension in all circumstances, if there is a survivor who can satisfy the Inland Revenue definition of dependant. We have noted an increase in the number of pension schemes which are now providing dependant's pensions as distinct from spouse's pensions.

Our paper deals with three separate but connected areas:

- the Scottish Divorce system;
- developments in the UK Divorce system;
- benefit design.

The present system in Scotland as introduced by the Family Law (Scotland) Act 1985 has given rise to a number of practical problems. Nevertheless, it does represent an advance by recognising that pensions are a valuable asset and should be taken into account in a divorce settlement. Much experience has been gained in the workings of the existing Scottish system, and we believe that consideration should now be given to its improvement. In particular, we suggest that the ex-wife should be able to have her share of pension benefits transferred to her own pension arrangement.

Lastly, we wonder if it would be preferable to design schemes which provide benefits which are independent of marital status.

**Dr E. M. Clive**, a guest said: As a member of the Scottish Law Commission I played a fairly large part in devising the report which led to the Family Law (Scotland) Act of 1985. It is fascinating to see the problems that are being debated now, some years later.

A number of questions may arise as to why the Commission did not adopt a different approach at the time. The most obvious one is "Why was no guidance as to valuation provided in the Act?" We considered, and sought advice on, the question. The advice was that any one system of valuation would not necessarily be appropriate in all circumstances. Having considered the advice we came to the view that valuing this type of asset was really just like valuing any other type of asset which is difficult to value and perhaps has restrictions on alienation. Generally speaking in the law the question of valuation is regarded as a question of fact, and expert advice, and we concluded that it would not be appropriate to lay down any one system of valuation. Perhaps in retrospect that was unfortunate. This may now be the time to remedy that matter. Certainly there seems to have been a good deal of difficulty in valuing pension rights on divorce.

Why did we not make any provision for making transfer values available or to make pension splitting possible? We considered this aspect as well and we quickly came to the conclusion that if we tried to include any recommendations on these matters there would be enormous delay before any reform was possible. We have got a system which was an improvement on the old system and which, I firmly believe, is an improvement on the present English system. I do not think we would have had an improved system if we tried to go the whole way in 1981 when our report was published.

Finally, what about interest? Our intention was that interest should be capable of being awarded from a date prior to divorce in appropriate cases. I am very pleased to see that in a recent case in the Court of Session the First Division in a case called *Geddes v Geddes*, has confirmed that it is possible under the Act to award interest from a date prior to decrees. I hope this opportunity will be grasped to introduce greater equity in these matters.

**B. J. Duffin** said: I shall confine my comments to the implementation of the Family Law (Scotland) Act 1985.

In the great debate between a "leaving service" and a "continuing service" approach, I strongly favour the continuing service method. The underlying approach of the legislation is to value any assets built up during the marriage and it seems most unreasonable to assume that the member has left service when we know this has not taken place. I acknowledge that this introduces a need for assumptions which may be taken from a wide range of reasonable expectations, but I think we should not shirk the challenge simply because it is difficult and in its place adopt an easier approach which we know is incorrect.

In paragraph 2.5 the authors touch on the subject of widow's benefits and lump sum death-in-service

benefits, but do not develop the argument. Even though the divorce has taken place, the pension scheme member has still secured an asset in the form of a future widow's pension, particularly the widow's pension which would come into effect after his retirement. Although the member is no longer married and therefore there is no immediate widow in prospect, we cannot eliminate this prospect and, as time passes, there must be an increasing probability of a member resuming a married state. Unless we are specifically advised of the marital circumstances and the assumptions to be made, I feel that an allowance for re-marriage should be made in the valuation and a summary of the assumptions should be published in the report. A statement which assumed convergence to the average proportion married in the population as a whole after a period of, say, 10 years might be appropriate. Otherwise convergence to a proportion of the normal married ratio – say 60% of the norm – would be suitable.

In respect of death-in-service benefits generally, including widow's death-in-service benefits, I feel it is important to examine the rules of the scheme to establish whether these have been accrued in respect of past service or are earned on a "pay as you go" basis. If a scheme leaver has an entitlement to a preserved death-in-service benefit, then this may be considered to have been accrued by his efforts during the period of marriage, and may be taken into account to this extent. However if no preserved benefit is given to members withdrawing from the scheme, then I suggest that future death-in-service benefit is only earned by future efforts and therefore may be disregarded in the valuation.

As with any valuation, the assumption regarding rates of interest or investment growth and the rates of tax to be used are crucial. In this case, as the authors rightly state, the paradox is that the value of the benefit depends on the perspective adopted – whether that of the pension scheme member who has the access to gross investment returns until retirement but is taxed on the total pension payable thereafter or the spouse who is liable to tax on income and capital gains throughout, but may withdraw funds otherwise without penalty. This question becomes even more complex if one considers the choice of investment vehicles – particularly between equity investment and fixed interest stocks.

As a central basis, I favour the use of gilt-edged securities of an appropriate term to establish both a nominal and an inflation linked return. This has the merit of also generating a consistent inflation expectation.

From the perspective of the pension scheme member, this produces a reasonable value, being consistent with the amount which he would have to place in a personal pension arrangement to secure the accrued pension and other retirement benefits built up over the period of the marriage.

From the perspective of the spouse, this valuation may be too high if we assume that equity investment is available and produces higher returns, but may also be too low if we consider the effects of income and capital gains tax. In my own experience, I have found that these effects roughly balance except when the pension scheme member is within ten years of retirement. In this situation, it is prudent to examine the valuation from more than one perspective and to advise the instructing solicitors accordingly.

The principles behind the Act are sound, but I agree with the authors that there are some aspects which would benefit from alteration.

- (i) I strongly suggest that the benefits of pension scheme membership should be valued as at the Trial Date rather than the Relevant Date, which is normally the separation date under the current legislation. This would be consistent with most other valuations for litigation. This would also allow full account to be taken of any developments which have taken place between the Relevant Date and the Trial Date and would rectify the anomaly that a significant change in investment conditions between the two dates cannot be corrected by the application of simple interest.
- (ii) The Act makes no reference to state benefits, and therefore it is unclear whether these should be included. I suggest that specific provision be made for the inclusion of any benefits accrued under the State Earnings Related Pension Scheme. This would remove the anomaly that arises between contracted-in and contracted-out benefits.
- (iii) Finally I agree with the authors that pensions legislation should permit the payment of a transfer value from the member's scheme to a personal pension arrangement and that this should be at the option of the member rather than at the option of the spouse. Nevertheless, in negotiation, it may be found unnecessary for such a transfer to take place because of other aspects of the financial arrangements.

**R. K. Sloan** said: I welcome the authors' approach of going back to the first principles of pension scheme design, since many of the problems posed by divorce cases stem from underlying inconsistencies and anomalies in the basic structure of pension schemes, which have often developed in a piecemeal fashion in reaction to successive waves of legislation, rather than having been designed to meet the needs of the current economic and social environment.

Dealing first of all with the specific question of divorce, I fully support the authors' suggestion in 5.5 that the effects of interest between the date of separation and the date of settlement should be permitted. Subject to the important proviso that the legal profession comes to accept this point, which of course also requires consistency with the other financial elements of the divorce settlement, then I believe this opens the way to a more radical change in the procedure for valuing pension benefits.

I believe that the entire calculation should be carried out as at the present time, that is at the date of settlement rather than at the date of separation, but of course based only on the benefits that have accrued during the relevant period of the marriage. Moreover, I believe the calculations should be based on the value to the scheme, i.e., a gross interest rate, rather than the cost to the member and his spouse after allowing for tax.

I agree with Mr Duffin that his calculation should take account of **actual** circumstances in terms of current age and salary, as well as all legislative changes that now apply to the member's own benefits, such as statutory revaluation. This settlement date approach would obviously take account of whether or not the member had left the scheme since the date of separation, but would take *no* account of subsequent **scheme** benefit improvements.

While the authors include a considered analysis of the effects of divorce on the couple's state benefits, which are disregarded in divorce calculations, I would draw attention to the anomaly whereby the value of GMP in contracted-out schemes does fall to be included in the divorce settlement as part of the overall scheme benefit. Since GMP effectively stands in place of the SERPS benefit given up, I feel that an acceptable practice should be developed to ensure reasonable consistency in this respect between otherwise similar schemes that are contracted-out or contracted-in.

As regards the all important choice between a cash equivalent or a continuing service value, I believe that **both** should be calculated and presented, but without any allowance for the probability of withdrawal under the continuing service value. It would then be left to the parties to agree an appropriate compromise figure between these two extremes, depending on the perceived likelihood of the member leaving or staying until retirement. I believe this simpler approach will more readily be understood by the legal profession and the divorcing couple than the somewhat esoteric actuarial technique of building withdrawal probabilities in to the benefit calculation.

Turning now to the wider issue of benefit design, we must first distinguish between the two distinct concepts of defined benefits, as in the case of final salary schemes, and defined contributions, as in the case of money purchase schemes.

Provided that both types of scheme have been designed with a similar benefit target in mind, then I believe that the outcome need be far less different than is often suggested, subject of course to the fundamental shift in financial risk from the employer, in the case of defined benefit schemes, to the member in the case of defined contribution schemes. The point is that this shift inevitably occurs whenever a cash equivalent is taken from a final salary scheme to a buy-out contract or personal pension.

In practice, it is often the case that defined contribution schemes also provide defined benefits, most commonly in the forms of death-in-service cover, whether as a lump sum or widow's pension or both. This really brings me to the fundamental issue surrounding dependant's benefits, namely whether they are provided in addition to a core pension benefit, or whether they are to be regarded as comprising part of the overall benefit value, thus leading to the suggested "allocation" approach at the time of retirement.

While employers should of course be left to decide which route they wish to follow, I believe that the whole ethos of employee benefit provision still suggests some degree of responding to need. Thus whereas the authors' benefit splitting approach put forward in 7.17 indicates a broadly cost-neutral 10% enhancement to the nominal benefit accrual when expressed as two separate lifetime pensions, one for each spouse, I would be inclined to suggest increasing this to perhaps a 20% enhancement, in fact about equal to the true actuarial value for *male* members. In other words, for every 100 benefit expectation by a single member, a married member and his spouse would each be given entitlement to a benefit of 60, that is a total nominal

benefit of 120. The overall package would of course be subject to cost constraints, so that the basic benefit unit for a single member need not necessarily be 1/60th of final salary.

A fundamental difficulty posed by final salary schemes is the fact that the ultimate benefit payable in respect of each year's company service depends on the individual's final salary many years hence, and his or her eventual marital status. Given that this can often prove unsatisfactory in the case of unusual career profiles, the unknown variable of future salary increases could be resolved by adopting the revalued career average approach, whereby each year's (say) 1/60th accrual could be revalued in line with an outside index such as RPI or Section 21 factors. If leavers' benefits were to continue to be revalued in similar fashion, then the problem of choosing between a cash equivalent and a continuing service value would disappear, both then being identical.

As regards spouse's benefits, mention has been made of the release of liability to pension schemes where members are divorced and do not remarry, while likewise there is a considerable additional liability if a member marries shortly before retirement. I am therefore attracted to the pension splitting approach whereby each spouse earns a vested right to an accruing benefit of (say) 60% of the single member's unit of accrual, which would be owned directly by each party and require no further valuation or splitting in the event of divorce, even though the benefit values are in fact different in money terms. Perhaps the outcome of the Coloroll case will necessitate going back to the drawing board.

In cases where there is an element of need enhancement in the provision of spouse's benefits, i.e., it is not cost-neutral, then this split vesting approach would require timely declaration to pension scheme administrators of the particulars of the spouse or dependant, since a retrospective award would in general be out of place, or expensive. Whether administration systems could cope is another matter!

It would of course be necessary to amend current legislation to permit the accrual of split benefits by the spouses and dependants of scheme members, but I believe that this would be a very worthwhile step towards improving the benefit design of pension schemes, as well as virtually removing any further problems over the splitting of pension benefits on divorce.

**D. M. Pike** said: Firstly, in section 1.5 the authors state that the divorce rates have not yet worked through to have a major impact on the proportion of men of retirement age who are married. However if we look at table A6, considering age group 60 to 64, we see that there has been a fairly significant increase in the proportion divorced from 0.8% to 5.4% even although there is a much smaller reduction in the proportion married. If we look at the proportion widowed there has been a reduction there from 7.3% to 4.9% which is perhaps due to improving mortality. I believe that improving mortality has offset to some extent the effect of increased divorce. It appears that perhaps half of the effect of increased divorce has come through to the proportion married.

Secondly, in section 7 the authors make some suggestions on changing benefit design. For instance, they suggest that at retirement the employee could be given a single life pension but have the option of surrendering part of it for a widow's pension. However, the authors do not go through a more rigorous analysis, testing the proposal against the principles in section 4, presumably because of restrictions of time and space. I think there would be repercussions in the incidence of widows who were left with no widow's pensions, which would have an effect on state benefits.

The final point I would like to make refers to Appendix D. I had not realised it is a feature of state benefits that if a married woman becomes divorced, she can retain her ex-husband's contribution record even if she re-marries after age 60. The authors have pointed out the possibility of a divorced woman putting off the date of her re-marriage for this reason. It also occurs to me that depending on her contribution record, my wife and I may be able to increase our entitlement if we divorce the day before her 60th birthday and re-marry on the day after her 60th birthday! This would be our version of "Bed and Breakfasting"!

**J. Porteous** said: I am rather against the continuing service approach. It is unreasonable to give a spouse a guarantee of future salary progression and benefits linked to salary when it is quite possible, especially in the current economic climate, that a pension scheme could wind up whereby the spouse will actually receive a much more valuable benefit than would the member.

If we are talking about a transfer value approach, I think one of the problems with future pension provision will be the increase in unfunded, unapproved arrangements. Under such arrangements there may be no such

thing as a transfer value. What happens if the spouse has a claim for some assets, and the husband cannot find those assets?

On pension splitting – if pensions are split and the spouse dies, does the husband get his pension back?

Finally, the idea of the dependant's option needs to be considered for potential selection against the scheme. Certainly at the moment in occupational schemes I would suggest that people in poorer health tend to select an enhanced spouse's option and perhaps the same would be the case starting from a nil spouse's pension.

**C. D. Daykin** said: May I congratulate the authors on coming forward with a very helpful and topical paper. I think it will help to inform the debate which is currently taking place.

I would like to comment on Appendix A, which presents some helpful statistics on the divorce rates per thousand marriages. It is useful to think of these in cumulative terms rather than just in terms of the rate. For example, at duration 11 about 20% of the 1980 cohort have divorced, whereas the corresponding figures for the 1970 cohort is only 11.2% at the same duration. This is a measure of the increased incidence of divorce in the more recent cohorts. If one then applies simple techniques, more commonly used in the general insurance field, to fill in the remainder of the triangle for the cumulative divorce rates, you come up with some interesting figures for the prospective cumulative divorce level for the 1980 and 1985 cohorts. The results suggest that after 10 years one might have about 18% divorced, after 15 years about 25%, after 20 years 30 to 35% and after 25 years approaching 40%. These are very substantial proportions of the original cohort; it is obviously a problem which cannot be ignored, either from the perspective of state benefits or of occupational pension schemes.

There were a couple of references in the paper to the state system, and I should firstly say that any remarks that I make are personal ones and do not reflect any official position.

Paragraph 3.10 refers to a possible increase in expenditure by the state. The widow's benefit needs to be considered carefully because the SERPS benefit consists of the basic pension to the member and a half rate pension to the surviving spouse. It seems to me that the relationship is important as I will show in a moment.

The Canadians have gone quite a long way down the route of splitting benefits, both in the state scheme and in private schemes. The state benefit accrues equally to each member of the pair and when they split up they each take their half with them. If only one person was contributing out of the pair, half of the pension accrues to them, the other half to the other person. This is broadly equivalent in some respects to our present system where the whole pension is attributable to the man and half is payable to the widow if she survives. It does not quite work the other way round yet but generally there are significantly more widows than there are widowers.

Another aspect of the state scheme which is essential to take into account is the possibility of income support. Any arrangement which leaves the divorcee without very much income is likely to put her on income support. Therefore any system that can be devised which will reduce the need for income support will result in a net saving to the state, even if there are the tax implications referred to by the authors.

If one thinks about occupational schemes then the same principles could apply. I am very much in favour of the method described in the paper as the "clean break and split of pension benefits" method. It goes furthest in the direction of maintaining the nature of the promise which has been made to the individual. After all, under the present arrangements under Scots Law it often seems that the split of the family property results in one person having the home and the other person having a pension. These seem to be quite different in principle since they are essentially basically different financial securities. What one would like to achieve is each individual being able to replicate their expectations of some sort of income in retirement for as long as they remain alive.

Consider a member who has a pension, with the spouse due to receive half of that pension on the death of the member. This may be viewed as an annuity of 1 to the member with a reversionary annuity of 0.5 to the spouse. Otherwise we could think of it in terms of a split benefit as an annuity of 0.5 each to both the member and the spouse, the latter also having the right to the reversionary annuity on the death of the member.

The above is more or less equivalent to saying that the member gets a half pension and the spouse gets a half pension, each from age 65 for their respective lifetimes.



The paper talks about cost neutrality and approaches it from the point of view of the scheme. There is nothing cost neutral about divorce and schemes in fact benefit from it. So any attempt to replace that value into the pension of either the member or the spouse is really giving them what one might regard as their due. It may be argued that this would be taking away a saving which the scheme might otherwise have had. I guess, however, that not many schemes are actually funding to take advantage of that saving although some may be projecting forward reducing proportions married.

Public sector pensions have some of these features already. The allocation option exists in a number of public sector schemes. I am not aware that there are any major problems of selection as mentioned by a previous speaker. Allocation does exist, with several different options available, for example in the teacher scheme. In the Civil Service there is a separate contribution for widows and orphans benefits of 1.5% which is payable by everybody – male and female – and is refundable to people who die or leave the scheme without a spouse.

My last points relate to benefit design. A number of the issues raised by the authors and by some of the subsequent speakers are points which I coincidentally put forward at the Seminar on Sex Equality and Pensions at York in October. I wonder whether the argument about deferred pay which they adduce in the paper actually takes one down the route of defined contribution schemes. As soon as someone starts talking about the inequalities which arise from the deferred pay concept in a defined benefit scheme one ends up saying that the only solution is to pay the same contribution for everybody. Generally, however, pension schemes have built up with some concept which goes beyond deferred pay: a concept of meeting needs as well as just deferring pay. This is the rationale for having benefits of the type we are talking about.

I wonder whether we are moving to a situation where most adult spouses or partners do, or could, work. If so, then why do we provide any benefits to them specifically at all? The benefit is really needed in cases where there is dependency, for example, because of ill-health or in the case of children being brought up. I wonder whether it is sensible to orientate our benefits towards providing orphans' or children's benefits in the case of the death of a member rather than spouses' benefits. That would get over some of the problems, particularly if one also had in mind the split of the member's benefit on divorce.

Finally, I suppose the main reason why people have not pushed forward with splitting benefits is that at the moment this falls foul of Inland Revenue requirements. If it were possible to come to an agreement on a sensible way forward, particularly, for example, if it was something that the Goode Committee recommended, I would have thought that the current Revenue position ought not to determine policy in this area.

**A. Neill** said: Very briefly, I like the Government Actuary's attitude to the Pension Schemes Office of the Inland Revenue. I also welcome the approach by the authors starting in Section 4. A fortnight ago whilst reading *The Scotsman* I thought that we had got some of the answers in the report of the Bannon v Bannon case. The problem was that I did not really understand some of it. However it did say that it is not acceptable to use a leaving service value because Mr Bannon had not left his scheme and I wonder how much this was influenced by the fact that Mr Bannon was a policeman and thus presumably less likely to leave service than most.

I seem to be one of the few people who is not keen on the continuing service value. My big worry is the position when the scheme or the company may terminate or liquidate. I would like to know what people are actually doing in practice when you get somebody who was working, for example, for Ferranti or for Leyland Daf or the Coal Board. Any probabilities incorporated into the calculation are not going to prove correct in practice.

**J. S. R. Ritchie** said: May I start with some reference to the Bannon case as I was the Actuary in Court who was testifying in favour of the continuing service method.

I think the previous speaker has put his finger on an important point in that the member concerned was a policeman and there was considerable emphasis in the evidence which I gave concerning the fact that he did have strong security of tenure. The other point about the police pension scheme which I think is very relevant is the fact that the gentleman concerned at the time of separation was approximately age 40. If he stayed in service another 11 years he would get a two-thirds pension. Whereas the alternative preserved pension if it had been assumed that he would leave service, would be payable from age 60. This was quite an important point which is quite specific to the police pension scheme.

Regarding possible ways forward, I am very much in favour of the clean break/capital settlement/transfer

value available method, discussed in sections 6.12 to 6.23. I take the point made by the authors in 6.12 that the spouse must not have the option of which method should be used. Clearly the spouse will prefer cash if there is a choice. However, I would still like it to be open to the two parties to agree that the husband can keep the pension with the wife keeping the house and the balancing adjustment made. This option would, I think, overcome the objection to the method raised in 6.18, namely that the home would have to be sold more often than at present.

I have two objections to the clean break/split of pension benefits method described in 6.24 to 6.33. The first is the administration burden described in 6.30. The second is that the logical conclusion of this method is separate member's and dependant's pensions as described in 7.17 to 7.19. I believe this would be disastrous for pension provision. It would be a significant psychological deterrent to employees to join an occupational pension scheme in the first place, since instead of appearing to accrue 60ths they appear to accrue 110ths, or some similar figure, with their wife accruing an equal amount. My experience of human nature and of people joining occupational pension schemes is that they would not appreciate this feature.

**A. C. Martin** said: I contributed the actuarial note on the subject of the Family Law (Scotland) Act 1985 in this hall 15 months ago. I have been actively involved in work on this subject since 1986. I was nominated by the Association of Consulting Actuaries as a member of the Pensions Management Institute, Working Group on Pensions and Divorce. The Group's report is due for publication at the end of April.

The Pensions Law Review Committee, or the Goode Committee, had one of its 81 questions covering divorce. It is therefore important to note the possibility of amending legislation in this area. I am sure it will be no surprise for you to learn that the chairman of the PMI Working Group, Sir Alex Atkinson, and Professor Goode have been in contact.

My comments relate to section 2.

In section 2.1 the reluctance of courts to pay attention to actuarial evidence is unfortunately well known. The *Auty* reference to astrologers has unfortunately dominated matters to a disproportionate extent. I would however refer you to a recent Court of Session decision in the case of *O'Brien's Curator Bonis v British Steel*. In that case the Lord President, Lord Hope, checked the "multipliers" by reference to the *Ogden* tables. Interestingly some parochial reference was also made to the potential use of Scottish Life tables, rather than English Life tables! To my knowledge this represents something of a landmark being the first endorsement of actuarial tables without individual admission of such. Some further credence to actuarial input is currently contained in the Law Commission Consultative Document No. 125 on structured settlements. We live in hope of some further progress in this area.

In section 2.3 the practical advantages of using cash equivalent transfer values are highlighted. It is very important to note that cash equivalents are not perfect, particularly with regard to discretionary pension increases, funding levels and retirement ages. This is most graphically illustrated in the case of 50-year-old police officers. I know of at least one case involving such an officer where "best advice" was don't retire until after your divorce.

In practice scheme administrators calculate cash equivalent transfer values in respect of total service, the quotation being relevant to the time of quotation. I regret there can be significant difficulties for legal practitioners to relate these current transfer values to a particular period of marriage and there is also the problem of relating them back to the "Relevant Date", the date of separation, which the authors correctly indicate may be several years ago. Considering the recent progress of interest rates gives some indication as to how the market values of cash equivalents at different dates may pose a problem.

In section 2.7 the authors highlight perhaps the crucial area of disagreement amongst practitioners in Scotland over the 1985 Act, that of tax. I believe that in the 1985 Act, the Scottish Law Commission wanted a value of what was in the pension fund, not what was required to replace it in an outside (taxed) environment. As the authors indicate this is most graphically illustrated in the case of a money purchase entitlement, £10,000 paid in today cannot be worth £12,000 tomorrow! I believe the aspects of taxation in deferment and in payment should be kept separate. Comparisons can in lay terms be drawn between the value of a house and its rebuilding cost. The courts will look for property values at open market sale levels, not inflated rebuilding costs (at a higher level which I am sure we all have to suffer for insurance purposes!).

In section 2.8 the authors indicate the problem of changes after the date of separation, e.g., redundancy. My experience of such changes is that the courts expect the original valuation to apply, however, they take

account of the changed circumstances in connection with the individual's "ability to pay". This has been considered formally in the Court of Session case of *Tyrrell v Tyrrell*.

In section 2.9 I regret I disagree with the authors in respect of the suggested spreading of initial expenses over the whole term of the policy. Extortionate front end costs are a fact of life and should be recognised as such. I would however encourage all life office providers to immediately cease the scandalous misuse of the word "value" in their disguise of initial expenses. (This is something of a personal hobby horse!).

In section 2.13 the practical time-scales of cases are highlighted. There has been some recognition of the decreasing value of money over time in the recent case of *Gulline v Gulline*. 15% interest (simple) was awarded from the time of judgement to retirement in the year 2000. More recently press reports of the case of *Geddes v Geddes* considered the possible revision of interest awards. I hope the comments of Lords Hope, Allanbridge and Mayfield will prove a catalyst for the correction of the current inequity of limiting awards to the monetary amount at date of separation.

One small point on Mr Pike's comments. The retention of a former husband's contribution record for the purposes of basis state pension does not extend to SERPS.

The PMI Working Group have virtually concluded their deliberations and are currently finalising their report. I am not going to tell you what is in the report! However, I would say that in terms of difficulty, the Inland Revenue regulations were less of a problem than SERPS and GMPs. I would however emphasise its publication, coupled with review of pensions by Professor Goode, will prove a significant driving force for amending legislation. I believe this legislation will bring the actuarial profession into very significant contact with the general public and very great care will be necessary in terms of marketing the underlying actuarial aspects. You will know there is currently great concern and litigation surrounding the work of auditors. The Caparro case highlighted in the Cadbury Report, is just one such example. I would therefore urge all actuaries to consider the general public or lay or dictionary interpretations of the terms "value" and "cash equivalent" in the light of the problem with the term a "true and fair view".

**M. D. Thornton** said: Mr Ritchie referred to men being perhaps reluctant to join a pension scheme which gave them benefit accumulating at only 1/120th per annum and gave their wives 1/120th also. However, they have an alternative.

We have seen in this country increasing legislation giving rights to full time employees and a corresponding movement towards the replacement of full-time employees by twice as many part-time employees to whom the legislation does not apply. I have a young friend in Germany who is building up a business there, greatly helped by a young lady who lives with him. When he indicates an intention of marrying her, his accountant holds up his hands in horror and says: "On no account do that, after all you do not want children, you have got everything else you want, and if you did marry her and it came to a divorce, the rights that the wife would acquire would be enough to cripple the business!"

In the current climate the more rights you give to a spouse the stronger the disincentive to marriage. That is something which should be borne in mind in any legislation which is proposed.

**C. M. Stewart** wrote: I should like to offer some thoughts on future benefit design, in particular in answer to the authors' question at the end of paragraph 7.5: "Should separate pensions be provided for the member and his spouse?" although I would prefer to say "his or her spouse".

It seems to me that the 1985 Act does only half of what is required. It identifies pension rights accruing during a period of marriage as joint property, to be valued and apportioned equally in the event of divorce. However, the growing proportion of marriages ending in divorce is only a manifestation of the growing independence, financial and in other respects, of women in marriage. What is required is not the demolition on divorce of a pension package designed with the member in mind, but better design of the package to match the interest of husband and wife equally, whether the marriage, sadly, ends in divorce, or whether it persists. I am optimistic that the future will see an improvement in the stability of the family structure once we struggle clear of past perceptions on the relation between the sexes. However, quite apart from divorce, there are grounds for recognising the needs of both marriage partners in the matter of pension rights.

This would mean splitting the typical pension accrual of 1/60th equally between husband and wife, 1/120th for each, each of the pensions to commence when the person concerned reached pension age, not

when the member himself or herself reached pension age. One might argue that the member's share should be rather more than one half, but that would not make sense so long as the accrued rights were required by law to be apportioned equally on divorce. There would no longer be a need to provide post-retirement pensions for widows or widowers as both receive greater benefits than the single member, a matter on which some have expressed concern. Benefits on death in service would be a separate matter and should be aimed principally at providing for the member's children.

Of course, it would not be as simple as this in real life. It would have to be decided how to deal with periods of legal separation and with the possibility of apportioning the pension accrual on a voluntary basis in stable family relationships other than marriage. It would also be necessary to make sure that if divorce were to take place, the separate pension rights would be respected and not added together, valued, and then reapportioned.

Under such a system, once divorce took place, the member's spouse would have identifiable preserved rights based on pensionable pay at the time of divorce, with statutory revaluation thereafter. The pension could be left in place, or a cash equivalent transfer value offered instead, if that is what the member's former spouse preferred.

The only comments I would offer on the other parts of the paper are to compliment the authors on their endeavours in this very difficult field and to say that, here as in the matter of funding, I believe that the basis should be the value of accrued rights rather than what is referred to as a continuing service value. I also believe, as I have made clear on a number of occasions, that if these two values are very different, the accrued benefits and ongoing benefits have got out of balance and the scheme design ought to be reconsidered. I would therefore support the arguments put forward by Mr Scott in his article in the *Journal of the Law Society of Scotland* to which the authors draw attention in paragraph 2.3.

**R. A. Scott** closing the Discussion said: I have to say that when I first qualified as an actuary I never envisaged that I would get involved in divorce, at least not on a professional basis. However it is a sad reflection of today's society that it is one of the growth areas for professional advice as confirmed by the statistics in Appendix A.

The Discussion today has shown how topical and difficult the subject is and our thanks are due to the excellent and comprehensive paper produced by the authors. Many hours of thought and research must have gone into the paper and I congratulate them on it.

I, like Mr Martin, have been actively involved in formulating proposals for changes to the divorce legislation, both in Scotland and in the rest of the United Kingdom through the working group appointed by the Pensions Management Institute. This group consists of experts from the legal and pensions professions as well as from the Equal Opportunities Commission, Inland Revenue and the DSS. The meetings have been lively as I am sure Mr Martin will agree, but they have confirmed that it is not just an actuarial subject. As highlighted in the report and the Discussions it also has legislative, administrative and state expenditure implications.

One point which is perhaps not so well highlighted in the report is the human angle. A divorce is a very emotive event. It can lead to vindictive and even irrational behaviour between the couple.

Indeed I was taken aback on several occasions by the crazed emotions described by the divorce lawyers within the group. Fairness is often ignored in divorce negotiations. Many of what I considered were sensible proposals for altering the legislation were discarded because they did not sufficiently protect the aggrieved party against the hostile machinations of the other spouse.

Unfortunately, I am unable to divulge the recommendations of the Working Group so my comments have to be fairly general.

The authors will be encouraged to hear however that each of the methods outlined in the report was considered prior to the final recommendations being made.

Before covering the points in the discussion, I would like to make some personal observations.

Firstly there are the practical differences between Scots Law and the Law in the rest of the United Kingdom. Many of these are well covered in the report, but one difference not fully discussed lies in the benefits to be included in the settlement. Scots Law is quite clear that only the benefits relating to the period of marriage should be valued, whereas, English Law is likely to require that the full benefits accrued right

up to the date of settlement (*including* benefits built up prior to the date of marriage) should be valued. The English Courts will then use their discretion to decide what proportion of these total accrued benefits should be shared out between the partners. As a result, a divorce in England will require a valuation of different accrued benefits than a divorce in Scotland, even for members of the same pension scheme.

The next point I would like to make is the seemingly obvious one that there are three parties in every divorce valuation; namely the solicitor, the actuary and the spouse. Each of these persons has different motivations and priorities for the divorce action. As I have already mentioned, the solicitor's views of a couple's morals and actions are generally a lot more cynical than my own. In addition the divorce lawyer, like the spouse, is unlikely to understand much about pensions and both will want to pay as little as possible for the actuarial valuation! As a result actuarial niceties and fairness are often a secondary consideration. This, coupled with the adversarial approach inherent in divorce actions in the UK, has led to the wide ranges of values currently being quoted by actuaries who may be given conflicting instructions depending on whether they are acting for the husband or the wife. It is in many ways like sale and purchase negotiations.

This state of affairs does not, in my opinion, reflect favourably on the profession with two actuaries giving opposing advice to the Court depending as much on the instructions received by the solicitors as their personal beliefs. Any testimony in Court is of course recorded for posterity, unlike the many frantic discussions which take place on sales and purchases. I have no doubt that the arguments used in such cases would be somewhat different if they were to be recorded in a Court of Law! Actuarial evidence may well be used as a precedent and I therefore disagree with the authors on their comment in paragraph 5.2 that any attempt by actuaries to influence unduly the choice of method would be unwise. In my experience the Courts, and solicitors, are crying out for guidance on the method to be used, as often are the actuaries, and we should actively influence this through joint consultations with the legal profession, and this effectively is what the Working Group is trying to achieve.

This influence should also extend to the treatment of tax and the inclusion of spouse's benefits. As I have said, without this guidance, legal precedents are set which may not be actuarially sound.

Another point that will be becoming obvious is that any method proposed should be as simple, as practical *and* as cheap as possible. Few solicitors welcome a large bill for the valuation report. Even fewer welcome wading through the report with all its numbers, assumptions and methods. The less they have to think about, or are required to understand, the better as far as they are concerned. This is another reason why actuaries should actively be involved in establishing a universal method for valuations.

Having said that, and as highlighted by the authors in paragraph 4.11, there is no perfect method that will keep everyone satisfied in every circumstance. Dr Clive confirmed that this was why no advice was taken before the Family Law (Scotland) Act 1985. Whatever is decided there is still a need for the Courts to retain their discretion.

The next area I wish to highlight, and it is a vital one, is the problem of obtaining consistency between persons with GMPs and those with SERPS benefits. These problems were highlighted by Mr Martin and are mentioned in paragraphs 4.9 and 6.21. They proved major obstacles to the Working Group in devising a workable solution. In particular GMPs can cause severe difficulties for the two methods favoured by the authors, namely payment of a transfer value and pension splitting within a scheme. These problems are greatest where the GMPs form a substantial part of the benefits, say more than one-third. This is the situation in hardship cases about which the Working Group solicitors and the Equal Opportunities Commission were most concerned. The obvious way around this problem is for the Government to change the legislation on GMPs and SERPS, and allow them to be split between the couple. Alternatively they could scrap contracting-out altogether, and perhaps that is the best argument for proposing the two methods! Unfortunately, however, I cannot see the Government either scrapping contracting-out or splitting GMPs between couples fully retrospectively. Another solution will therefore have to be found for this problem.

A further question is whether the State's inflation proofing of GMPs should also be included in the valuation. Personally I think that it should, since it is a benefit lost to the spouse, and it would be consistent with the valuation of SERPS benefits if they too have to be included in settlements for members of contracted-in schemes. This will cause problems. However, they are not insuperable if one is trying to obtain a simple and practical approach.

Referring back to the paper and the discussion, Chapter 1 and Appendix A certainly provide some interesting statistics on the falling marriage and re-marriage rates, coupled with the increase in divorce rates.

I was certainly unaware of the extent of the changes in recent years and it was interesting to see the authors' projection that in 40 years' time only 63% of males will be married at retirement age. This may have implications not only for future costs but also for the use of unisex annuity rates, since the lower the proportion married the bigger the difference between the male and female costs.

The problems with the spouse's death in service benefits have been discussed tonight and are highlighted in paragraph 2.5. There is a reasonable argument to suggest that this benefit should not be included because, once the member is divorced, the scheme will no longer pay out the benefit and its value is effectively lost to the member as well as the spouse (unless of course the member re-marries and an allowance for this could be made).

If the early leaver method is advocated, as I think it should be, allowance will be made for the spouse's pension, although often only for the minimum requisite pension. Where circumstances are such that the Court feels the full spouse's death in service cover should be included, this could be done by obliging the member to affect an appropriate term assurance policy. If, for example, this is impossible because the member is in serious ill health, then it would be worth recommending to the Court that the divorce should not proceed. This is possible under the legislation in England and Wales, on the grounds that divorce will result in great financial or other hardship to the respondent and that it would in all other circumstances be wrong to dissolve the marriage.

Members do however accrue entitlement to the spouses' death after retirement pensions during their membership and these can be more easily accommodated. Indeed they are, as far as I am aware, always included in the divorce settlements in Scotland.

The authors say in paragraph 3.4 that schemes would *not* benefit from the release of liability for spouse's benefits upon divorce when pension splitting is used. However, half the liability *will* be released on divorce in cases where only 50% of the spouse's pension is allocated to the wife.

It is an interesting question whether 100% of the spouse's pension rather than 50% should be allocated to the spouse, and the authors highlight this in paragraph 6.5. My own feeling is that if 100% is allocated then it will only be fair to use joint mortality for the valuation of the pension benefits since this would accurately reflect the spouse's interest in those benefits – that is the spouse would only receive a share of the pension if the member were also alive. I have done some simple calculations and compared with the figures in paragraph 6.5; a split of about 55% to 60% would apply to a member's wife, and about 45% to 50% to a member's husband. I think intuitively however that if anything other than 50% of the value of the member's benefits goes to the spouse, we shall have difficulty in persuading the fairness of the settlement to the Courts, let alone the member! I also dread to think what the European Courts will come up with if different proportions are given to men than to women.

In paragraph 3.10 the authors say that any measure of pension splitting will increase the expenditure of the State because of the loss of income tax. However I do not think that the loss will be as high as is imagined in that more and more women are working themselves and earning good pensions. It is likely therefore that there will be fewer career housewives in the future, and many women will be taxed in retirement regardless of the divorce settlement. As the authors also state in paragraphs 3.8 and 3.9, any loss of tax will be offset by the removal of the married couple's allowance and the reduction in income support. Mr Daykin also pointed out that the state will not have to pay out the widow's SERPS benefit unless the member re-marries. The extra costs to the State are therefore, unlikely to be that high.

Having said that, however, the huge growth of personal pensions which the Government have instigated, and the consequent poor ultimate pensions which many people will be receiving in 20 to 30 years time may well have a large impact, both socially and in support costs from the state. However, that is again another matter and I am of course aware of the record new pensions business reported by the life offices for last year!

The authors state in paragraph 2.3 that I put forward a number of arguments in favour of the leaving service value. One of the points made is that such a valuation is independent of a member's future achievements. This was in fact one of the principal reasons why I recommended the leaving service value, since divorce settlements in Scotland specifically exclude anything earned outwith the period of marriage. The authors' statement in Appendix C that "the family home is specifically included as matrimonial property even if acquired by one party before the marriage" is wrong, if the home has remained in the name of that party and the home was not acquired specifically as the matrimonial home. The solicitors I have talked to are in general agreement that salary increases earned by the member above the rate of inflation are due to his own efforts and not the joint efforts of the couple and they should properly be excluded from the

valuation. I should add however that solicitors have occasionally been prepared to gloss over that argument in cases when they have been acting for the wife!

In paragraph 2.4 the authors say that an argument for using the continuing service value is that “an actuary will generally calculate different cases on the same assumptions.” I do not see that as a sound argument *per se*, because there may well be good reasons for having different assumptions in different schemes. For example, do you assume the same salary increases or mortality for policemen as for a senior executive in a private company? Actuaries will have justifiable reasons for using different transfer value bases and, given the guidelines in GN11, they must be fair for each particular scheme’s circumstances.

Having said that, I agree that there can be problems with discretionary increases and certain public sector schemes where a pension is available at an earlier date than that assumed in the calculation of the transfer value. Some allowance should be made for the latter point especially where the member is close to or over the earliest possible retirement age. Indeed as has been discussed tonight, the recent Court case in Scotland, *Bannon v Bannon*, effectively ruled that the transfer value basis for a long serving member in the police scheme is not a true reflection of their accrued pension rights. This ruling was essentially for the reasons outlined by Mr Ritchie and it did not specifically give reasons why the early leaver method should not be appropriate for other cases.

A net basis is also effectively trying to predict a tax regime which will be in force years in the future. As we know, often to our cost, it is difficult enough to predict what the tax regime will be after the next budget let alone in 20 to 30 years time! Mr Martin has already indicated that where the net interest approach produces values substantially different to the transfer value, this could lead to ridicule and confusion. If one accepts this argument, however, it has to be extended to the continuing service basis which can also produce substantially different values to the transfer value, i.e., the early leaver basis.

As stated in paragraphs 2.13 and 5.5, the valuation of benefits in Scotland is made at the Relevant Date and, as confirmed by Mr Aitken and other speakers tonight, generally with no allowance for interest between that date and the date of divorce. The reason for this appears to be that the member’s pension is deemed as the single property of the member. This is then consistent with the value of the matrimonial home which, if it is in the single name of the member, is shared out using the value of the house at the Relevant Date with no allowance for changes in value since then. Perhaps Dr Clive can put me right on this point. With regard to the case he described, interest was only granted from the first date at which it was possible for the wife to be divorced. This does not therefore solve the problem of interest from the Relevant Date. Having said that however, interest will automatically be allowed for during the intervening period if the pension splitting or transfer value route is adopted.

Problems with money purchase schemes are highlighted in paragraph 2.9. Unlike Mr Martin, I agree with the authors that there should be some allowance for the initial expenses being spread over the lifetime of the policy. A possible solution, should the splitting route be advocated, is to split both initial and accumulation units accrued to the Relevant Date.

With regard to the current position in Scotland, a possible solution is to use the value quoted to a continuing member rather than the surrender value.

The authors mentioned unfunded schemes in paragraph 2.11. The same principles could be extended to poorly funded schemes such as the Maxwell schemes. As suggested by Mr Aitken earlier, the only fair method is to allow for pension splitting in such cases with the benefits remaining within the member’s scheme. In that way the security of the benefits remains the same for the spouse as for the member. Also, if the spouse were to ask the member’s employer to transfer monies from an un-funded scheme, I very much doubt if he would agree to this.

With regard to case law highlighted in paragraph 2.12, the continuing service method is now becoming very common in divorce settlements in Scotland. As much as anything else this is because the early settlements were done on this basis and they have been used as precedents for future cases. Another reason is that the level of understanding of the continuing service method compared with the early leaver method is still low amongst solicitors and sheriffs. As stated in paragraph 2.12 one of the main arguments used by the Courts, and by Mr Duffin and Mr Sloan, against the early leaver method is that it is only appropriate if the member had actually left the scheme at the separation date. In fact it is the principles and methods behind the early leaver valuation which makes it appropriate in my opinion and it is merely coincidence that it is the

same value as an early leaver would receive. Remember, that it effectively inflation proofs the pension right through to retirement, and salary increases below or above this level are earned not as a result of the joint efforts of the couple but purely as a result of the member's own efforts. Following the principles of the Act, therefore, these higher increases should be excluded from the settlement.

The authors highlight problems with lump sum death in service benefits in paragraphs 2.5 and 4.2. Personally I did not think that the lump sum death benefit should be included in a settlement since there is no accrued entitlement to it, and since it is paid at the Trustees' discretion. There is also the possibility that the spouse may not have received it in any case had he or she remained married. This may happen for example if the spouse were not dependent on the member. If, after divorce, the spouse *is* still dependent on the member at the time of his death, the Trustees will have discretion to pay at least part of the benefits to that spouse and, if the financial details come to light, it is likely that they will do so.

One of the crucial problems highlighted by the authors in paragraphs 2.7 and 2.10 is whether the value should be calculated as the "cost to the scheme of providing the benefits", that is on *gross interest, gross benefit basis*, or as "the cost to the individual of replacing the benefits", that is assuming net rates of interest and net pension benefits. Like Mr Sloan and Mr Martin I cannot see an argument for using the net basis except possibly in cases at or near retirement. A gross basis should obviously be used if a transfer value or pension splitting basis is adopted.

The current situation in Scotland is, as described by Mr Daykin, that the matrimonial home is often used to pay for the pension rights. This is obviously a gross investment in that any gains on the house are tax free and, as stated by the authors and Mr Duffin, there are also many investments available to the wife which do not attract tax. The use of a net rate of interest is effectively penalising the member for the fact that the spouse cannot earn as high a return as the pension scheme. This seems unfair particularly given that the member is having to come up with cash in the first place.

In paragraph 4.5 the authors define what they mean as "fairness" to the spouse. In our discussions with the Working Group, any settlement that ties the spouse to the member was strongly resisted by the Equal Opportunities Commission and the pensions lawyers. As a result, the fairest solution may not necessarily be the best solution, and again the authors refer to this problem in paragraph 6.24.

When talking about the transfer value method in paragraph 6.13, the authors say that a past service reserve could be possible. However, this may well cause problems with GMPs, and it is totally inappropriate for poorly funded or un-funded schemes. Further, should the member be made redundant or leave the scheme for any reason, he or she may be left with nothing which is hardly the aim of the legislation. I would also like to ask the authors what they consider is the equivalent of the past service reserve in money purchase schemes?

Another way of splitting the pension benefits is to calculate the value of the agreed benefits to be split, and then apply a transfer-in basis to this value in order to purchase benefits within the scheme for the spouse. The spouse would then become a member of the scheme with the same rights as deferred pensioners. This process releases the tie between the spouse and the member after the date of divorce, and this method was therefore preferred by the Working Group. Again I would recommend that an early leaver valuation is used when calculating the value since this reduces GMP problems, and for the other reasons already stated. It would also leave the member with a reasonable pension if he or she was subsequently to leave.

As regards the final method proposed, namely deferred maintenance and allocation of spouse's benefit, this is unpopular with solicitors for the reasons outlined in paragraph 6.37, principally because it goes against the clean break principle. Indeed it was interesting that in the Working Group this method was not seriously suggested despite the fact that Mr Ellison was a member of the Group. The problem with tax outlined in paragraph 6.36 can actually be allowed for by the Court when determining the maintenance order.

With regard to future benefit design I found the chapter most illuminating and several thought-provoking and innovative ideas were proposed by the authors. There is no doubt that social values and practices are changing and pension design must be looked at accordingly. It is probably just as well however that Mr Pike's "bed and breakfasting" approach is not possible!

On the subject of deferred pay outlined in paragraphs 7.6 and 7.7, my own feeling (although probably not the Court's feelings given what Mr Daykin has said), is that the dependant's benefit is *not* deferred pay even though the member's pension benefit *is* now seen as deferred pay. The dependant's benefit is effectively an extra life assurance benefit for the member's family.



One solution to the problem might be to retain this benefit but ask the members to pay an increased contribution of perhaps 0.5% to 1% of pensionable salary in order to receive this benefit.

An alternative solution is the “dependant’s allocation” outlined in paragraph 7.10. However one disadvantage of this is that it would result in reduced benefits for married employees. There is also the possibility of selection against the scheme but it was interesting to hear Mr Daykin say that this does not happen in those public sector schemes that have a similar option. In any case this approach could cause problems with GMPs. Also would there be different Inland Revenue maximum tests for single people as opposed to married people? Having said that it is an attractive idea and should be considered.

With regard to the adult dependant’s pension, there will be problems with proving dependency as highlighted in paragraph 7.20. The authors say in 7.16 that the introduction of such a pension “would increase costs for pension schemes compared with the cost if spouse’s pensions only are provided.” This would not be the case however if the spouse were also required to be a dependant in order to receive a pension.

With regard to separate member’s and dependant’s pension described in 7.17, again there would be problems with GMPs. There is also the possibility that the scheme may be over-providing for the partner, e.g. if he or she is also working. As described by Mr Thornton the alternative approach in 7.19 might even discourage single people from getting married! However, it deserves attention as highlighted by Mr Stewart.

Finally, I hope that today’s discussion has been of help to the authors who, as I have said, should be congratulated on the quality of the paper.

**P. A. Hurcombe** replied: Pension schemes do not exist in a vacuum: they must reflect the social and economic environment in which they operate. Tonight we are here to explore one of the more neglected areas of actuarial statistics – the area of marriage and divorce rates and how these affect pension schemes.

We do believe that the current legislative system, although an improvement, is not working correctly. Dr Clive gave some background on why the system was introduced as it was. I have much sympathy with the view that it was not possible to give guidance at the outset. I certainly have sympathy with the view that had they tried to get everything right at the outset it would have delayed matters so far that nothing would ever have been introduced.

However, I do think that the difference between continuing service and the leaving service values are so fundamental that some sort of decision must now be made. You will be relieved to learn that I am not going to go into detail of my view about the relative merits of the two approaches. I feel however, that the Bannon v Bannon case, although initially seeming to clarify matters may not help much when examined closely.

The other major problem with the current Scottish system is the lack of access to pension scheme assets. This, we believe, gives problems both in practice, and in principle. Why should the non-pension scheme member be able to raise immediate capital on the prospect of benefits as the scheme member? Our definition of fairness to the scheme member when considering the way forward included the proposition that members should not be forced to finance a settlement from their resources. I was interested to note that nobody disagreed with that view.

Mr Scott disagreed with our suggestion that actuaries should not unduly influence the decision on valuation methods. I should perhaps make it clear that our comment was in the context of existing Scots Law where I think it would be very damaging to the reputation of the profession to be seen to be usurping the authority of the Courts. It does not suggest that actuaries should not play their full part in developing a system in the UK as a whole and thereby providing better systems than the existing method.

There were a number of comments on our four suggestions for developing a system in general. The view was that either transfer value or pension splitting would be a way forward and I hope this will come out in the PMI review.

Mr Daykin, in his comments on pension splitting, suggested that the costs of dividing the initial spouse’s benefit would be small. I think he was making the same point as us, that although there is a cost to schemes of paying spouse’s pensions to divorced spouses, it is a very small cost. It may well be that schemes would be prepared to meet this cost.

Although the majority of the paper dealt with divorce a significant part of the paper considered decreasing marriage and increasing divorce rates. Perhaps surprisingly nobody commented on whether the statistics that

we have shown in the paper will actually continue or whether the current rates are just an aberration which will be reversed. Indeed nobody commented on whether these statistics, which are derived from population statistics apply equally to the more limited population of occupational pension scheme members. Assuming, however, that there will be some move in the direction indicated in Appendix A, we raised a few questions about dependants' pensions and spouses' pensions and whether in the light of the falling proportion married it would be considered reasonable that dependants' pensions should only be paid to spouses in future.

We came up with two main suggestions. One was spouses' allocations and the other was wider use of dependants' pensions. Actually the majority of speakers seem to favour the third option, namely separate pensions for both members and spouses. I did notice however, that Mr Ritchie commented on the presentational difficulties that the third option might introduce. Certainly the approach has some attraction, although it is arguable that it is akin to using a sledgehammer to crack a nut. Either pension splitting or a transfer value would get round the divorce aspects of the problem without requiring such a fundamental change in benefit design.

Section 7 is not a finished product and was very much intended to throw out a few ideas for people to consider. I believe that benefit design may have to change to some extent to reflect the change in family structures which appear to be developing. The form of benefit design which might materialise in the future is still very much an open question. Indeed overall this paper makes no pretence to have all the answers to the issues raised. As such the contributions tonight are just as valuable as the paper encouraging the debate. We are grateful to all the speakers.

The issue of the interaction of pensions and divorce will not go away and we regard it as vital that the profession should play a part in future developments.

**Mr I. M. Aitken and Mr P. A. Hurcombe**, replying in writing to points in the Discussion said: The discussion contained, as might be expected, a number of comments upon the method of valuation of pension benefits under the Family Law (Scotland) Act 1985. Since the discussion we have had the opportunity of reading the full judgment in the case of *Bannon v Bannon*, which was referred to by amongst others Mr Ritchie. This reading confirms that, in the absence of any specific legal guidance that one method should be adopted in all cases, Courts will generally wish to consider which method may be most appropriate in the circumstances of a particular case. Factors such as the nature of the scheme, security of employment and the age of the member are likely to be important in each individual case in determining whether a continuing service value, a leaving service value or some compromise value is appropriate. This reinforces our view that it would be unwise for actuaries to be too dogmatic about which is the "correct" method of valuation.

Whether this is a desirable state of affairs is open to question. Dr Clive made mention of advice that any one system of valuation would not necessarily be appropriate in all circumstances and that the valuation in any case would be determined as a matter of fact based upon expert evidence. With the benefit of hindsight, we believe it would have been preferable if at least some guidance upon method of valuation had been given at the outset, even if this did not go to the length of laying down one valuation method.

We were pleased to note general agreement on two issues: that the current treatment of GMPs and SERPS is inconsistent, and that it would be preferable if benefits were valued at date of divorce rather than at the date of separation (or equivalently that interest be added). In some early cases, not only was no interest added between the date of separation and the date of divorce, but payment of a lump sum was then deferred until retirement age with no addition of interest for this period either. Recent cases have produced, in our view, more sensible settlements, but there seems no sign of accepting the principle of adding interest from the date of separation.

As the Independent Working Group on Pensions and Divorce has published its report, we do not propose to deal in detail with the section of the discussion on future developments in pension and the divorce law. We were however pleased to note that there seemed to be general agreement with our two preferred methods of payment of a transfer value and pension splitting. It does appear that the term pension splitting may be ambiguous as some speakers interpret the split as being based upon the salary at the date of divorce, with the spouse's share subsequently receiving deferred pension increases. Our meaning was that both parts of the pension would subsequently increase in line with the member's salary increases, until such time as he leaves service, dies or retires. If the spouse does not receive the benefit of these increases, then there seems little attraction in her retaining the benefit in the member's scheme, except in unfunded schemes where a transfer

value may be unavailable. We note Mr Daykin's comment that the split of pension benefits method goes furthest in the direction of maintaining the nature of the promise which has been made to the individual. Mr Scott argued that salary increases after the date of separation earned by the member above the rate of inflation are due to his own efforts and should be excluded from the valuation. It is interesting to note that this point was addressed in *Bannon v Bannon* and rejected.

One specific question raised by Mr Porteous on pension splitting was if the spouse dies before the scheme member, does the member get his full pension back? We think the answer must be no in order to preserve, at least, approximately, cost neutrality to schemes.

Both Mr Daykin and Mr Scott referred to the question of whether pensions can be considered as deferred pay and if so whether the concept of a defined benefit scheme remains valid. There may indeed be a danger that if schemes remove discrimination on the grounds of marital status, then in time discrimination on the grounds of age will also be called into question, which would effectively spell the end of final salary schemes. However, as the statistics in the paper show, the proportion of people who are married is steadily declining and in our view the issue of marital discrimination cannot be ignored. What changes may be appropriate is something which we leave for further debate.