The pension split: unfair shares?

Focusing on the short-term financial needs of clients on divorce can often be to the detriment of their longer-term financial security—but are family lawyers prepared to engineer the drive towards fairness & a pension sharing revolution? Grania Langdon-Down reports

The 'elephant traps' surrounding pensions on divorce could see a tidal swell of negligence cases against family lawyers unless they get to grips with the true value of a couple's pensions, warns James Copson, co-author of a good practice guide.

Research for the 'Guide to the Treatment of Pensions on Divorce', published this summer by the Pensions Advisory Group (PAG), found that, of the 369 court files studied, 80% revealed at least one relevant pension and yet only 14% contained a pension order.

Concerns around pension advice has clearly struck a chord with family lawyers, with more than 170 solicitors, barristers, and legal executives responding to a LexisNexis/Mathieson Consulting survey on engaging pension experts in financial settlements.

Half of those responding are highly experienced with 15 years-plus PQE and nearly two thirds spend 75% of their time on matrimonial finances. A third work in family teams which generate more than £1m in fee income.

A fifth had completed more than 25 financial remedy orders in the previous 12 months, with a quarter completing 11-15. Four out of ten say they engage a single joint expert in up to a quarter of cases, while three out of ten do so in up to half their cases. In 88% of cases, the expert comes from an actuarial firm.

The three main reasons for not engaging an expert are low value of pension (75%); reticence or refusal by client (70%) and cost (51%). The top selection criteria are reputation of expert and user experience, followed by cost, delivery time scale, complexity of case and recommendations.

Those responding ranked the top benefits for practitioners from having a pensions report as a fair client outcome (54%); precision of settlement (41%); followed by protection from client complaints and defence against negligence claims (both 15%).

In a key question on risk, just over half of respondents (58%) feel they are 'comfortably protected' from a professional negligence claim if their client, who refuses a report, signs a waiver or disclaimer.

It prompted comments from some responders. 'I'm a barrister, it's the solicitor's call. If I firmly believed expert required, I'd seek written acknowledgement of refusal to accept my advice.'

'Well, it should be absolute protection,' another said, 'but solicitors always seem to be considered fair game when the client is aggrieved about the outcome.'

What is worrying experienced family lawyers is that the PAG report still needs to spell out the message that: 'Ignoring the pensions or agreeing to ignore the pensions is not an option'.

'It happens too often because, for many people, pensions do not represent real money today,' says Copson, family law partner at Withers and a member of Resolution's Pensions, Tax and Financial Remedies Committee.

'The fact this is still happening, 19 years after pension sharing was first introduced, is a real worry. It strikes me that this results from a lack of understanding among parties and their lawyers. Both may also be scared off by the complexities of many pensions and by the costs of finding out what they need to know to get a fair result.'

Pauline Fowler, family partner with Hughes Fowler Carruthers, leads on pensions for Resolution. 'Part of the problem is that we have a complicated pensions industry, with a wide range of different financial instruments,' she says.

The 'unaffordability' of legal advice and lack of legal aid for financial remedy cases also mean many couples represent themselves, says Jane Craig, head of the family department at Penningtons Manches Cooper. 'Often the less well-off party will focus on their immediate to medium term financial needs for a house and income for themselves and any

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children to the detriment of securing their longer-term financial security.'

This can have a devastating impact as women live, on average, four years longer than men and, among those aged 55 to 64, are almost 20% less likely to have built up any private pension.

During the summer, Penny Mordaunt, then Minister for Women & Equalities released the report 'Gender Equality at all Stages: A Road Map for Change?' It reports that only36% of financial remedy disposals issued in 2017 include a pension sharing or attachment order 34.

But is this just the tip of the iceberg?

Absolutely, says Craig. 'Without legal advice, most separating couples do not end up finalising their financial claims against one another through the courts, either via a consent order or by a court-imposed decision following a hearing in front of a judge,' she explains.

'Yet you cannot share a pension without a pension sharing order and you cannot have a pension sharing order unless there are court proceedings.'

Family barrister Grant Lazarus, of Liverpool-based 7 Harrington Street Chambers, says the 2018 statistics show an even lower take-up than the gender equality report suggested.

There were 118,141 divorce petitions, with 43,018 financial remedy applications, of which 25,834 were lump sum orders and 19,698 property adjustment orders. But only just over 13% had either pension sharing orders (11,316) or pension attachment orders (4,632).

Two possible reasons are, he says, the 'disturbing' issue, picked up in the PAG report, that wives often feel they can't pursue their husband's pensions because the emotional and personal costs are too high.

At the same time, some husbands, generally the higher pension holder, still find it difficult to accept that their pension fund accrued throughout a long marriage is regarded as a matrimonial asset.

But, he stresses, in the majority of divorces, *neither* party will have acquired any significant occupational pension. 'A comparison of modest level money market pensions is far easier,' he notes. 'The likely outcome will, more often than not, be offsetting rather than pension sharing. This may explain the low percentage of PSOs.'

Increasing numbers of couples are turning to the online divorce system—managed by HM Courts and Tribunals Service. The process is being updated to include a 'behavioural nudge' and improved guidance, with women required to tick a box to confirm that they have considered their husband's pension pot before they can obtain an online divorce.

But does this go far enough?

'I wouldn't single out pensions over other financial arrangements,' says Fowler. 'I would suggest that divorcing parties confirm they have considered the financial position before the divorce can be granted using a formula of words such as "the financial position, including housing and pensions."'

Craig believes the government should run a public information campaign rather than leave it to a tick box exercise.

'A clear steer to include pension disclosure in any negotiations process is, of course, beneficial,' she says.

'But the issue then is how to ensure that separating couples understand what that pension disclosure actually means and how the pension assets can be used upon divorce or dissolution.

'Also, when pensions are disclosed, are they 'similar beasts'? For example, defined benefit (final salary) pensions are not the same animals as defined contribution pensions. What tax implications will there be if they are accessed? What will a share of a pension produce in terms of capital and income and, importantly, when?'

So, what are the complicating features - from pensions held overseas, income gaps and tax implications—that can catch out the unwary?

George Mathieson, CEO of Mathieson Consulting, says potentially problematic areas include a mixture of defined benefit and defined contribution schemes; uniformed services schemes (armed forces, police etc) where retirement dates change; and cases where lifetime allowance issues prevail.

Offsetting should raise immediate questions, he says: 'How do you start comparing a pension of £10,000 pa with the equity in a house? Other complicating factors include significant age differences and if there is a choice of pensions to share.'

Mena Ruparel is a solicitor, arbitrator, trainer and consultant. 'Many solicitors have little understanding of even the basic types of pensions and tend to treat them all as though they are the same,' she says. 'This is partly the fault of the CEV (cash equivalent valuation). We are asked in the Form E to use this as a basis for valuation without understanding how it is calculated and that it means different things in different pensions.'

What is vital, she stresses, is that solicitors remember they are not financial planners and they instruct an expert as early as possible. Otherwise, the risks of failing to notice an issue or 'creeping' into giving financial advice are high.

The PAG and FLBA have discussed a joint approach to identifying cases where a pensions on divorce expert (PODE) will

Pension splits in practice

George Mathieson shares some examples of the fallout from naïve pension planning and the benefits of unearthing hidden guarantees

i. A husband and wife agreed a DIY divorce, with pension sharing orders. They did not realise that it can make a difference which pension is shared, rather than simply choosing the scheme which charges the lowest fees: 'This naïve approach cost both parties c£7,000 pa per annum in lost pension income from age 65 for life.'

ii. An elderly couple didn't think they needed an expert and agreed a 50% pension sharing order over the husband's pension of £65,000 pa. His pension was reduced to £32,500 pa. But his ex-wife was only able to secure a pension for herself of £10,000 pa, effectively converting a £65,000 pension into a joint income of £42,500 pa.

iii. The parties were about to share a pension where the husband's defined contribution fund was said to have a transfer value of £750,000. Neither was aware of a number of hidden guarantees. 'We suggested the husband should be allowed to retire first, as we believed the transfer value would be greatly enhanced,' he says. 'Overnight, the transfer value increased from £750,000 to £2.3m. Can you imagine the claim waiting to happen if his ex-wife had received 50% of £750,000 instead of 50% of £2.3m?'

probably be required.

'There is a valid argument,' Lazarus notes, 'that a generally poor understanding of pensions, coupled with fear of complaints or professional negligence actions, can be used as a marketing tool by PODEs in order to generate actuarial reports in cases where the cost and delay is disproportionate to the very limited benefits and simplicity of the issues.

'However, the permission of the court is required before expert evidence can be adduced and FPR r25 and a properly trained district judge should prevent this.'

In very broad terms, he says it is less likely that expert input is needed where the total pension provision between the parties is less than £100,000 and is entirely of the defined contributions 'money market' nature.

However, as soon as there is a comparison between money market and defined benefits schemes or a comparison between different defined benefits schemes, expert input is likely to become increasingly essential.

What is impossible, he says, is to give meaningful advice as to offsetting without having worked out the benefits that could be obtained by a PSO.

'A comparison of the different types of pensions is a 'red flag',' he says. 'The ability to take pension benefits from 55—sometimes with brutal tax consequences—is often a feature to be considered when trying to find a mechanism for producing capital to meet housing need.'

Lifetime allowance and the annual allowance tax charge are problems that will arise rarely but will almost always require actuarial input.

Always get advice, says Copson, on public sector schemes with combined values of more than £100,000; where there are occupational schemes set up before April 2006; old schemes with guaranteed rights, such as a high annuity rate; where a party is seriously ill; and where the lifetime allowance is likely to be exceeded, currently £1.055m.

Mathieson adds a word of warning. 'All PODEs are incredibly busy so seek advice as early as possible. It also takes up to 12 weeks to get all the information the experts will require. The much-talked about CEV for the Form E is simply not enough information on which to base decisions.'

Given that 12-week timescale, the survey asked practitioners when they would expect delivery of a report. Half said within 15 weeks and a fifth 20 weeks.

Asked if clients would pay a premium if the report came within 15 weeks, half of the responders said no, while 18% said £250. One suggested £500, depending on the value and complexity of the pension, higher for an exceptional difficult case.

However, other comments were less generous. 'Clients should not pay a premium just as lawyers have a fixed hourly rate and do not impose a premium if we work weekends or late at night—it comes with the territory.'

'Why should there be a premium,' another commented. 'Either the timescale can be met or not! You should not have to pay more to be put at the top of the pile.'

What is becoming increasingly clear is that the consequences of getting it wrong can be substantial.

Lazarus has been instructed in 165 solicitors' negligence cases over the last six years arising out of pension sharing or offsetting orders. One went to a county court trial but is unreported. While some had no merit, others settled with a confidentiality clause.

'Too many solicitors continue to advise wives that pensions are very complicated; that they will not see the benefit for many years; and that they need the security of the house,' he says. 'In many cases, that might, actually, be entirely fair. In too many others, the capital advantage gained is vastly outweighed by the benefits that are lost.'

It is worrying, he says, that practitioners are giving 'positive, persuasive and apparently confident advice' about offsetting without any proper understanding of the complex issues involved.

The result is that worthy claims have been almost entirely successful, he says. 'Almost all settle, because the defendant insurers recognise the validity of the claims, and the claimants' solicitors recognise litigation risk on issues such as limitation, causation, and quantum.'

The one case he has taken to trial succeeded because 'the high street solicitor concerned had patently not even a superficial understanding of several of the issues I have outlined. The same is true in many of the cases which have settled – that is why they settle'.

Although the legal profession is now better educated and 'less prone to crass negligence', Lazarus says 'every new generation of solicitors, counsel and, indeed, judges, needs training in an area of financial remedy that is complex and emotive.'

Family law continues to prompt one of the highest levels of complaints to the Legal Ombudsman.

'Solicitors need to be careful not to do too much, for instance by giving financial advice, to keep clients happy,' warns Ruparel.

'There is a fine balance between providing a good standard of service and succumbing to client pressure. This often happens when clients tell the solicitor that they won't instruct an expert, that they have a deal and the solicitor should just advise on the deal and draft a consent order. But how can solicitors advise on a deal where an expert is vital?'

The PAG research found that the majority of claims of negligent advice has involved ill-considered offsetting arrangements, says Craig. 'In addition, pension experts are often not instructed in order to save time or money or because the court does not deem it necessary,' she says. 'This results in parties or lawyers making their own assumptions or guesses as to the pension situation. This can have a significant impact on the parties and could lead to potential negligence claims.'

Claims can also arise over failure to include state pensions or advise on clawback by the pension provider. 'This can result in in disgruntled clients,' she warns, 'particularly if the pension member has been paying maintenance to their ex in the intervening period to cover the income gap before the pension sharing order kicks in.'

For Copson, practitioners too often fail to update values during the divorce process with the risk of falling foul of the

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'moving target' syndrome.

Under English law, parties must share a fixed percentage of the cash equivalent of their pensions, he explains. But, in a final salary scheme, for instance, there could be a significant swing in gilt rates between the date of the valuation and the date of the sharing.

Mathieson has seen more than 100 cases where parties—usually ex-wives—have come back five years or more after the divorce and claim that their solicitor was negligent in the way the pensions were dealt with (see box on p12, Pension splits in practice).

But it is not just practitioners or couples who struggle with pensions. For Craig, *WS v WS (Financial Remedies: Pension Offsetting)* [2015] EWHC 3941 (Fam), [2016] Fam Law 564 is the 'stand out recent case where pensions were misunderstood'.

The court decided to offset the value of a defined benefit pension scheme using the *Duxbury* formula, she explains. 'The decision was made without reference to an expert pension report, as the court refused to order one. The reason for choosing to offset rather than pension share was that it was thought that sharing would take the husband over his lifetime allowance, resulting in severe tax consequences.'

However, Craig says, had a pension sharing expert been involved, they would have advised that this was not the case: both the pensions involved had been crystallised and so had already been tested against the lifetime allowance.

Faced with a range of options for offsetting, she says, the judge found that there was 'no obviously right figure or correct calculation.' Had a pension expert been involved, the lifetime allowance misconception would have been corrected and they could have provided a set of balanced offset calculations to assist.

In his foreword to the PAG report, Family Court President Sir Andrew McFarlane also highlights 'divergent approaches to pension sharing in different court centres [which] have brought the integrity of the system into question'.

Fowler says that most cases where pensions are an issue are not big enough money cases to be heard at High Court level, and so are rarely reported.

'Most practitioners and most judges are keen to see lower value matters resolved by way of compromise because of the impact of legal fees,' she explains. 'What I have seen is a reluctance—or outright refusal—at directions appointments to appoint a pensions expert who could advise both parties. That puts the issue of the pensions much more on the back burner.'

Lazarus says that most judges dealing with financial remedy claims understand the basic principles of pension sharing and offsetting - sometimes with prompting from advocates.

But he says: 'I would be surprised if more than 10% of cases which reach FDR go on to a contested final hearing.'

He points out that many full-time district judges haven't had any previous financial remedy experience while in practice.

'We have recently been promised that only properly 'ticketed' specialist DJs will deal with money on divorce cases, which will undoubtedly help,' he says. 'In some courts, the FDRs are simply slotted into an otherwise overly busy list. It is extremely dispiriting, but not unusual, to craft a balanced and developed position statement/skeleton argument, and then realise the DJ has not had time to read it.'

There is also a lack of DJs in many areas, with gaps filled by deputies, he says, so any hope of a consistent judicial approach from such a widely-sourced group is 'probably unrealistic'.

But even experienced, full-time judges are not immune from a failure to understand the basics, Lazarus adds. 'A comparison of CEVs for different occupational pension schemes is very often pointless, as they are calculated differently and will produce different benefits.

'I have personal experience of a full-time judge ignoring submissions to adopt a percentage PSO that would provide equality of pension benefits in retirement. Instead, the judge insisted on imposing a percentage PSO that would provide equality of capital fund – despite the PODE report very clearly explaining why this would produce inequality of income later.'

Brexit uncertainty

Another high-risk area involves overseas pensions, with Brexit uncertainty continuing. In an analysis for LexisNexis, Michael Allum and Stuart Clark, partners at The International Family Law Group LLP dealing with international pensions in divorce cases, say that obtaining effective UK pension sharing orders after an overseas divorce is already very complex. Jurisdiction in some cases relies on EU law.

'If there is a deal, the EU Maintenance Regulation will remain in force during the transition period, December 2020 or later,' say Allum and Clark. In those circumstances, jurisdiction would still be possible under MFPA 1984, Pt III until at least the end of the transitional period. The same applies if Art 50 is extended.

But if there is a 'no-deal' Brexit with no transitional period, the EU Maintenance Regulation will cease to have effect after the exit date. 'So, a UK pension sharing order after a foreign divorce would require one spouse to be domiciled here or habitually resident here for 12 months,' they note. 'Often this jurisdiction is not available. Against this backdrop, practitioners should act fast to protect their client's position. A law change is needed urgently.'

As Copson points out: 'There are lots of elephant traps with pensions on divorce. If you're out of your depth, accept that fact and send the client to somebody who can truly assist him or her. Then, get educated so that you can be of greater assistance for future clients.' NLJ

Brexit: jurisdiction & overseas pensions

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Michael Allum & Stuart Clark, partners at The International Family Law Group LLP.

Grania Langdon-Down is a freelance legal journalist.

Survey details: 173 lawyers completed the 2019 LexisNexis and Mathieson Consulting survey 'Engaging pensions experts for financial settlements', which was distributed via *NLJ* & *Family Law* websites and e-newsletters in July and August 2019. Many thanks to all who took the time to take part and to Mathieson Consulting for working with us and Grania for researching and writing it up.