pgs superannuation consulting pty ltd
ABN: 35090921618
8 April 2011
Newsletter

Family Law Valuations Explained for Practitioners

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Abstract

One of the most common issues faced by a family law practitioners (FLP) is explaining to clients why the value of the member statement is different to the family law valuations (FLV). Related questions include why are some FLVs greater than the member statement whilst others are less. Yet other FLPs ask, “why can’t I use the member statement value in the property pool?” Be informed - not exposed and read on! See last page for acronym listing.

Accumulation Schemes & Allocated Pensions

Valuations of accumulation schemes are straight forward – the value is simply the account balance. Accumulation schemes consist of invested funds contributed by either by the member, and/or the employer and/or the Government. Accumulation schemes can be thought of as akin to money in the bank. The FLV is the account balance. The only other consideration is surcharge. This is an excess contributions tax applied to high income earners between 1996 and 2005. It needs to be deducted from the account balance to derive the FLV.

Family law practitioners (FLP) do need to take into account the time difference between the date of the valuation and the date of the orders – if investment markets have changed in this period, there will always be a loser and a winner. Orders need to be structured or reviewed to capture this difference – a subject of a future newsletter.

An income stream paid paid from an accumulation account is sometimes called an allocated pension or an account based pension. The FLV is simply the account balance being the value of the assets supporting the pension.

When an accumulation account is split, the non-member spouse has a separate account created in his or her name. He or she can move that account into a superannuation scheme of their choice. From age 60, no tax is payable on any withdrawal.

The value of accumulation schemes can be compared directly with real or non-superannuation assets. However, because superannuation cannot be accessed until preservation age (about 60 but depends on date of birth and whether employed), it is generally dealt with in the context of a two pool approach.

This is where property pools are separated into real assets and superannuation assets and each given consideration in accordance with the four step approach institutionalized in Full Court Case of C&C (2005) FamCA429.

On average, out of every 5 superannuation schemes encountered by a FLP, 1 will be a defined benefit scheme. The other will be an accumulation scheme. FLPs will need to be particularly vigilant when dealing with defined benefit schemes.

Defined Benefit Schemes

It is because the FLV of accumulation schemes can be determined from the member statement that sets the scene for confusion for defined benefit schemes. This is particularly so if defined benefit schemes are rarely encountered.

Payment Phase – Defined Benefit

When a pension is being paid from a defined benefit fund, it is more obvious that a valuation is required. First, there is no member statement that gives a competing value. Second, it is more intuitive that a fortnightly pension has a capitalized value many times greater than the annual pension.

The FLV of a pension is the net present value (NPV) of future income streams – which sounds complicated but it is not. Suppose you are valuing an income stream that only lasts one year and was paid at the end of that year. Using 10% interest rates as a proxy for what that money might earn (in reality, it would be less), then the NPV would be $90.9. In other words, $90.9 now and $100 in one year are equivalent sums. The NPV is really an expression of the time value of money. For a second year, the 10% is applied to the $90.9 to derive $82.64. So $100 in 2 years time is equivalent in value of $82.64 today. If $100 per annum is paid for 3 years, the NPV would be the sum of a lesser amount each year for 3 years – ie $90.9 + $82.64 + $75.13 = $248.67. Now the FLV of the pension is simply the NPV of all future income streams. Life expectancy determines the length of the income stream.

Growth Phase

Most interests are in the growth phase when contributions are being made.

Member Statement Value vs. FLV

It is the growth phase that defined benefit schemes present the greatest challenge to FLPs. In the growth phase, there is a member statement. There is a value on that member statement. How is that value different from a FLV? Why shouldn't the member statement value be used?

A member statement (MS) shows the value of the superannuation entitlement that has accrued to the date of that MS. What can the FLP expect the MS to show? Let us assume that a person has a superannuation salary of $60,000 and has been in the fund for 10 years. Assume also that the rules of the fund are such that each year, a member accrues 20% of the super salary. The accrued benefit multiple is then 0.2 per annum. After 10 years, the multiple would be 10 x 0.2 or 2.0. The MS would show a value of $120,000 (ie the super salary of $60,000) by 2.0 or $120,000. So the member has accrued $120,000 worth of superannuation after 10 years of service.

In a defined benefit scheme, the $120,000 is not payable now. It is a promise to pay on retirement. Just as with the pension, a dollar today is worth less than a dollar at some future date. That future date is the retirement date, which under the Regulations is deemed to be age 65.).

A MS can be said to be looking backwards as it show what has accrued over the employment history of the member. On the other hand, the FLV projects forward to the retirement date and show the present day value of the entitlement that would be payable over the lifetime of the member.

FLPs should now appreciate that there is little relationship between a MS value and a FLV for defined benefit schemes. In the following sections, it will be shown that the FLV value can be higher or lower than the MS value. The consequences to the FLP of not obtaining a FLV will also be discussed.

Categorization of Defined Benefit Schemes

DB schemes can be categorized in many ways. The complexity is such that there is, of necessity, overlaps between the categories.

a. Separate Interest and Non-separate Interest Schemes

DB schemes are either separate interest or non-separate interest schemes. My newsletter of March 2011 examined in detail the implications of such a dichotomy. Briefly, a separate interest scheme is a DB scheme where the trustees have changed their trust deed to allow a split interest to be created in the name of the non-member spouse rather than waiting until a payment is made to the member spouse. This is what happens to splits in accumulation schemes so all accumulation schemes create separate interests.

DB schemes that are a non-separate interest scheme need quite different considerations and communications with the client. These issues are outlined in my March 2011 newsletter.

Trustees do not disclose in the superannuation information form whether the scheme is a non-separate interest scheme. This is a major deficiency and calls for heighten awareness by FLPs. A negative answer to the question, “Can I roll out the split interest?” is one of the best indicators of a non-separate interest.

b. Scheme Specific Factor Schemes and Default Schemes

To facilitate comparisons between schemes, the *Family Law (Superannuation) Regulations 2001,* specifies a valuation regime for DB schemes that is based on macro economic assumptions such as the rate of inflation, scheme design, investment returns, wage increases, longevity and retirement age. These assumptions are referred to as default assumptions as they apply unless the Attorney General gazettes an alternative. That alternative is referred to as scheme specific factors.

When a FLP applies for a superannuation information form, the trustees must disclose whether the scheme specific factors apply.

There are many schemes that have scheme specific factors. These are listed on the Family Law Courts web site and can be obtained by clicking here. Scheme specific factors can give a FLV that is materially different than that derived from the default Regulations.

The existence of scheme specific factors is one reason why it is difficult to predict whether the FLV is higher or lower than the MS.

c. Lump Sum Schemes and Pension Schemes

Some DB schemes only pay a lump sum. These are the most straight forward of the DB schemes. Telstra DB Scheme is an example. Because the lump sum is a promise to pay from ages 55 to 65, its FLV is always less than the MS except at age 65.

Some DB schemes only pay a pension. The FLV is the present day value of the future income streams discounted over the life expectancy of the member.

Some DB schemes pay a mixture of lump sum and pension. The FLV is a mix of the FLVs for the lump sum and the pension.

For Commonwealth Government Schemes (CSS, PSS, MSBS and DFRDB) the pension is very lucrative relative to the market rate. At younger ages, - say below 40, the time to retirement means a hefty discount factor so the FLV is less than the MS value. However, after say 45, the value of the pension kicks in and the FLV becomes greater than the MS value.

Needless to say, most of these schemes are governed by scheme specific factors.

Death and Resignation Benefits

The FLV is sometimes compared against the death or invalidity benefits as justification for not using the FLV where it is less than the MS value. However, the FLV measure the here and now.   An invalidity benefit is not relevant if the member is not an invalid. If the member is in the growth phase, then the FLV reflects that growth phase. Invalidity benefits or death benefits are just not relevant.

Why Should a FLV be Obtained for a Defined Benefit Scheme?

As has been discussed, the FLV for a defined benefit scheme bears little resemblance to the member statement value.

Without a FLV, it is not possible to ascribe a correct value to the superannuation asset. It is not possible to meaningfully trade off between superannuation schemes and between superannuation assets and real assets. Without a FLV, FLP mistakenly use the MS balance. This is a high risk practice.

Risks for FLP in Not Obtaining a FLV

Let us suppose that a property settlement was concluded using a MS with a balance of $100,000. Later, the client established that the correct asset value for their super was $60,000, - the FLV.   The question is, “Who wears the $40,000 loss?” Clearly, the FLP is at risk. What would be the outcome if it could be established that the FLP on the other side knew that the MS should not be used as the FLV? There are risks for both FLPs if the FLV is not obtained.

Recent changes to Court procedures require the FLP to sign a Statement of Truth. Knowingly submitting a MS value in lieu of a FLV for a defined benefit scheme may even place PI claims at risk.

Summary of Acronyms

- **FLP** - Family Law Practitioner
- **FLV** - Family Law Value
- **DB** - Defined Benefit Scheme
- **MS** - Member Statement
- **NPV** - Net Present Value

Any questions or feedback? Email here

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