



Practical Pensions

Presentation to Resolution West Kent POD
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Notes commence from Slide 4.

[What & how ?]

What ?

- Pensions in family law
- Recent legislation
- New issues – same problems

How ?

- Case study
- You do some work as well as me !

How long ?

- About 1 ½ hours – hopefully !
- But DO ask as we go

Notes commence from slide 4.

[Case study – the basics]

Take a couple of minutes to read the case study.

Notes commence from slide 4.

[Question 1]

- Is the offer fair ?

Upto
100% PCLS

£30,356
(PCLS)
+ £53,445
(Ogden tables)
= £83,801

- Maskell v Maskell [2003] 1
FLR 1138

- CETV ≠ Cash
- 25% PCLS plus pension less tax
- Except when it does !

50% of £ 83,801 = £ 41,900

Not too far short then !

The question is then one of what level of discount to apply for Cash in lieu of a Pension CETV.

The case of Maskell, where the pension was not in payment, was the first to confirm that the court must not equate money in a pension fund with money that may be derived from the sale of an asset. Typically only 25% of the fund may be turned into cash (note however even here the member must be of the relevant age and schemes rules must permit it) with the remaining 75% then used to create a future income stream. Remember however that schemes may have protected tax free cash (PCLS) levels under the old rules (e.g. pre-87, 87-89 and post-89) greater than 25% and to a possible maximum of 100%.

At first sight this offer looks unfavourable however considering the numbers further suggests this may not be the case. Firstly the offer is, broadly, £ 35,001 Cash in lieu of a 50% sharing order against £ 121,425 which equals £ 60,712. Tax free cash of £ 30,356 can be released (i.e. 25% of £121,425) and we then have to value the residual pension income stream which commences in 2 years time.

In this instance I used Ogden tables (6th edition Table 19) to value the future pension income stream arriving at a value of £53,445 giving an overall value of in immediate cash terms £83,801 for the CETV of £ 121,425. Therefore a cash value for 50% sharing order might be £41,900 (i.e. 50% of £ 83,801) and the offer of £ 35,001 should be viewed in this light.

[Question 2]

- Is it OK to use the fund value here ?

- DC Fund value
£ 121,425

No !

- CETV **£ 756,691**

Why ?

The members annual benefit statement suggested his scheme contained both Money Purchase (DC – defined contribution) and Final Salary (DB – defined benefit) elements and the statement showed only a value for the former. The CETV provided on application to the Trustees included both elements. If the original offer had been slightly better it may have been accepted.

[Why the difference ?]

- Hybrid scheme – part DB / part DC
- Fund value relates to DC element only
- CETV also includes value of DB element
- Hybrid arrangements becoming more common as DB schemes close – beware !

Hybrid schemes which mix DB and DC benefits are becoming more common as DB schemes close and are replaced by DC schemes but often the DB element is retained in the background, but scheme members may not fully understand how their benefits are structured. You need to be clear as to what is included and what is not as it is easy to miss.

[Question 3]

- Is it OK then to use the CETV of £ 756,691 ?
- Read the small print “special arrangements”
- Enhancement to DB/DC benefits to £ 42,149 pa
- What’s this worth ?

No

The CETV of £756,691 also appeared not fully value the benefits. It was based on adding a value for the DB pension of £26,195 pa (see bottom page 2 of case study) to the DC value of £121,425. However the member has the benefit of an underlying guarantee of a minimum pension of £42,149 pa (see “selected information” on page 2 of the cash study notes) and this guarantee had not been valued by the CETV.

If we then value this guarantee we reach £ 1,080,743.

[Real CETV]

£ 1,080,743 !

[A one-off surely ?]

PWC report in June 2008 found that –

- 80% schemes closed to new entrants
- 16% closed to future accrual
- Further 11% planning to close accrual
- 35% looking to buy out benefits

4 in 5 DB schemes will not accept new members, 1 in 4 are also closed or considering closing to future accrual (i.e. existing benefits are retained but future years of service & salary increases do not count) and 1 in 3 are looking to move their scheme to an insurance company buy-out.

What this means in practice is that most private sector DB schemes you come across will be in a different state from that which appears to be the case.

[A one-off surely ?]

- DB schemes are fast dying out
- Hybrid arrangements more common
- A variety of backstops negotiated

Beware – obtain and read the small print

Often the only way you can work out what is actually going on with the scheme is from the Scheme Rules, Members statement and Scheme valuation. Also different members may have different terms to compensate them for the loss of their DB rights within the same scheme.

In this instance there is an either/or guarantee. Other examples include a Guaranteed Annuity Rate, a minimum fund value or were offered a fund “enhancement” to leave. Some of these guarantees, as here, can be extremely valuable and it is perfectly right and fair that their value is allowed for.

[Update on CETVs]

- New CETV calculation rules & guidance from 1st October
- Two values – Initial cash equivalent (ICE) and a Reduced CETV if scheme is in deficit
- GN11 now gone – now “Best estimates”

The new rules effective from 1st October but seemingly little overall effect on CETVs.

However they formalise the right to have two values – an Initial Cash Equivalent based upon the value of the members pension rights and a reduced value based upon what the scheme can afford based on its level of funding.

[Question 4]

- Which CETV do you use ?
- Initial CETV
- Which one have we got here ?
- We don't know !

Use Form P
Pension Inquiry form
Sections A – C free
Section D – may charge

The new regulations require ONLY the Initial CETV (ICE) to be used in divorce but unless it states clearly both figures or that it is the ICE you cannot be certain which one you have.

Form P is the standard form of enquiry and asks the reduced CETV question (Section C Q3) and also, reference the earlier tax free cash point, the maximum lump sum (Section D Q1). Although schemes are entitled to charge for Section D only most do not in our experience.

The spouse is also entitled to receive almost all of the same information directly from the scheme excepting the CETV under the Provision of Information regulations – see www.opsi.gov.uk/si/si2000/20001048.htm

[CETV issues]

- Regulations from 1st October 2008 require schemes to quote only ICE on divorce
- Do they know it's a divorce ?
- Do they know the regulations ?
- i.e. Do you know it's the right one ?

If the member does not advise the Trustees it is for a divorce they may only provide a reduced CETV. They may also not be aware of the new regulations – see http://www.opsi.gov.uk/si/si2008/uksi_20081050_en_1

[Deficits are rare aren't they ?]

PPF 7800 Index December 2008

	This month – end Nov-08 ¹	Last month - end Oct-08 ¹	One year ago - end Nov-07	End Mar-07 ²
Deficit of schemes in deficit	£155.0bn	£122.1bn	£58.3bn	£38.5bn
Number of schemes in deficit	6,690	6,468	5,354	4,821
Surplus of schemes in surplus	£19.0bn	£24.7bn	£84.4bn	£106.3bn
Number of schemes in surplus	1,047	1,273	2,400	2,933
Aggregate balance	-£136.0bn	-£97.3bn	£26.1bn	£67.8bn

86% of all schemes
are in deficit

Each month the PPF release figures of the funding position of private sector DB schemes – see http://www.pensionprotectionfund.org.uk/index/ppf_7800_index.htm

The PPF requires all schemes to value on a s.179 basis (under Pensions Act 2004) and this value is used to determine the level of underfunding in a scheme which then determines the levy it pays to the PPF. It is one of the three valuations that you will likely see in a schemes triennial valuation report.

5 out of 6 schemes have a current deficit on a s.179 basis.

This does not mean however that 5 out of 6 schemes will be giving reduced CETVs.

[Let's share ?]

- Who pays the guarantee ?
- Will the scheme raise the CETV (did they forget the guarantee) ?
- Is it a reduced CETV ?
- If the scheme won't then what ?

In this case it is not clear where the liability for the guarantee falls – employer or pension scheme. The distinction is important as if the former then the Trustees may not increase the CETV but should do if the latter.

If the scheme will not raise the CETV then an alternative valuation should be obtained and used to negotiate with the other side to apply for an unequal sharing order such that the end result is that both parties achieve equality based on the higher guaranteed figure.

[Thank goodness –
that's that then !]

Oops – the employer has just gone bust !

[Question 5]

- OK – so what happens next ?

Trustees notify the Pension Protection Fund (PPF)

- PPF have 28 days to decide if scheme qualifies to enter assessment period
- Then scheme stays in assessment period for a minimum of 1 year

The Trustees notify the PPF who decide if the scheme is eligible to enter the assessment period. During the assessment period which lasts at least 1 year, and more typically nearer 2 years, the Trustees continue to run the scheme while it is assessed to see if the assets exceed those needed to meet the PPF pensions that would be payable. If the scheme has sufficient assets then it goes into wind-up and benefits are normally secured via an insurance company but if the assets are insufficient then it enters the PPF.

[Not come across the PPF ?]

Completed assessment

- 67 schemes
- 20,645 members

Small beans then ?

Currently in assessment


- 265 schemes
- 120,722 members
- plus 8 per month

You probably will !

Whilst there are relatively few schemes actually in the PPF at the moment (around 1% of the total) many more are in the assessment period with a combined total of around 5% of all schemes involved at various stages then. On average a further 8 schemes per month are going into assessment and the current economic climate suggests this number will grow (e.g. Woolworths have 10,000 members in it's DB scheme with a deficit of £100m it is reported).

With then 1 in 20 schemes involved at the moment you are highly likely to come across the PPF at some stage.

[PPF – does it matter ?]

- H – pension of £ 42,149 pa
 - PPF pay 90% of the cap at age 65
 - Max £ 27,770 pa
 - Increase at 2.5% pa on benefits accrued from 6/4/97
 - Reduced if NRA before age 65
- 
- H pension capped at £ 24,309 pa

PPF benefits are limited – see http://www.pensionprotectionfund.org.uk/index/protecting_peoples_pensions.htm

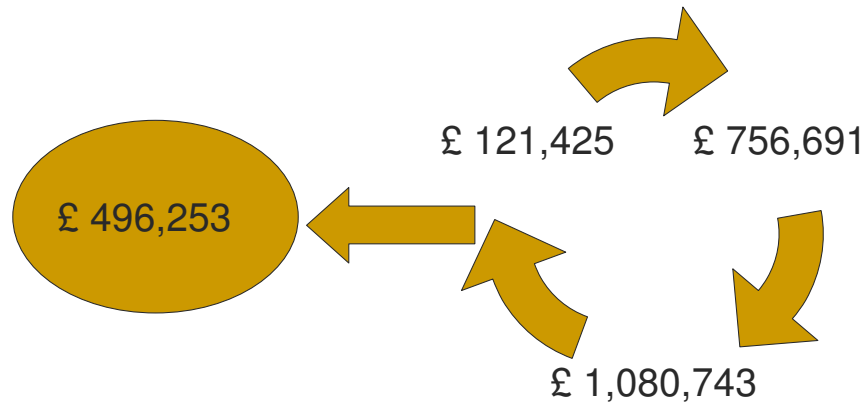
The maximum pension is capped so higher earners, as here, see a significant reduction, and in most cases the PPF only pay 90% of the benefits (100% is paid if you have already reached the schemes normal retirement age, it is a survivors or ill-health pension).

The future increases point seems minor but is crucial as you need roughly 1.8 x the same fund to buy an index-linked pension for a 60 year old male compared to a level pension. Given DB membership has been reducing for 10 years now most members benefits will have built up before April 1997 and hence receive no future increases.

In this case study the member will see his pension reduce from £ 42,149 pa to £ 24,309 pa and with most the latter never increasing because his benefits were built up mainly before April 1997.

Also the PPF do not pay tax free cash.

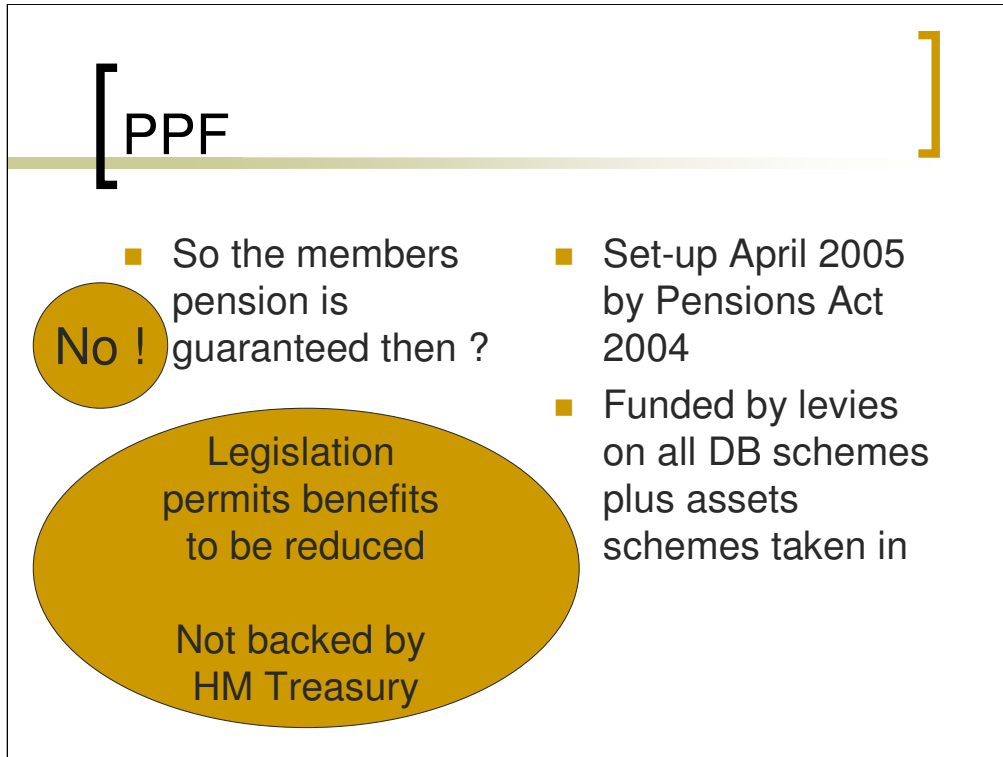
[So what is our CETV now ?]



This slide speaks for itself as highlighting the issues with a CETV. Accepting the initial offer would have been a negligence claim in waiting !

[Question 5]

- What are the implications then now the PPF are involved ?



The PPF funding comes from –

- The assets of the schemes taken in are transferred to the PPF
- All DB schemes pay a levy to the PPF
- Investment returns on the assets taken in

But by it's nature any scheme taken in will have a deficit and the levy is then being met from a shrinking pool of remaining schemes. Looking ahead then, based on the recent numbers, currently 99% of schemes fund 1% in the PPF, this would move if all those in assessment went into the PPF, to 95% funding 5% and so on. A good few actuaries have questioned from the outset whether the PPF is viable in the long term. This is catered for in the Pensions Act 2004 by permitting the DWP to reduce to the pensions cap further.

The latest proposed levy for 2009/10 totals £ 700m but ... on the 19th January the Nortel Pension scheme applied to the PPF. The scheme, which has over 44,000 members has a reported deficit in excess of £1bn ! More than the whole of the levy for next year !!!

The Pensions Act specifically excludes top-up funding from the Treasury for shortfalls.

Even then the reduced pension payable to the husband here is not guaranteed !

[PPF]

- Can we share ?

Yes ... but

Pensions Bill 2008
finally ridden to the rescue

- Sharing order granted before entering, or during, assessment period will be implemented but ...
- What about benefits already taken into PPF ?

A sharing order can be granted and implemented during an assessment period (or if granted prior to entering the PPF it can still be implemented) but benefits will be based only on the PPF capped benefits and not the actual funding position of the scheme or the members pension rights.

[Pensions Bill 2008]

- Gained Royal Assent 26th November 2008
- Allows sharing of PPF benefits (Part 3 Chapters 1 & 2)
- Spouse becomes a Pension Credit Member of PPF i.e. no external transfer ?

Pensions Act 2008 permits now the sharing of compensation benefits in the PPF. However it is not quite clear yet whether the pension credit spouse has to become a PPF member or if the pension credit may be transferred out. I have raised a query with the legal/technical department at one of the large insurance companies and they say it is not clear & proposed we ask the PPP. This I have done but, at the time of preparing these notes, have not received a reply.

[What have we (hopefully) learnt ?]

- Pensions can provide 100% tax free cash
- Varying discount methods for cash
- Don't accept a CETV at face value
- Use Form P if not getting outside help for DB schemes
- Obtain & read the small print
- Most private sector schemes are in deficit

These are the key points I hope have been taken on board today.

[What have we (hopefully) learnt ?]

- New CETV rules from 1st October – which one have you got ?
- Can share during a PPF assessment period
- Pensions Act 2008 now allows PPF sharing
- With Pensions WYSIWYG is often not the case
- Significant scope for (expensive) errors

“**What You See Is What You Get**” - this is NOT a motto to apply to pensions !

In this case study if the original, potentially not unreasonable, offer had been accepted the client would have suffered extreme detriment.

It is very easy to make expensive mistakes with pensions and it is difficult to apply any “rule of thumb” – for example many actuaries will say a CETV under a £150,000 is not worth a full report. If applied in this case to the original £ 121,524

[Miscellaneous updates]

- With Profits – most schemes reintroduced MVRs in October
- Safeguarded Rights – abolished from 1st April 2009
- Money Purchase values showing large daily swings
- TPR guidance on Mortality assumptions

For with-profits plans (both pensions and non-pensions) MVR had been either reduced or removed by this summer. However October saw virtually all providers reintroduce or raise these significantly. Any with-profits valuation from before October should be revisited.

Safeguarded Rights are created when a sharing order is applied to benefits built up from contracting-out of the State 2nd Pension. These rights cannot provide a tax free lump, be taken before age 60 or after age 65. These rules are being abolished from 1st April 2009.

When comparing Money Purchase schemes try as far as possible to have all values given on the same day as the huge volatility in the market means you may not be comparing like valuations.

[Reference material]

- Copy slides on our family page
www.canecohen.co.uk/family.html
- “Pensions & Family Breakdown” 2nd Edition – David Davidson
- “Pensions on Divorce Update” Family Law Week podcourse – David Salter
- “Pensions on Divorce” – SIFA Handbook

[And now an unabashed plug !]

"I have received your report dated which is the clearest pension report I have ever read. You also came up with a solution. Thank You."



Mary Raymont
partner & head of family team
Brachers solicitors

"I have been most gratified by your help and prompt assistance and look forward to dealing with you again."



Tony Gore
Deputy District Judge &
consultant
Wellers solicitors



A brief plug for the work that we do with a couple of quotes to support our claim to expertise in this area !



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