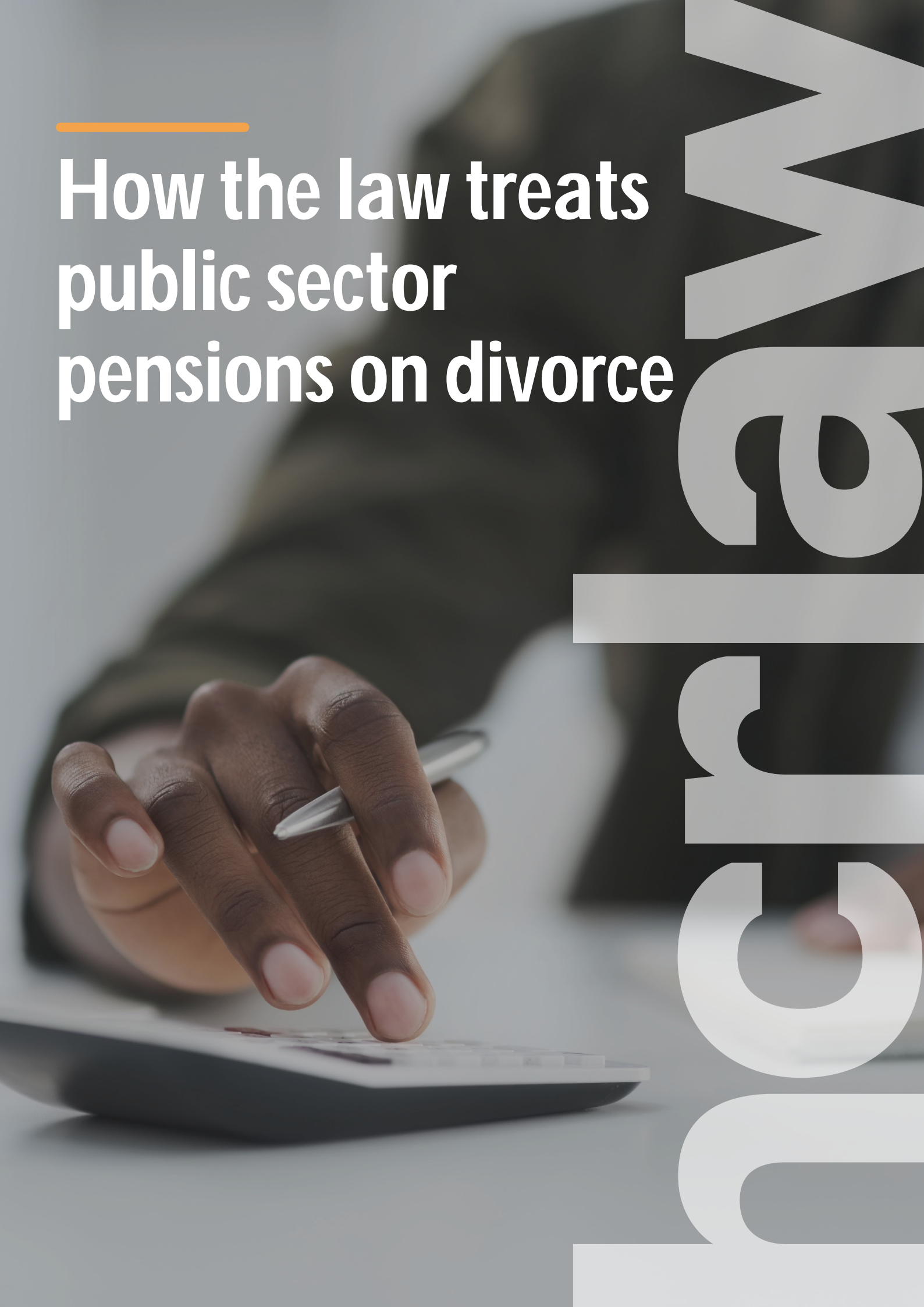

How the law treats public sector pensions on divorce

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It will come as no surprise that a public sector pension is often a couple's most valuable asset, but its treatment and division on divorce is not straightforward.

This is partly due to public sector pensions being subjected to considerable reform and change in recent times.

The change

In 2015 the UK government introduced a seismic change by moving most public sector pension members from final salary schemes into less attractive career-average schemes.

These changes were applied across the board and impacted most public sector pension members retrospectively, not just new entrants to each individual scheme.

The fortunate few who were closer to retirement, were given transitional protection, and permitted to stay in their older, and more advantageous final salary legacy schemes, otherwise known as the "underpin".

Some members were subjected to tapering, with a hybrid of their pension accrual remaining with the previous final salary legacy scheme and the rest moving across onto the reformed scheme.

However, the vast majority were moved entirely onto the new career average scheme whether they liked it or not.

The net effect of this change was that younger public sector workers, inevitably further away from retirement than their older counterparts, would have to work for longer in exchange for less pension entitlement when they eventually retired.

The overwhelming rhetoric from those employed in the public sector was that this was unfair and not what they signed up to.

Understandably, there was a swell of resentment at the government's reforms.

The legal challenge

In response to the changes, a legal challenge to the fairness of the reforms was launched by claimants who were members of the judicial pension scheme and the firefighters pension scheme.

Those legal challenges were successful in the first instance and so the government appealed.

In December 2018 the Court of Appeal dismissed the government's argument and their grounds for appeal in *Lord Chancellor and Secretary for State for Justice v McCloud, and Secretary of State for the Home Department v Sargeant* (2018) EWCA Civ 2844.

In that case, the Court of Appeal found that the changes implemented to public sector pensions by the government in 2015 were unlawful and discriminatory towards younger members of public sector pension schemes because they did not afford them the same protections given to older members.

As a result of this landmark ruling, the case has been christened the "McCloud judgment" and is now frequently quoted in cases involving public sector pensions and particularly by divorce lawyers who are left grappling with these changes when advising their clients.

What is the McCloud 'remedy'?

In 2021 the government acknowledged the unlawful age discrimination highlighted by the McCloud ruling and introduced the Public Service Pensions and Judicial Offices Act 2022 to put in place a legal framework to rectify this. The 2022 Act required government departments to make amendments to public service pension scheme regulations

to remedy the age discrimination identified in McCloud and, effectively, to compensate the members affected.

This was known as the “McCloud remedy” and it came into effect on October 1 2023.

Essentially the remedy attempts to address the age discrimination by giving affected members the option to select whether to receive the pension benefits that they accrued between April 1 2015 and March 31 2022 from the older legacy scheme (the final salary scheme) or from the new reformed scheme (the career-average scheme).

How are public sector pensions valued and dealt with on divorce?

When it comes to settling a divorce case involving pensions, the main options available to the parties and the Court are:

1. Pension Sharing Orders

A percentage of a member’s pension fund is effectively shared via a transfer of a pension credit to the non-member spouse who must then invest that pension credit into a separate pension fund for themselves.

2. Offsetting

The non-member spouse with the inferior pension provision receives a greater share of the available capital instead as an “offset”. For example, via the retention of the family home or some other capital asset such as savings or investments.

3. Pension Attachment Orders

These are very rare. The pension is retained by the member spouse, but a portion of the monthly income and/or lump sum received from that pension, when the member spouse retires, is transferred to the non-member spouse as ongoing “maintenance”.

When considering options for pension sharing or offsetting, the first step is to gather all the relevant information.

Each spouse should request the Cash Equivalent Transfer Value (CETV) of each pension scheme at the earliest opportunity and a state pension forecast via a BRI9 application on the .gov website.

With public sector pension schemes, there are added complications to consider.

Some CETVs can be undervalued as they assume that the pension member is leaving active service immediately, which in most cases they are not, and so the projected figures apply discounts that can render the CETV inaccurate.

There can also be different benefits to each scheme, different discounts applied if the member leaves the scheme early, different retirement ages and, in some cases, an age disparity between the parties to consider.

When faced with complex pension schemes, divorcing couples are encouraged to get expert advice and a report from an actuary or a Pensions On Divorce Expert (known as a PODE). The PODE can provide expert advice on several key factors including:

1. An analysis of the pension rights of the parties earned to date, to include the CETV’s provided and their accuracy.
2. A pension sharing calculation that would achieve equalisation of pension “income” and “capital value” in retirement, based on the entire pension accrual to date.
3. A pension sharing calculation that would achieve equalisation of pension income and capital value in retirement, taking into consideration the relationship accrual only (ie from the date of cohabitation or marriage to separation). nb this is often known as a pension sharing calculation on the “apportioned rights”.
4. Offsetting calculations.
5. Hybrid calculations for a mixture of pension sharing and offsetting.

Guidance from the Pensions Advisory Group report (PAG) 2019 and 'PAG 2'

As pensions are seen as a very thorny area and constantly evolving, recent guidance has been provided to family law practitioners and the judiciary via the 2019 PAG report. The follow up to this, known as PAG 2, released in December 2023, was an evolution of the initial report and has been endorsed by the president of the Family Division, Andrew McFarlane.

In general terms, PAG and PAG 2 reach broadly the same conclusion, which is that in most cases it is meeting the parties' needs in retirement that is the crucial factor.

Therefore, as a pension is effectively an asset to secure an income stream in retirement, the parties should strive, in most cases, to seek the equalisation of pension income in retirement rather than the equalisation of capital value.

The apportionment question

One area that has been a hot topic for family lawyers and divorcing couples has been the apportionment question, and whether it is fair for pensions that have been accrued pre marriage or post separation to be included in the overall marital pot for division.

For instance, is it fair for the police officer who has 15 years of pre-relationship accrual in their police pension to have to share their entire pension pot with their spouse on divorce?

Is it fair for the NHS worker to be forced to share their entire pension with their spouse even though they separated more than 12 years ago, and have continued to make pension contributions since separation, but, for one reason or another, have only just made a recent decision to divorce?

The initial PAG report from 2019 seemed to address this issue when it recommended that meeting the needs of the parties will be the primary consideration for a court when looking at the issue of pensions and not the specific dates of accrual.

The PAG Report 2019 (para 1.15, page 11) states: "Just as is the case with non-pension assets, in needs-based cases the timing and source of the accrual of pension entitlement is unlikely to be relevant since the court can have resort to any assets, whenever acquired, in order to ensure that the parties' needs are appropriately met."

And goes on to say: 'In a case driven by needs, any pension asset acquired pre-marriage or post-separation is (just like any other class of asset) likely to be relevant notwithstanding its 'non-matrimonial' nature. The normal approach of the court will be to have regard to pension rights accrued to the date of hearing.' (para 6.13, p.31).

Arguably this guidance on pensions is inconsistent with the courts' approach to the treatment of capital assets in divorce, which can be defined as matrimonial and non-matrimonial property, and if falling into the latter category can often be successfully ringfenced and not included within the marital pot for division.

It was hoped that PAG 2 would have provided clarity on apportionment. Disappointingly it did not, but it does provide avenues to justify apportionment arguments being successful in shorter marriages and cases whereby there is a significant portion of non-matrimonial pension accrual.

PAG 2 (Para 4.11, page 26) states: "All cases will be determined upon their own facts. The 'marital' element of any pension will usually be shared equally. For the reasons set out above, in needs-based cases, the timing and source of the pension saving is not necessarily relevant, but the court will nevertheless have regard to the length (or shortness) of the seamless cohabitation/marriage in determining the extent to which the needs of the claiming party will justify a division of the pre-cohabitation/marriage element of the pension."

Short cohabitation/marriage cases may require consideration of whether any asserted need for retirement income is a relationship generate' need to justify invasion of an otherwise non-matrimonial asset.

PAG 2 therefore, certainly seems to re-open the door to those apportionment arguments and implies that judicial discretion

should be applied to each individual case, particularly in shorter marriages or where there is a larger proportion of pre-cohabitation/marriage or post separation pension accrual.

Impact of the McCloud remedy for divorcing couples and lawyers

The McCloud case remains very topical for affected public sector employees and it presents divorce lawyers with extreme challenges in terms of being able to conclude financial settlements within a reasonable timeframe.

CETV's issued prior to October 1 2023 for reformed 2015 schemes are inaccurate because of the unlawful age discrimination established in McCloud, and public sector pension administrators have been tasked with re-calculating new CETVs for members so that they are McCloud-compliant.

Prior to the McCloud remedy, obtaining a CETV for a public sector pension had already been an arduous waiting game of anywhere between six to 12 weeks, but since the remedy was implemented the waiting times for updated McCloud-compliant CETV's has significantly increased.

The police, armed forces and NHS pension administrators do now appear to be getting on top of the backlog and are producing the revised CETVs more readily, but many other public sector administrators seem to be struggling.

For instance, in my caseload, the Teachers' Pensions scheme seems to be incredibly slow at churning out new McCloud compliant CETV's for their members.

The impact of the McCloud remedy has delayed the process for obtaining financial settlements for divorcing couples where there is a public sector pension.

Podes have been pausing their reports while waiting for McCloud-compliant CETV's, and there have also been significant delays in financial remedy court proceedings, with hearings repeatedly adjourned to permit pension administrators more time to produce the new McCloud compliant CETV's, and in turn, time extensions have been granted to Podes to file their pension reports.

The frustration among those affected is palpable with many complaining that they just want to get divorced and move on with their lives.

The bottleneck of queuing public sector members, patiently waiting for access to their pension information, will undoubtedly get relieved at some point, although at the moment there is light at the end of the tunnel for some, but not for all.

For further information



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