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Dear Sirs

A Fairer End to Relationships – Consultation Response

I am writing on behalf of Excalibur Actuaries to respond to the above consultation.

Excalibur Actuaries is a leading provider of Pension on Divorce Expert (PODE) reports throughout the UK. I was a member of the Pensions Advisory Group (PAG) for the publication of “A Guide to the Treatment of Pensions on Divorce” and chaired the pension experts committee for the publication of “A Guide to the Treatment of Pensions on Divorce – Second Edition” (colloquially known as “PAG2”). I also am a member of the Institute and Faculty of Actuaries’ working party for pensions on divorce.

Pensions are often one of the largest assets in divorce settlements. PODEs advise the courts and divorcing parties to help them decide the sharing that is appropriate by answering instructions such as “what sharing is required for equal retirement incomes” or “equal capital values”. In addition, where the party with the larger pensions has more than one pension, PODEs identify the best pension to share, which results in a better outcome for both parties – typically resulting in higher pensions after sharing and improving the resulting outcome by thousands or tens of thousands of pounds. As PAG2, paragraph 1.7 says “...**the financial cost of making an uneducated guess about the pensions with a view to avoiding the relatively modest cost of a PODE report and so getting it wrong can be immense for either party.**”

I respond only to those questions where there are pension aspects or elements to consider.

- 1. Do you agree with the government's view that the objective for the sharing principle is to give equal benefit to the parties of matrimonial property by dividing matrimonial assets equally?**

Response: In general, we agree with the broad principle. However, the purpose of pensions is to provide income in retirement and so, in needs cases (i.e. the majority of cases), the courts usually aim to have equality of income rather than equality of capital, although the latter can be fairer in some cases. This is an important distinction and is discussed in PAG2, including the following points:

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1.17 “In a needs-based case, in particular where there is a significant Defined Benefit pension involved, for the parties or court seeking to identify a fair outcome the appropriate analysis will often be to **divide the pensions separately from the other assets**, based on an **equalisation of incomes** approach.”

6.13 “There are two main reasons for dividing pensions according to their income value: equality and needs.

Equality — Given that the object of the pension fund is usually to provide income in retirement, **it will often be fair** (where the pension asset is accrued during the marriage, including cohabitation seamless to marriage) to implement a pension share that provides **equal incomes from that pension asset**” and

“Needs — In many cases the parties will be dividing modest pension funds. It follows that, in order to determine whether the parties’ needs are met in retirement, they will need to know what their respective incomes are likely to be following any Pension Sharing Order. A division that pays little or no attention to income-yield may have the effect of reducing the standard of living of the less well-off party significantly.”

Furthermore, Cash Equivalent values (CEs) are often not an appropriate way of measuring a pension’s capital value (this is a weakness of the approach to divorce in Scotland). Relevant extracts from PAG 2 include:

1.18 “**Lawyers need to have firmly in mind the inherent limitations in the use of Cash Equivalent (CE) figures.** Even where a Defined Contribution scheme (e.g. a money purchase scheme) and a Defined Benefit scheme (e.g. a final salary scheme) have a similar CE value, their value for the purposes of divorce (e.g. in terms of what the benefits are worth to the parties or might cost to replace) can be very different indeed. A PODE should be able to identify whether this issue arises and, if so, may play an important role in identifying how this difference may be handled to produce a fair result....”

2.24 “value of public sector pensions: **CEs are often not representative** of the value for divorce purposes...”

3.11 “CEs of Defined Contribution and Defined Benefit schemes are very often not comparable. Another way of looking at this is that the income produced by an equivalent CE can be significantly different between a Defined Benefit and Defined Contribution scheme and even between different Defined Benefit schemes.”

As such, we agree with the principle of equalising matrimonial assets but in needs cases (i.e. the majority), we recommend that the starting point should be pension sharing to result in equality of income in retirement. Where there are elements of both needs and sharing in a divorce, pension sharing to result in equality of income in retirement based on the pensions accrued over the relationship (from cohabitation into seamless marriage) may be fair. The vast majority of Excalibur Actuaries’ instructions are to provide equality of income and about half of those instructions then ask for an additional calculation for equality of income based on the pensions accrued over the relationship.



2. Do you agree with the government's view that the court should consider the sharing principle as the starting point and consider the needs principle where equal sharing would not allow needs to be met?

Response: See 1 above.

4. Should the court be able to consider how the property has been used, shared and treated by the parties, and over what time period, when deciding whether non-matrimonial property has become matrimonial?

Response: Yes, although we note that “the property” if considered on an asset-by-asset basis may be too narrow. An overall view should be taken. Otherwise, there is a risk that divorcing parties may seek to spend matrimonial property (e.g. a pension accrued during the relationship) and hold onto non-matrimonial property (e.g. a pension accrued before the relationship).

8. Do you agree that the stages should be focused on the following:
- 1) first consideration to the welfare of any children of the family;
 - 2) capital and income needs, including their housing and pension needs in keeping with the standard of living during the marriage; and
 - 3) where resources allow, discretionary need, in keeping with the standard of living during the marriage?

Response: Yes, although we note that treating housing and pension needs together by way of offsetting can result in unfair outcomes. As PAG2 says in Part 7 Key Points ix, “the obvious solution is to **try, if possible, to deal with each asset class in isolation and avoid offsetting.**”

10. Do you agree that this checklist should include an explicit reference to any disadvantage suffered as a result of the relationship?

Response: Yes, noting that economic disadvantage should include any loss of pension as well as earnings.

19. Do you agree with the government's view that the court should specifically be required to give consideration to pensions accrued during the marriage and pension needs when making financial orders?

Response: Whilst we agree with the principle, “give consideration” is not sufficiently clear. Pensions are often overlooked or inadequately addressed on divorce. We recommend:

- a. The starting point should be for pension sharing. As noted above, PAG2 recommends dealing with each asset class in isolation and to avoid offsetting. In addition, unless sharing is the starting point we will continue to see an increase in the gender pension funding gap.
- b. Clear guidance on ringfencing pensions accrued outside the marriage, noting that in the majority of cases the parties' needs will mean ringfencing is not appropriate.
- c. That the objective in the vast majority of cases should be for pension sharing to equalise retirement incomes and not capital values. If equality of income is codified (along with the situations where equality of capital is appropriate), it will reduce the number of



questions a PODE is required to answer which, in turn, will reduce the cost of PODE reports.

- d. Codification based on PAG2, Part 6, is considered so that it is clearer when a PODE is and is not required. This can help ensure proportionality and reduce costs, particularly in low value cases.

Furthermore, Excalibur Actuaries considers that the Government should use the consultation as an opportunity to review current pension sharing practice including:

- i. Most public sector pensions provide that pension sharing is “internal”. Very few private sector defined benefit pension (DB) schemes offer internal sharing and require “external” sharing with the spouse required to transfer their pension credit typically to a personal pension. The consequences are:
 - 1. The spouse, typically the wife, is forced to accept a defined contribution (DC) pension with the associated investment, inflation and annuity risks whilst the husband has the security of a DB pension.
 - 2. DB external sharing conflicts with the principle of “Protecting the Vulnerable”, particularly those most at risk of financial insecurity - specifically women.
 - 3. External DB sharing usually results in worse outcomes than internal DB sharing for both parties because it requires higher sharing but results in lower incomes.
 - 4. DB pension transfers are subject to FCA regulation. Both the FCA and the Pensions Regulator (TPR) take the view that DB transfers should only be permitted if it can be shown to be in the member’s interest. But pension sharing on divorce is not properly regulated. We have a regulatory anomaly in that DB transfers to personal pensions are protected, with FCA requirements for financial compensation on mis-sold personal pensions and TPR warnings of pension scams but with the spouse forced to take a transfer on divorce in cases of external DB sharing. We believe this is a regulatory blind spot which has had significant costs to divorcing parties over many years.

Excalibur Actuaries considers that private sector DB practice for external sharing may constitute indirect sex discrimination and require further investigation. External sharing for DB pensions should continue to be available but in more limited circumstances.
- ii. Typically, pensioners are required to pay for a DB CE quotation whereas those who are over one year to retirement age have a statutory entitlement to receive a free CE quotation (usually limited to one a year). The charges for pensioner CEs vary widely. Insurance companies often provide CEs free of charge but pension schemes run by third party administrators typically charge around £1,000 + VAT, which the pensioner often has no choice but to pay. We recommend that all CE quotations (limited to one a year) are provided free of charge to remove this anomaly.



- iii. There should be a requirement for DB pension schemes to provide free of charge and upon request, an internal sharing illustration of the pension that would be provided to the spouse if there is a pension sharing order for 50%.
- iv. The costs of implementing pension scheme orders varies widely, depending on the pension provider. Again, insurance companies often implement pension sharing with no charge whereas pension schemes run by third party administrators can charge several thousand pounds which the parties often have no choice but to pay.

There is a further anomaly in that a pension scheme transfer is free of charge but a 100% pension share will incur a charge.

We recommend that the pension sharing charges levied by pension schemes are abolished or regulated by TPR.

- v. Providing a default arrangement when the spouse fails to nominate a pension scheme where there is external pension sharing.
- vi. Many pension schemes provide a “Scheme Information Form” which sets out key pension scheme information along the lines recommended by the FCA, TPR and the Pension Administration Standards Association used for pension transfers. We recommend these are made mandatory (along disclosure of pension scheme information regulations lines). Furthermore, we suggest simple extension to include information about pension schemes’ sharing on divorce policies along with how pensions are calculated so the pensions accrued during the relationship can be determined. Such changes would reduce the cost and speed up the production of PODE reports.

Whilst the charges incurred in obtaining a pensioner CE quotation and pension sharing may have been appropriate when the legislation for pension sharing was implemented, the automation of administration systems over the past 20 or so years make high charges no longer justifiable. Charges are not made for other events (e.g. retirement, death). In addition, many DB pension schemes now have a surplus of assets. The high charges currently levied in many cases conflicts with the principle of “Protecting the vulnerable”.

37. Do you agree with our proposed approach in relation to remedies for cohabitants?

Response: Yes, although thought will need to be given to the detail of how pension sharing applies to cohabitating couples, such as the timing of implementation of sharing and ensuring pension sharing does not attract tax charges.



Excalibur Actuaries supports the intention behind the consultation of encouraging agreement and settlement. However, we feel the Government can go further and use this consultation as an opportunity to drive for greater equality as well as improved outcomes for divorcing parties, particularly those that are vulnerable, at a time when their finances are under severe pressure.

Yours faithfully

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Director & Actuary

Excalibur Actuaries Limited